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Table of Contents

PSZ 2017. angol.szam_beliv_v16.indd 3 2017. 04. 06. 7:28:53

PSZ 2017. angol.szam_beliv_v16.indd 4 2017. 04. 06. 7:28:53

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Csaba Lentner

Snapshots of Hungary: Balance, Growth and Dynamism

Editor-in-Chief's Foreword

Journal of Economic Literature (JEL) code: A2, B1, G01, N10, P10, P20
Keywords: Hungary, political economy, fiscal policy, monetary policy, society, Soviet period, crisis management, history of the economy

The ultimate goal of economic policy is to create and sustain a society motivated towards economic conditions capable of development and of achieving surplus. The success of economic policy is accomplished in rising living standards and sustainable economic growth. However, permanent growth is based on and arises from financial equilibrium at the level of the central and local governments, companies and households, collectively strengthening one another. It is a feat of economic policy virtuosity if a country is able to maintain financial equilibrium and economic growth simultaneously. In the past few years Hungary has been characterized by such a phenomenal performance.

Social welfare and its economic basis, the achievement of surplus and the proportionate distribution of the income and profit generated according to social needs and in a humane spirit, is the responsibility of the politicians in control of economic policy, "in exchange" for being an important source of political stability. This is because the primary criterion of creating a good economic policy is the formation of income conditions aligned to the needs of residents, citizens and families and the maintenance of a hopeful public sense of peace. In other words, the management system that is applied must be adjusted to the given country's economic and social conditions and demands. It is essential that economic policy should also follow international trends. It should also fit in with fashionable economic tendencies. However, this should not be

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PSZ 2017. angol.szam_beliv_v16.indd 5 2017. 04. 06. 7:28:53

exclusive. Similarly, current economic policy should not rely on past conditions more than can be justified. Every nation and country has a history, and the economic policy of the present must be in harmony with the previous periods, peculiar features, work ethic and inherited social expectations of the nation. But perhaps most importantly, economic policy should conform with the current demands, characteristics and abilities of the society. In the past few decades, Hungary's fundamental problems arose in this sensitive area. Both the Soviet-type planned economic system and the neoliberal market economy that followed its collapse, which were fashionable in past decades, failed to fulfil expectations after being introduced to Hungary (and, to a greater or lesser extent, the whole of the ex-Soviet region) without any transition or foresight. In Hungary the slow but uninterrupted crisis of production built around the planned economy was made irreversible by the weakening of the Soviet Union. The Hungarian communist elite of the time maintained their political hegemony, and the full employment and free healthcare and education that they favoured, with the help of IMF and World Bank loans from the beginning of the 1970s. The system restricted the attaining of substantial surplus and caused inefficiency and disinterest at a social level, and was doomed to collapse by world economic changes, the more efficient production cultures of other nations, rising oil prices and increasing loan rates. The seamless introduction of the neoliberal market economy, which was adopted by an increasing number of countries from the 1980s, failed to improve the results. By the end of the first decade of the twenty first century, the systemic crisis of the change of regime in Hungary had become obvious. The USD 20 billion sovereign debt accumulated between the early 1970s and the 1990s had increased sevenfold, to USD 140 billion, by 2010 as a result of 20 years of uninterrupted neoliberal economic policy, while the population also sank into debt: they owed USD 40 billion. In the case of a country of 10 million, these data represent a debt trap for the state and for families. The economic policy expectations of lending banks hiding in the shadow of external loans created a framework for the economic policy of the various governments. Budget acts and social benefits were managed according to the expectations of the international banks providing the loans, in a similar way to the era of the planned economy and to other countries provided with IMF loans, for example in Latin America and Africa.

To understand Hungarian economic and social policy, it is essential to refer to Hungary's centuries-long search for independence. The nation has been living in the Carpathian Basin for eleven centuries now, having adopted European culture, Christianity and a European form of state only in the 9th or 10th century after the settlement of the Magyar tribes here. From the mid-16th century, the Kingdom of Hungary was torn into three parts during the Ottoman-Hungarian wars, and was deprived of sovereignty and an independent economic policy in each of those parts. When the Ottoman regime weakened and its army was ousted at the end of the 17th century, the territory came under the rule of the Habsburg Empire and then the Austro-Hungarian Monarchy, with rather limited independence in economic policy. The latter state ”flowed” into World War I, which the Hungarians were on the losing side of, and was followed by the loss of two-thirds of the country's territory and nearly fifty per cent of its population. The achievements of the system which was rebuilt between the two world wars were then sacrificed during World War II and then, from 1947, by the Stalinist dictatorship and by the softer Kádár regime that replaced it. However, the fully neoliberal system that flared up from the 1980s was also a failure. Perhaps the greatest failure was the fact that it also removed and crippled the achievements of the alternative Hungarian production method, which was a combination of the planned economy and a quasi-market method, launched in the late 1960s within the constraints of the planned economy, but relying on internal resources and endogenous factors and with numerous elements differing from the "bigoted" and inflexible planned economy, as it boosted social performance and financial interest. In other words, it suddenly cut off the opportunity of an organic transition to a market economy through small-scale subsistence farming practiced in parallel with large agricultural plants, state property rental, and the "euphoric ecstasy of performance" by "economic collectives". From the 1990s, the official economic policy increasingly focused its operation on accession to the European Union, enforcing the free movement of money, working capital, services, goods and labour. And so, surrendering the protectionist defence of the internal markets and breaking down the role of the state, regulation, control and the ownership of state holdings became the characteristic economic direction, which corresponded to the spirit of the age. Instead of capitalism relying on internal resources, the neoliberal market economy was based on external fundamentals (FDI). The distressing consequences included accelerated indebtedness, the liquidation of the national wealth, large masses of unemployed people (with one and a half million unemployed between 1989 and 1995), and decline in entrepreneurship and Hungarian companies' chances of operating. Although the influx of international companies, FDI and EU funds (PHARE, SAPARD, ISPA) provided impetus to Hungary, this was only limited and incomplete. Although the technical basis of production and services was transformed and became more modern, the size and level of consumption by the population changed, the institutional system became more similar to that of Europe, and the limited labour absorption of foreign direct investments and excessive favours granted in the form of exemption from taxes caused gross budgetary problems and, moreover, a budget deficit. As Hungary had already weakened before the 2007–2008 crisis that started in the "Anglo-Saxon" markets, it hit Hungary the hardest in the region. The situation became particularly grave because foreign direct investment and sovereign debt financing, in other words, the use of external resources, was the deepest, most intensive and most exclusive in Hungary: FDI was almost the exclusive basis of the operation of the national economy. When the external resources dried up, and the internal resources were insufficient as they had been left to wither, Hungary drifted towards state bankruptcy, which was temporarily fended off in 2008 by a 25 billion dollar loan from the consortium of the IMF, the World Bank and European Central Bank. A permanent solution was not provided by loans but by the new type of economic policy that unfolded from 2010.

For the European and overseas nations the crisis that hit in the second half of the 2000s meant the opportunity for renewal and looking forward, the setting up of new economic policies and the adjustment of the old neoliberal method to trigger a smoother and more predictable growth and development. After 2010, the Hungarian government moderated the application of the neoliberal economic philosophy, levied taxes on commercial banks and public utility service providers and tightened their supervision. The state adopted a proactive role in engineering the economy. By repurchasing the previously privatised national property, it has created a more predictable environment for controlling the economy. It has started to take steps on behalf of businesses to acquire market share in Russia, China and the African continent. It is imposing taxes more in tune with the ability to pay of international companies, i.e. higher taxes, while simultaneously granting tax allowances and more favourable market conditions for Hungarian residents, who were pushed into the background for decades. The personal income tax payable by employees was cut from 36 to 15 per cent, and extensive programmes were started to support families in having children. The national economic units that are in a critical financial situation (local councils, consumer and corporate customers indebted in foreign currency) were involved in financial consolidation. The burdens incurred by the various government budgetary subsystems, companies and families on account of the previous defective economic policy decreased, while demand increased considerably due to income regulation and economic growth. Financial stability and then the conditions for growth were created in Hungary through the balancing and consolidation of the financial processes of the budget and then, after 2013, by the management of the National Bank of Hungary which had a new approach, and this beneficial process has been ongoing for half a decade. The Hungarian central bank's policy of cutting the base rate, properly managed policy of moderating inflation, its Funding for Growth Scheme and the direct and indirect facilities provided to cut sovereign debt have turned residents (banks and households) into sponsors financing the sovereign debt, and reduced the country's external exposure as well as the interest payable on the sovereign debt. The budget deficit has decreased below the three-percent criterion set at Maastricht and the rapid economic growth that has been generated by fiscal and monetary instruments had resulted in the fall of government debt from 85 to 75 percent of GDP in seven years, while the ratio denominated in foreign currency had decreased by 60 percent. While maintaining its independence from the government, the central bank has regained its function of serving the national economy and the public good through the actions it has taken to refinance the real sector and mitigate indebtedness, in other words by the application of the multiple mandate system. Tighter Hungarian financial regulation, more powerful support to domestic companies and the population, and the completion of the central bank's operation with crisis management functions have been combined to form a system that is termed the "Hungarian method" and which comprises elements that are present in numerous places across the world, albeit in different forms. After all, economic policy and the method of handling the crisis may not be imported and nor may it be standard, but instead it should be adjusted to the country's needs, circumstances and operating ethic. As there are hardly any isolated countries in the world, economic and social policy trends and principles influence the

PSZ 2017. angol.szam_beliv_v16.indd 8 2017. 04. 06. 7:28:53

relations of all countries. However, they cannot be expected to be enforced as a standard and to impact in the same way everywhere, and it is impossible for them to result in the same economic and social situation. Although no country can block changes, it is important that economic governance should consider the country's history and circumstances and the requirements of its society and market participants. Hungary was not averse to change when it started to access the European Union three decades ago, and when it became a full member in 2004. However, by now the guiding principles of the European Union's economic policy have become slightly outdated. How can an alliance that is currently facing a security, foreign affairs and demographic crisis, struggling with increasing imbalances and characterised by sharply falling economic data be Hungary's exclusive point of reference and allied partner? This is why Hungary is orientating itself towards Eastern Europe, the Far East and Africa. This is why Hungary is firmly protecting its borders and why it wants to use economic instruments to maintain a society based on work instead of an economy based on subsidies. Despite the fact that Hungary's handling of the crisis has been successful, the country cannot fight towards the front echelons of history if it is unable to avoid the trap of mediocre development. The current standing of the Hungarian economy still leaves something to be desired, but it holds promise because there is the ability and the support of society to step into the ranks of permanently successful nations.

To react in advance to the slogans that will soon emerge from false prophets, it should be made clear that this publication is not a PR book, nor is it intended to be a unilateral guide to success, and therefore problems have also been addressed with the objectivity worthy of an academic workshop.

Hungary has been fighting its demons to this day. The Hungarian economy is successful, demand from the population is on the rise, and yet, numerous academics, mainly inherited from the past, impede the teaching of the economic regulation and methodology of a proactive state. It cannot be ascertained whether these people are averse to development and are vegetating in the past (in the ideologies of failed socialism or in the full neoliberal market economy) are concentrated in a single institution. It cannot be stated that they are linked to specific universities or departments or the Hungarian Academy of Sciences. In other words, there are no academic workshops exclusively advocating neoliberalism or the proactive state method. This is because the universities and the Hungarian Academy of Sciences are no longer homogenous. Academic professors and public administrative managers who believe in a system of unconventional economic and social concepts have appeared. Nevertheless, Hungary's achievements are being pulverised by orthodox concepts and their advocates. However, we know that nothing new and permanently sustainable can be built on the renaissance of obsolete ideas. We are fighting for the opportunity to teach the central bank's policy supporting good governance, the government's successful economic policy, and the methodologically-renewed control over public finances. For the opportunity to write books about their operation, and to organize academic workshops to familiarise ourselves and others with our methodology, as these are the ways to make the intellectuals of the future, companies, banks and government officials understand

PSZ 2017. angol.szam_beliv_v16.indd 9 2017. 04. 06. 7:28:53

how the Hungarian economy works and achieves success. But if we allow the curriculum and objective academic research be curbed, then we will not be able to develop ourselves to the level of the researchers leading the ideological support for the failed Soviet and neoliberal economic policies during the "wasted" decades, and we will not be able to make future intellectuals understand what caused Hungary's failure in the previous decades.

A new world and a new system of economic concepts are being created. Or perhaps being revived all over the world, including in Hungary, as an alternative to Adam Smith's paradigm (*The Theory of Moral Sentiments,* 1759, and *The Wealth of Nations,* 1776), with the work of Antonio Genovesi and Friedrich List standing to the fore, and following the philosophy of John Maynard Keynes, who highlighted state and fiscal intervention. The basis of the system of concepts that re-establish the state's rational efforts to engineer the economy is that under weak state control and regulation, the profiteering of the isolated and competing market participants kept in an information asymmetry led to a crisis. The situation that had evolved by 2007–2008 was more than just a crisis of the "Anglo-Saxon" mortgage markets, more than a financial crisis and more than a global economic crisis. Actually, we are facing a systemic crisis, the crisis of the neoliberal production method built on the unlimited automation and independence of the market participants, which has occurred in the past decade.

Conservative economics is Hungary's official economic policy, organised around the ideal of a human-centred economy based on work and coordinated with government instruments. Unfortunately, as the social sciences are still heavily one-sided and rooted in the past, insufficiently qualified economists, lawyers and public administration specialists are filling positions of responsibility. There is a lot to do. Naturally, Hungary's specific achievements are low and public administration is limping along, while the exemplary cooperation between the government and the central bank is creating economic growth and simultaneous financial equilibrium. If the transfer of the new kind of knowledge is blocked already at a junior level, then how will Hungary become competitive? And then, with a masterstroke, the opponents of our doctrines will blame Prime Minister Viktor Orbán and his government. The fact that, because of the formerly feeble performance of the Hungarian economy, several hundreds of thousands of fellow Hungarians have left the country to seek employment abroad poses a problem. They are mostly young and highly qualified people. They are missing from production. In order to regain competitiveness after a successful fiscal and then monetary consolidation, a higher number of employees are needed with higher qualifications. In the new, and still evolving, situation the formation and teaching of an independent economic policy that relies on internal, endogenous factors is indispensable, as the age of imported economic policies is over because it led to failure.

The aim of this publication, Volume XIII of *Polgári Szemle,* is to give the reader – wherever in the world – a better understanding of the economic and social changes that have been under way for the last seven years in Hungary. Drawing on the ideas of the best conservative intellectuals, a glimpse is given into the changes in Hungary's economic policy and public finance system, their intellectual foundations and their

PSZ 2017. angol.szam_beliv_v16.indd 10 2017. 04. 06. 7:28:53

achievements. We draw from Hungary's cultural and historical past so that the reader will understand and see the spiritual roots, traditions and history of this nation which has been living in the middle of Europe for eleven centuries, accept our preference for ethnic homogeneity and our strong intention to preserve our European identity, and improve their understanding of the necessity for and method of creating an independent national economic policy that has been delayed for five hundred years. And we also wish to explain the fast pace adopted to overcome the "historical phase delay", and to familiarise the reader with the main academic books about these changes which form a taxonomy.

I wish you productive reading!

On behalf of the editorial board,
Professor Csaba Lentner
Editor-in-chief of Polgári Szemle

PSZ 2017. angol.szam_beliv_v16.indd 11 2017. 04. 06. 7:28:53

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Sándor Kopátsy

Hungarian Compass Between East and West

Summary
We, Hungarians, have been caught between East and West several times throughout our history and we could also say that we have had to manoeuvre continuously in this situation for 1200 years. Today, we are witnessing the search for a way forward in the European Union and unprecedented economic success spearheaded by China in the East, while in the past 50 years greater social and economic changes have taken place than in the preceding 5000 years. It is in this transforming world that we must find points of orientation and succeed by relying on Hungarian virtues and using a good compass.

Journal of Economic Literature (JEL) code: A1, B0, G0, N3
Keywords: Far East, overpopulation, crisis, China, Hungary, European Union

During our history, we have been caught between East and West several times in situations where our region was declared a buffer zone between Western and Eastern great powers. The first time we were squeezed between East and West was the Hungarian conquest of the Carpathian Basin. We were the first pastoral people heading towards the West to encounter a settled population using the method of triple crop rotation here in Transdanubia and along the peripheries of the Great Plain, while the foundation of our statehood coincided with the conversion of semi-barbaric European peoples to Christianity.

It was in the 16th century that we became a buffer zone for the second time as in its struggle against the Hispano-Austrian Empire it came in handy for the West conquering the oceans and becoming religiously independent that the Turks were threatening Vienna through us in the middle. Typically, the Turks have not grasped to date why we talk about Turkish occupation whereas they only wanted to squeeze the Habsburgs, the

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PSZ 2017. angol.szam_beliv_v16.indd 12 2017. 04. 06. 7:28:53

oppressors of West-European Protestants. We played a role in one of the greatest struggles of European history and defended Christianity against the Turks.

For the third time it was in Yalta that we found ourselves between East and West. Essentially, the same thing happened in 1944 as in 812: a Western and an Eastern great power declared our region as a no man's land. There is an uncanny resemblance, the only difference being that in this no man's land this time it was not the Turkish Empire but the Eastern great power of the age, the Soviet Union, that was in a position to dictate. Thus, over the past 1200 years there have been a number of examples of our country playing a role in the great European drama. Let us have a look then at the current state of Europe and the East and our economic, social and geopolitical prospects. Let us see what we can expect from the East and the West!

The East and the West are progressing along different paths

In the past 50 years, only those countries have been successful where the behaviour of the population has been characterised by puritanism in the West and the Confucian lifestyle in the Far East. Therefore, the past half-century has clearly proven that the road to success is only open for these two forms of behaviour, as only Puritan Western and Confucian Far Eastern societies have advanced compared to the global average, while all other cultures and forms of behaviour have dropped behind. However, the West and the East are progressing along distinctly different paths, as is apparent from international data and analyses.

Politicians and economists are beginning to realise that the performance of the advanced Western societies is only a fraction of what has been achieved in the Far East. It must be accepted that even the Puritan societies of the West are not able to keep pace with what is dictated by the Far East. Economics has not even reached the point of looking into the reasons for Far Eastern success, whereas they are obvious on both sides.

– The employment rate of the working age population is high in the Far East and low in the West. This is particularly sharply manifested in the lower quality quartile of the workforce. Western politicians are beginning to realise that they are unable to provide employment for low quality labour and that the latter is not motivated enough to work.

– The level of savings is very high in the Far East and very low in the West. Even if it has been evident for decades, no particular importance is attached to it.

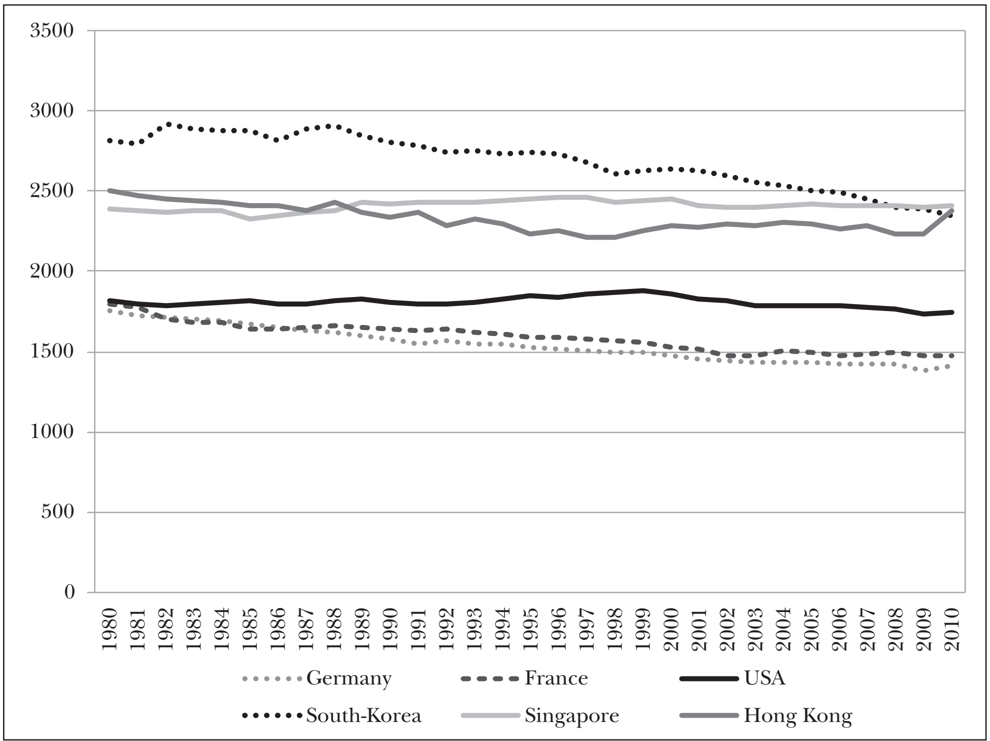
– The desire to learn is very strong in the Far East and it is rather weak in a substantial proportion of the population of the West. The advantage of the Far East in terms of the effectiveness of education is even greater, yet nobody takes notice of that.

The Puritan West wants to have an ever-improving lifestyle while working increasingly less and to enjoy more years in retirement. However, the poorer people are in the Far East, the more willing they are to work, study and make a sacrifice for learning. They work far more in the four former British colonial regions, especially in the United States, than people in the EU Member States. As a proof, it is enough to highlight a few

PSZ 2017. angol.szam_beliv_v16.indd 13 2017. 04. 06. 7:28:53

figures. In respect of the number of hours worked annually, Hong Kong, Singapore and South Korea stand out. In 2010, in these countries the annual average number of working hours per worker was in the 2200–2400 range. Add to this the fact that in South Korea this figure was close to 2800 in 1980. Among the leading economies of Europe, the same figure dropped below 1500 hours in Germany and France in the past 15 years. Between 1980 and 2010, the annual number of hours worked has been declining the most rapidly in the Netherlands and France by 0.8 and 0.6 per cent, respectively. In 2014, the average hours spent in work was 28.9 and 36.1 in the Netherlands and France, respectively, based on OECD figures. These figures alone would be enough to demonstrate that while Europe is trying to succeed with less work, the East tends to work more, the bigger the problem it faces.

Figure 1: Average number of hours worked per employee by country, 1980–2010



Source: FRED, 2010

If we contrasted the number of years spent in retirement with the number of hours worked rather than with the number of years spent in work, we would arrive at an even more tragic picture. That is because in EU countries the working time has dropped by 10 per cent on average over the past 30 years. Combine this with a nearly 10 per cent increase in the number of years spent in retirement despite the fact that the retirement age has been raised. More typical than anything else is that while in the EU

Member States, primarily in the Mediterranean countries, the number of people retiring before reaching full retirement age steadily grows, in Japan people like to work on past the retirement age. Let us now look at the difference between the official retirement age and the actual age of retirement by region based on OECD figures. We can see that in Japan and South Korea people tend to work longer than they are required to; in the US they work roughly as much as they must; while in Europe they work less.

Table 1: Effective age of retirement versus the normal retirement age

	Normal age of retirement	**Effective retirement age**
South-Korea	61.0	72.9
Japan	65.0	69.3
USA	66.0	65.9
Germany	65.0	62.7
France	61.2	59.4

Source: OECD, 2014

Differences in the field of intellectual property, knowledge and education are even greater than in the activity of those participating in producing the national income. Based on educational achievements, all Far Eastern countries are ranked in the top segment of countries. Only Finland can compete with South Korea, Taiwan, Japan, Singapore and Hong Kong. Except for Japan, the countries listed are even more advanced in terms of the percentage of university students attending world-class western universities and their academic achievements there. Moreover, the superiority of Far Eastern countries is even more evident in terms of the degree to which families support non-school-based learning. In these countries, it is quite common that families spare no effort to help their children achieve as good academic results as possible. Admittedly, there is no better predictor of future achievements than the quality of education. The outcome of school-based education is primarily dependent on parents' attitude to the effectiveness of learning. It is in this respect that the advantage of the Far Eastern culture is the greatest.

European dilemmas

Today cooperation is more useful than exploitation but the euro area crisis has made it clear that the European Union is walking the wrong path. Instead of being strong, the European Union wanted to become big at any cost and now fails to realise that it is exactly this determination that causes its growing weakness. The competent leaders of the European Union have failed to realise to date that where there are tensions in the financial world there society is ill and it is not possible to cure this disease by financial means. I would not entrust my money to whoever has introduced a common bank and a shared currency for the Germans, Greeks and South-Italians.

PSZ 2017. angol.szam_beliv_v16.indd 15 2017. 04. 06. 7:28:54

In Europe there are essentially three significantly different cultures and, accordingly, three different kinds of Christianity. Of these three, only one, the North-Western culture, belongs to the top segment of the world and it is this culture that is typical of the French, South-Germans and Austrians. In Europe, it is only these peoples that belong to the advanced West. European Mediterranean peoples have received and are still receiving a huge amount of help from Northern peoples through tourism and aid and would not have achieved on their own even the level where they are now. Concurrently, Orthodox Christians are increasingly dropping behind.

Currently, the European Union is unable to compete with the two other giants: the United States and China. The leaders of the European Union have not reckoned with the fact that only that economic community can be healthy where the behavioural culture of the population is more or less identical. If the European Union had only expanded up to a point where it can still preserve its relative homogeneity, it would be much smaller but significantly much stronger today. It was not worth pushing the boundaries of European integration beyond that point.

Ever since I was a student I have held the opinion that the level of social development of every country in Europe can be measured in a coordinate system where the y-axis stretches between Malmö and Athens and the x-axis between Moscow and Seville. Put more simply: “Tell me how strong the effect of the Gulf Stream is and I will tell you where that country stands.” That is the logic on which my book entitled *Towards the West* is founded, which book introduces how and why social and economic development starting in Egypt and, at the beginning of the third millennium, culminating in Norway moved toward the North-Western region.

The crisis of the European Union has been made apparent by the exit of Great Britain. From that moment on, the European Union cannot remain what it has been since its inception. Or it will return to what it served initially: the free movement of goods, services and people. As for the free market of goods and services, it can only be realised if the Member States’ sovereignty is preserved. Economists have not clarified to date the prerequisites of the free movement of goods. The free movement of goods and services essentially can operate between states of all kinds of culture and levels of development if, and only if, the sovereignty of states is preserved in the area of changing the value of their currencies. Only those states can have a shared currency which are culturally related and also the level of their economic development is nearly identical. The European Union must be a customs union of free and sovereign states!

The EU was already a lame duck with Great Britain but it is even more so without it. This is also true of its role in the world economy but goes even more for its military strength. Europe is not a player in world politics in terms of its military power. NATO essentially means the United States but even that did not result in a significant military weight as the other members have always devoted limited resources to this purpose. The United States has significantly curbed defence spending from 5.3 per cent to 3.7 per cent in the past 8 years. Great Britain, which has exited, aside, the EU Member States’ expenditure remains below 2 per cent and its share is decreasing, except for

Poland where it has somewhat risen. The lack of Europe's military power is well illustrated by the fact that the European Union is not a military player without the United States. Add to this the fact that it is not competitive economically either and is increasingly lagging behind.

The rise of the East

If we want to see the future we have to keep our eyes on China. This is true from several aspects. China is currently the engine of global economic growth to the extent where its development has a decisive impact on global demand for raw materials. As a result of China's spectacular development, the world economy's demand for raw materials has grown at an unprecedented pace and, as a consequence, the amount and percentage of mining royalties have also grown. No similar growth in demand for raw materials has ever been recorded in the history of the world economy. China's size and speed of growth is unprecedented. The industrial revolution of the West affected one tenth of humanity in its first 200 years and, as a result, growth in per capita GDP was hardly 1 per cent. By contrast, China means one fifth of the global population and has increased per capita performance by approximately 10 per cent on average in the past 25 years. Enough to think about the fact that the industrial revolution was predominantly based on coal and iron ore and Europe, poor in these two products, was able to meet demand for them until the mid-20th century. Today, China produces 10 times as much steel as did Europe at the end of the 19th century.

However, in hardly a quarter-century China has walked the classic path of industrialisation and so the level of its demand for raw materials is decreasing and thus in the future the greatest growth in consumption demand will no longer come from mining but from agriculture. Social scientists have hardly dealt with this shift in demand but biologists have. Thanks to them, the revolution of producing aquatic animals has begun. This revolution is only in its inception phase but its speed is several orders of magnitude faster than that of terrestrial livestock because their potential reproduction of those species is greater and therefore so is their selection. The engagement of water, especially salt water of the sea, in production can have a much higher potential than terrestrial areas.

The fact that in the foreseeable future the greatest consumer demand will be for food production has, to the best of my knowledge, been so far realised only by the Chinese. This comes as no surprise because compared to its arable land area an overpopulated China will be the largest consumer of foods. Characterised by slow population growth but rapidly growing wealth, China will increase meat consumption but will not be able to produce sufficient forage to meet this demand. All we can see today from this is that it is the largest soybean importer of the world. Its leaders have already formulated the concept whereby feeding the population can primarily be organised in Brazil. China has already expressed this in action, which is shown by the fact that they are looking for opportunities to intensify political and economic relationships with Brazil. As a case in point, it has been announced recently that China has undertaken to build a railway

PSZ 2017. angol.szam_beliv_v16.indd 17 2017. 04. 06. 7:28:54

line connecting the two oceans in Brazil. In other words, they have already realised that effective access to the Pacific coast with goods can only be possible through a modern and high-performing railway connection. Seeing such developments, I am sometimes saddened by Europe's prospects and by the earthbound and narrow-minded outlook of the European Union's leadership compared to China's leaders.

Seeing the pace of China's development, the West should be both more modest and more patient before it levels criticism. For example, in respect of the natural environment and water management it can be said that China has been the best water manager in world history. It has 7 per cent of water resources in the world and supports 20 per cent of the world's population with that. Despite its limited opportunities, China has increased per capita GDP and wealth 5 times the EU average and 10 times so last year alone.

The role of a compass

The world economy and the power centres therein are undergoing transformation and such transformation is always accompanied by conflicts but it also offers opportunities and possibilities. History has proven that tests society is facing always lead to greater results if they are withstood. What is it that we, Hungarians, can build on in this changing world economic and geopolitical environment?

Hungarian people are exemplary in their diligence and hard work. Economic success in our present age depends, and will depend even more in our foreseeable future, on which people can make best use of its time. There has never been a people that has used the opportunity to earn supplementary income in their leisure time by work other than Hungarians in the 1980s. In other words, there has never been a people that has relied on enterprise to such an unprecedented degree. Our entrepreneurial spirit is a tremendous asset.

Hungarians are individualistic and good organisers. The fact that we arrived here as a pastoral people and were able to establish lasting statehood in that capacity does not need to be emphasised; however, it also has to be seen that we continue to experience its consequences. Pastoral people are inherently characterised by total economic atomisation and, as a counter-balancing factor, an organisational capability based on arms. Therefore, in their economic interdependence, shepherds also lived in constant fear of others and it was this duality that determined their character. Shepherds were individualists, made excellent soldiers and their leaders were excellent organisers. That is what our individualism and also our desire for unity stem from.

Creativity and the Hungarian genius. As my career led me into the field of economic policy I instinctively reached out for the works of Széchenyi, who I consider a political genius. By my old age I think that his greatest merit was that he was ahead of his age by 200 years by realising that what was primarily needed was not more arable land but more educated people. Today we can see that his prophesy is fulfilled to an increasing degree and the greatest asset is an educated mind. István Széchenyi did

PSZ 2017. angol.szam_beliv_v16.indd 18 2017. 04. 06. 7:28:54

not only give crop production areas to the country but also the Academy of Sciences, the Chain Bridge connecting Buda and Pest and, most importantly, a vision of the future.

Just as a small horseshoe multiplies the power of horses, so does a compass weighing only a few hundred grams multiplies the safety of ships at sea in foggy or overcast weather and enables navigation far from dangerous coastlines. The primary precondition of all my unexpected successes in life has been my compass. I have never got lost. I have always realised where political boundaries, invisible to many but critically dangerous, lied and have been able to remain within my possibilities. I did not want to live long. I am already 35 years older than I was hoping to be, for which I thank my lucky stars as during the war I was brought on the verge of physical and mental devastation many times. However, I have never got lost and survived everything amidst the conditions of the country and the world, because I have a good compass. I feel myself lucky because I have lived long enough in an age where we have enjoyed much more progress during a hundred years than for many thousand years beforehand. Events are becoming increasingly challenging and it is critically important to have the ability to orientate ourselves in a rapidly changing environment.

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PSZ 2017. angol.szam_beliv_v16.indd 19 2017. 04. 06. 7:28:54

About the author: The over-50-year career of one of the best known economists of Hungary has encompassed economic reform agendas through the control of privatization following the political changeover to establishing a novel economic approach in our present time. He has been involved in all the economic reform programmes since 1953. During the 1956 revolution he was President of the National Planning Office and the Revolutionary Committee of Ministries. Because of his role undertaken in the revolution he became a sidelined black sheep under the Kádár regime. So far he has published nearly 30 books, in which he uses convincing and modern arguments to prove the truth which was proclaimed by István Széchenyi 170 years ago: "…educated minds are the greatest asset of an economy". According to his creed, in today's developed and advanced society it is no longer the capital investment or infrastructure that make or break the success of an economy but the quantity of highly educated and talented workforce. A society with a new outlook also requires an approach in economics that factors is intellectual assets besides physical assets and, moreover, increasingly puts talent, high-quality education and expertise before anything else. This article is his upcoming book focus on this subject.

PSZ 2017. angol.szam_beliv_v16.indd 20 2017. 04. 06. 7:28:54

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Csaba Lentner

Scientific Taxonomy of Hungarian Public Finances After 2010[1]

Summary
For four decades after World War II (between 1947 and the end of the 1980s), a Soviet-type planned economy introduced under external pressure prevailed in Hungary. When this line weakened, the then "trendy" neoliberal market economy system gained ground. Although the Hungarian planned economy was characterized by a practice saturated with market elements, intended to increase the financial interests of domestic residents, still control by external fundamentals, deregulation and chopping government functions became the general market practice. However, neither the planned economy modelled on the Soviet system, nor the neoliberal market economy model built on the principles of the Washington Consensus suit the Hungarian conditions. The Crisis of the neoliberal model had become obvious by the end of the 2000s. In contrast to this, however, after 2010, a proactive economy influencing state model came to the forefront during the practice of recovery from the crisis.

Recalling the historical events preceding the changes, following the new international trends after 2007–2008, and the successes achieved using unconventional instruments after the 2010 government change, all give a reason for the existence of Hungarian public finance reforms. With institutional thinking coming to the limelight and by demonstration of the new type of instruments, the author scientifically justifies the unconventional methods used in Hungarian public finances. In the author's opinion, after the 2007–2008 crisis, all over the world evidences suggest an increasing shift in thinking towards the institutional framework and the need of state influence, control and regulation of the economy. There is a strong demand for ad-

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PSZ 2017. angol.szam_beliv_v16.indd 21 2017. 04. 06. 7:28:54

dressing informational asymmetries, increasing government control and improving the conditions of competition by means available for governments. This analysis provides a scientific outline of this taxonomy.

Journal of Economic Literature (JEL) code: A2, B1, E12, E5, G01, H6, N10, P10, P20
Keywords: political economy, fiscal policy, monetary policy, planned economy, subprime crisis, new public finances system

Increasing institutional thinking – A historical and international outlook

Although nearly all the most prominent personalities in the more than two hundred years history of economics were engaged in public finance issues, the approach that consciously endeavoured to integrate economic developments into the social and political reality only appeared about a century ago. In our days, thinking in terms of institutions is especially topical, as the crisis that erupted in 2007–2008 proves that the market must not be left alone and economic issues should not be construed without their consequences taken in the broad sense.

According to Ronald Coase (1937:386–405; 1991), an economist awarded the Nobel Prize in 1991, for a long time economics neglected institutional questions and was only engaged in completing and formalizing the ideals of Adam Smith's 1776 *Wealth of Nations,* a book that undoubtedly triggered revolutionary changes (Smith, 1776). All this means that economists paid insufficient attention to the developments within an organization or a company – this was the subject matter of Coase's research – and to the social and political environment and context of economic decisions.

Institutions matter – this was succinctly worded by Douglass North, Nobel Prize winner of 1993 (North, 1993; 1994:381–391). Following the traditions of Thorstein Veblen (1899), Walton Hamilton (1919:309–318) and John R. Commons (1936:237–249), this school of economics defines institutions as any factor that has an impact on economic decisions: formal rules, i.e. laws and other government regulations, and informal factors, i.e. culture and even the religious background. Nowadays it is difficult to believe, but for a long time economists were nearly divorced from everyday reality and failed to consider that in different legal and cultural settings people react differently to the individual economic policy and public finance developments and decisions. Hungary's experiences of the past two decades show the significance of this topic, as the recipes borrowed from more developed market economies and countries that have been learning democracy for a longer period did not fit the Hungarian features and frequently failed in Hungary.

As the ideas of John Maynard Keynes gained ground in the 1930s, the institutional approach, which emphasized the significance of rules and standards, was pushed to the background (Keynes, 1936). A few decades later, during the 1980s and 1990s, in-

PSZ 2017. angol.szam_beliv_v16.indd 22 2017. 04. 06. 7:28:54

stitutionalists, including the above-mentioned Coase and North, the 2009 Noble Prize winner Oliver Williamson, once again made their way to the mainstream economic thinking (Williamson, 2000:595–613). Nevertheless, their theoretically underpinned ideas were less fed through to practice, apparently, this was delayed until the 2007–2008 crisis. The efforts at breaking the preponderance of schools celebrating market mechanisms proved to be futile for a long time, and a series of economic collapses were required to make the world realize that a self-remedying market, unlimited reason, or public finances operating without regulation are non-existent.

Undoubtedly, economic policy and public finances must also place special emphasis on the costs of economic and financial transactions and on the fact that one of the high-priority duties of economic management is to cut these costs. This means that institutions, rules and law must be adopted to reduce transaction costs. If we accept that these costs typically arise from uncertainty and risks, then one of the purposes of a state is to create a background that keeps such market uncertainties in check and moderates them. For this reason, one of the main paths of institutional thinking is the research of the regulatory matrix required for the creation of a smoothly functioning economy and state. According to the classification given by Harvard professor Dani Rodrik, there are four distinguishable institutional groups that are indispensable for economic and social development (Rodrik, 2000; 2003).

– Economic development is inconceivable without the institutions that guarantee the protection of ownership rights (*market-creating institutions*), as protection and guarantee for the given type of ownership rights are the prerequisites of development.

– *Market regulating institutions:* even classical economics admits that there are market failures that need to be addressed – they include externalities, imperfect information and the restrictive consequences of the economies of scale.

– *Market stabilizing institutions:* all institutions aimed at ensuring a stable economic environment, including price stability, the minimization of macro-economic volatility, or the aversion of financial crises (central banks, exchange rate regimes, and fiscal and monetary rules).

– *Market legitimizing institutions:* It is insufficient to prove the superiority of the market economy in schoolbooks and journals, the society should be persuaded to accept the institutions that address market fluctuations and negative outcomes, hammer and protect social trust (social security and unemployment insurance schemes, welfare benefits, pension funds, and the public finance system).

One of the important areas of the institutional approach to the public finance system is central bank regulation, which was among the first areas to be reshuffled as a result of the crisis. In Rodrik's model, the central bank is seen as one of the most important stabilizing institutions in the economy. According to this classical approach, this serves price stability, however, after the events of the 2007–2008 crisis, the central banks' responsibility for general macro-economic stability and perhaps even social stability is also being raised. The financial crisis put an end to the previously created consensus on monetary policy. The redistribution effects of monetary policy came to the forefront again, and the modelling of central bank decisions and their transparency

PSZ 2017. angol.szam_beliv_v16.indd 23 2017. 04. 06. 7:28:54

inevitably required the creation of a conceptual framework that allows the complex interpretation of monetary policy decisions in a social context.

In the 20 to 30 years preceding the crisis, reflections about the central bank policy were rather single-minded. In their studies, Barro and Gordon, on the one hand (Barro–Gordon, 1983:589–610), and Kydland and Prescott, on the other, determined the basic frame of mind in relation to central banks' independence (Kydland–Prescott, 1977:473–492). More complex approaches more susceptible to realities were put on hold till today, despite the fact that already back in 1983 John Woolley set up a typology of the factors having their effects felt through the government and those beyond the government, as well as the structural and the less embedded factors that may influence central banks' decisions (Woolley, 1983). The 1998 Russian crisis was an additional warning sign. This was the very first caution that called attention to the insufficiency of the means available for regulatory and supervisory regimes, which acted against the efficient and safe operation of the financial system over the long term. This is because in the course of the deregulation that lasted for nearly forty years before the collapse of the Russian stock exchange, guaranteed legal institutions disappeared from the financial and capital market regulation (Kecskés, 2016:333–356). Experiences in monetary policy and the related research may be useful, among other reasons, because they shed light on the thorough changes that may follow in the next few decades in relation to the totality of public finances on a theoretical and practical level.

Fundamentals of fiscal and monetary policy after 2010

Before the crisis it was generally accepted that central banks must operate in the "one objective – one instrument" framework, and in the European continental space this meant that the only factor they were required to take into account was inflation, and if they intervened to adjust inflationary developments, they do it through short-term interests.[2] This "one objective, one instrument" principle is a classical operational scheme for central banks. However, the crisis superseded this paradigm (Blanchard et al., 2012:174), and currently central banks apply a great variety of instruments[3] and in addition to their primary aim, they also focus on other goals like financial stability, boosting lending and support to the government's economic policy.

According to the consensus made after the crisis, price stability is required for sustainable, long-term growth in the economy, however, this condition is insufficient; what is more, the central bank should use the instruments to achieve macro-economic stability. Thus the central banking practice has developed in the direction of facilitating economic policy objectives in the broader sense, keeping the price stability objective as a priority. The arguments "limiting" the requirements of central banking operation, prevalent before the crisis (Kydland–Prescott, 1977), seem to be losing force, their enforceability is declining, while the elaboration of post-crisis theories providing a scientific basis for "optimal" central banking operation is in progress.[4]

In contrast to the conventional approach, the two most important branches of economic policy[5] include a budget policy underpinned by a god tax system, and a monetary

PSZ 2017. angol.szam_beliv_v16.indd 24 2017. 04. 06. 7:28:54

policy having complex economic objectives and placed in a social context. This means that in an institutional perspective, the public finance regime is built on fiscal and monetary policies. The long-term sustainability of fiscal policy has a substantial impact on any particular country's sovereign risk assessment, and indirectly, the elbowroom of monetary policy. A low deficit improves a country's investment rating. Fiscal policy may also influence monetary policy decisions through consumer prices – indirect taxes and regulatory prices. Fiscal policy is one of the fundamental means of economic government and the method of influencing the economy by budgetary means. The incomes generated in the economy are centralized and redistributed by means of this policy. Thus, in addition to generating tax revenues for the income side of the government's account, absorbing the redistributive function of the state, it finances the social sector, public administration and public services, and supports families that undertake to raise children, households and businesses struggling with income disparity, and entrepreneurs who especially fit into the government's objectives. Indirectly, it determines the amount of income the income owners are allowed to retain and the additional income deprived person can have access to, and raises the amount of funds required for the tertiary sector of the state. It ensures the payment of interest on government loans. Its long-term purposes include promoting the financial advancement of the national economy, businesses and families through the creation of optimum income positions. Fiscal policy is the sovereign means used for centralization and redistribution processes, with the government's political priorities and public finance policy principles in respect of the economy and society manifest in its technique, extent and character. Fiscal policy is necessary to serve the sustainability of the national economy's operation through the centralization, redistribution and regulation of financial processes (beyond the budgetary sector), and monetary policy is required to provide assistance to this function using its facilitating mechanisms (without interfering with its independence).

The most important means of fiscal policy is taxation, and in the case of a crisis, based on Keynes' model, the generation of additional demand moderates oversupply and then gets economic growth moving. In a crisis mode, fiscal policy primarily endeavours to increase taxation efficiency, quell black economy, and increase the volume of taxes collected.

Monetary policy, and its institution, the central bank, is the other significant branch of public finance policy. It had been involved in the refinancing of the real sector up to the mid-1990s and in financing the sovereign debt up to the turn of the millennium – with decreasing activity in Hungary.[6] It gradually withdrew from these classical roles during the fulfilment of its obligations regarding accession to the European Union. However, the central bank's refinancing functions was performed without due circumspection, and on numerous occasions, financial disadvantage was caused.[7] Fast withdrawal of the central bank from refinancing, almost without transition, was unjustified by the current level of the Hungarian economy and society, which would actually require an expansion in refinancing, particularly in order to strengthen Hungarian businesses and agricultural producers. The same can be said of the central bank's withdrawal from financing government debt.

PSZ 2017. angol.szam_beliv_v16.indd 25 2017. 04. 06. 7:28:54

The sovereign debt and the budget deficit did not decrease with the central bank's withdrawal from financing. Rather the reverse: financing them from the free market is more expensive, and withdraws funds from the social and economy development chapters of the budget. Moreover, significant financial risk is also involved, as in the past decades Hungary's sovereign debt was financed, for the most part, from abroad, ab ovo making the national economy vulnerable. Budgetary expenses did not decrease and did not become more sensitive as a result of channelling deficit financing to market funds. Deficit generation was due to system failures, and the method of its financing had no impact on it. Budgetary expenses exceeded budget revenues as a result of the crisis of state-owned companies after the change of regime, the weak capitalization and low tax payment capacity of start-up SMEs, and the tax benefits and exemptions granted to international companies. On the side of governmental expenditures, the budget[8] was required to support the citizens who dropped out of the social divisions of labour and sank into debt in increasing numbers, and to finance the reorganization and consolidation of businesses and local councils that became inoperable.[9]

The exchange rate regime is selected by the government in agreement with the National Bank of Hungary. Since 26 February 2008, the exchange rate of the forint to the euro as a benchmark currency has been freely floating, and forint fluctuations are determined by market forces. The expansion of lending in forints after the turn of the millennium, and in foreign currency after 2002, mainly to households, and especially to dubious debtors, caused serious financial instability in both the household and the local council sector as a result of the 2008 exchange rate explosion, risk premium increase, job losses and income reduction. Due to the debt spiral, the previous managements of the National Bank of Hungary faced heavy social criticism. The household sector's foreign currency loan debts were consolidated initially by the new government, and then after 2013, by the central bank, and thus the financial uncertainty pressing the country was reduced.[10]

Article 41 of the Fundamental Act stipulates that the National Bank of Hungary is the central bank of Hungary responsible for monetary policy in the manner specified in a separate cardinal act (the Central Bank Act of 2011 and then of 2013). The primary objective of the MNB is to achieve and maintain price stability. Without prejudice to its primary objective, it supports the economic policy of the government, using the monetary policy instruments at its disposal. In terms of content, the Hungarian central bank's activity serves public good. This means that the statutory mandates are ultimately enforced in the interest of social and economic benefits to the public. The three objectives of the central bank include the moderation of inflation, boosting economic growth and maintaining financial equilibrium. It affects three areas: the general government, businesses and households. The central bank's operation has its effects felt at a macro- and micro-economic level and in a social context.[11] The central bank has become part of the public finance system.

The National Bank of Hungary is a member of the European System of Central Banks (ESCB). The MNB and the members of its decision-making bodies are inde-

PSZ 2017. angol.szam_beliv_v16.indd 26 2017. 04. 06. 7:28:54

pendent in carrying out the tasks and meeting their obligations conferred upon them by law, and may not seek or take instructions from the Government, the institutions and bodies of the European Union, the governments of its Member States and any other bodies, other than the European Central Bank. The mechanism that supports fiscal policy evolves from the central bank's on deliberation and responsible conduct pursued in the interest of the national economy, implemented without jeopardizing the primary objectives related to the maintenance of price stability.

In 2013, Parliament adopted a new act on the central bank, while the guarantees for the central bank's independence were retained (Act CXXXIX of 2013). In addition to the central bank's traditional duties, the new regulation tackles the scope and opportunities of efficient macro-economic duties and interventions, the related international cooperation and the supervision of the financial intermediary system.

The low inflationary level, which was made the primary objective of the central bank two decades ago, was considered as an indirect stimulus of economic growth. However, nowadays this correlation is questioned by economists. The central bank of the US, for example, has been working, since the 1970s, to achieve three goals and maintaining inflation at a low level is only one (and not the primary) objective, next to boosting growth and employment. In the monetary policy priority order set up by FED, the acceleration of growth and increasing employment have been given even more emphasis since the 2007 crisis. In order to mitigate the crisis, FED started extensive quantitative easing programmes. As a result, by the autumn of 2014, the US economy had recovered from the crisis, and so FED stopped quantitative easing.

From September 2012, the European Central Bank decided to refinance the government securities of the weakly performing Member States falling within the monetary union.[12] The Bank of Japan is also performing massive quantitative easing to boost the economy. The Funding for Lending Scheme launched by the Bank of England was also aimed at boosting the economy. The Bank of Argentina has been setting multiple central banking targets since March 2012, its objectives include ensuring monetary and financial stability, job creation, an economic development that creates equilibrium between incomes, and to a limited extent, the use of foreign currency reserves for financing sovereign debt.

From the spring of 2013, the underlying conditions were created for decision-making in the new type of central banking policy that followed the new world economic trends.[13] In other words, the bigoted, normative, one-sided system of central banks' primary target regime focusing merely on inflation did not survive the crisis in Hungary either. The Funding for Growth Scheme launched by the National Bank of Hungary in the summer of 2013 is a significant element in achieving a breakthrough in growth. To this end, HUF 750 billion was made available in the form of credit limit in the first phase (in 2013) and HUF 2000 billion in the second phase (2014).[14] The FfG Scheme is the organic continuation of the reliability and grading applied by the National Bank of Hungary in the course of cutting the refinancing base rate. As developments favourable for the scheme, by early 2013 price stability has been established and financial stability had also improved a lot in Hungary. From 2014 on, the country

PSZ 2017. angol.szam_beliv_v16.indd 27 2017. 04. 06. 7:28:54

was in the position to achieve permanent growth, and so the National Bank can contribute to the breakthrough in growth.

– By the implementation of the Funding for Growth Scheme, the National Bank of Hungary is actually regaining the refinancing functions it used to have in the early 1990s and had been terminated by the 1990s in respect of the real sector and by the turn of the millennium in respect of sovereign debt financing during preparation for accession to the European Union.

– The central bank base rate was cut to 3.8; 3.2; 2.1; 1.05 and 0.9 per cent on 28 August 2013, 27 November 2013, 23 July 2014, 27 April 2016 and 25 May 2016, respectively, as against 7 per cent recorded on 21 December 2011.[15]

– In February 2013, the expected total annual inflation was estimated at 2.8 per cent. Since 2014, inflation has been around zero. Inflation was at this low level for the last time before 1970.

In order to facilitate the activity of the National Bank of Hungary to strengthen monetary stability, with effect from 1 October 2013, the legislator merged the Hungarian Financial Supervision and its powers into the central bank.[16] Thus micro-prudential regulation, influence and the underlying control facilities were added to the central bank's macro-prudential regulation, adjusted to the international and European Union trends. In September 2013, European Parliament included the 150 largest banks of the European Union under the European Central Bank's control. Since the crisis that erupted in 2007, fundamental changes have taken place in the approach to public finance, which were followed suit in Hungary after 2010.

In addition to the refinancing base rate, which had a beneficial impact on sovereign debt financing and commercial lending rates, and the Funding for Growth Scheme, the central bank's Self-Financing Programme[17] facilitating the financing of sovereign debt also had a significant role in cutting the sovereign debt, which had represented nearly 10 per cent to GDP, between 2010 and 2017, and in the considerable reduction, approximately halving, of foreign currency denomination. By 2013, the Hungarian economy had been over the fiscal policy refashioning,[18] and between 2013 and 2016, the monetary policy regime was also successfully changed. However, in order to achieve a breakthrough in competitiveness, further efforts need to be made in both fiscal and monetary policies.[19]

The government's role – In a historical and scientific perspective

Due to its interdisciplinary nature, public finance as a scientific discipline includes politics the economy, using the legal instruments at its disposal, legitimizes an existing order and operates it in practice. Although the operation of a state may be compared to that of a joint stock company, primary profit interests may hardly be assigned priority in the organization of public services. The management type state operation manifest in the DMP[20] paradigm was ultimately born in a neoliberal economic system. In a mechanism that proclaimed and enabled unlimited automatisms for market par-

PSZ 2017. angol.szam_beliv_v16.indd 28 2017. 04. 06. 7:28:54

ticipants. The state did not influence, control or sufficiently regulate the operation of "joint stock companies"[21], and so without control, the company limited by shares functioning as the fundamental unit of the neoliberal production method failed.[22] The transposition of the organizational and operational principles of this insufficiently regulated corporate form and their application to the operation of the state and public administration and public services was thus ab ovo doomed to fail. The unregulated joint stock company, the bank – as a system-specific element – proved a fiasco as a result of the operation of the non-regulating state. Corporate-level lack of regulation also deprived the regulator with a substantive right, i.e. the state, of regulation to a major extent. The minimum control and regulation of market participants and the corporate profiteering that arises in such a situation and the accumulation of informational asymmetries led to a crisis. By 1929–33 it had grown to an overproduction crisis, and by 2007–2008 an overlending crisis. The latter was manifest on the level of both the state and the population. Public administration and the public service system, improperly pushed towards enforcing market principles, the state struggling with system function disturbances and the unregulated market units all sank into a crisis.

András Tamás (2013) writes that every Liberalist effort made, using all kinds of argumentation, at restricting the opportunity of state action in the creation of the state's own economic policy, financial or social system insists on the legal regulation enabling market globalization, on the deregulation of the law in force, on forcing global money market conditions in the public sector and on a completely new "legal" grounding. They insist on public administration that is mainly management, its acceptability is marketing and its truth is usefulness and profitability (for someone).

During the crisis the identification of those accountable for the problems was frequently demanded. The political situation was frequently criticized for too lenient rules created according to economic lobbies. Although in the USA extremely strict rules were introduced in 2002 (SOX), strict rules alone are incapable of guaranteeing long-term reliable economic operation. This is because close and efficient compliance with the rules is indispensable (Kecskés–Halász, 2013:216).

In a public administrative context, the DPM paradigm is the economic constituent of the New Public Management, a concept that has become outdated by now, as the active state has a strong supervisory and regulatory effect on the operation of public services and public utility companies. Thus after 2010, the government regulated the service charges of public utility companies that were privatized for the most part in the 1990s in Hungary. Then in numerous cases the state repurchased the companies. Thus, in respect of companies providing public services, centralization, nationalization[23] and, through them, the increased service of public good is a requirement and an operating principle. This is ensured by close government control and, in many cases, national ownership. The new theoretical model that replaces the DPM paradigm is CNPG[24].

Regarding Hungarian history, Lajos Lőrincz concludes that (Lőrincz, 2010a:39–45) whenever royal power strengthened and/or a powerful government was in office,

PSZ 2017. angol.szam_beliv_v16.indd 29 2017. 04. 06. 7:28:54

the country's security, international relations and economic position became acceptable, chaos, economic crises an isolation, on the other hand, resulted from languishing governments.

The choice between a strong and active versus weak and nodding governance is a long-standing conundrum. To quote academician Antal Mátyás (2007), Neo-Keynesian economists (representing a neoclassical synthesis) have a lopsided position on the operation of the automatisms of the capitalist economy. In the short term, they dispute the stability of the capitalist private sector. According to Tobin and his co-author, Buitner, labour and capital underemployment is sufficiently frequent and permanent to justify objection to economic policy intervention (Tobin–Buitner, 1982:183). Modigliani takes a similar position: monetarists are wrong when they believe that the economy is protected against shocks to the extent that stabilization policies are no longer needed. With knowledge of data from the Unites States and other industrial countries, their claim that stabilization policies have not reduced, but rather increased problems is incorrect (Modigliani, 1988:126). The fact that the neoliberal method of production collapsed in the spring of 2007 and has not revived is a powerful witness to the highlights and references made by Antal Mátyás. According to András Kecskés, the laziness that is content with the momentary management of problems and market recovery is discernible in the process of the financial crisis that started in 2007 and went global by 2008. At the same time, for the purpose of long-term solutions, the strength required for altering the theoretical bases was insufficient. Even the crisis was insufficient to break the false liberal concept of self-regulation, based on a purely market approach, and the necessity of government intervention and involvement was mentioned only to the extent required for a fast aid to financial institutions (Kecskés, 2011:387, 363).

The world order organized on the basis of neoliberal principles and the neoliberal method of production built on the Washington Consensus sank into a crisis. For its mitigation, both in the United States and in Hungary active government and central bank policies came into the foreground, and so the economy regulating role of the "state" appreciated, while due to its assistance to fiscal policy, monetary policy (placed in a macro-economic perspective) was integrated in the institutional system of public finances. Monetary policy does not concentrate public funds (it is not a tax collecting authority), and yet, with the appreciation of its support to economic policy and with the outdating of its limited, anti-inflationary central banking role in the continental European area, especially in Hungary, it was assigned a new role. Increase in the importance of government instruments, in the complexity of central banking activity and its integration in the public finance system, in other words, the "state's" taking an active stance also increased the significance of statecraft, and more specifically public finance policy.

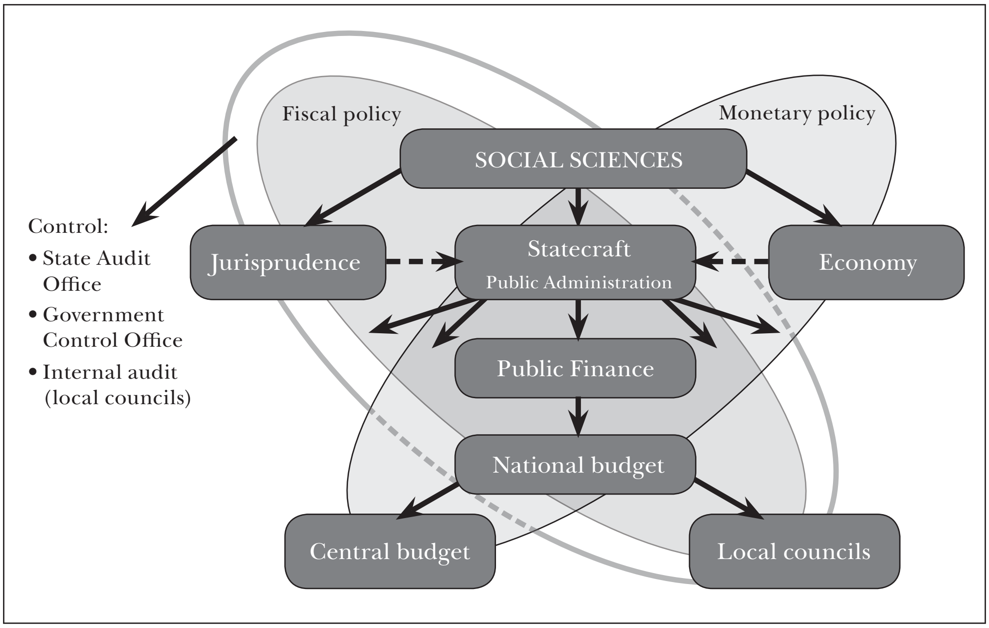
Statecraft is a multidisciplinary concept, as it includes all the disciplines dealing with the essence, organizational structure and operation of the state. In this perspective, special significance is assigned to the science of administration, law, economics, politics, sociology and history. Modern state studies are a combination of the afore-

PSZ 2017. angol.szam_beliv_v16.indd 30 2017. 04. 06. 7:28:54

mentioned disciplines, focusing on state operation and aimed at the analysis of efficient state operation at the cross section of the economy, law and society.[25] And its analytical methodology can only be implemented using a combination of economic, legal and other social sciences. The governmental and central banking instruments applied to overcome the crises caused by the market participants' unlimited, uncoordinated and less state-controlled operation (between 1929 and 1933 and after 2007–2008) increase the significance of intervention, and as a concomitant, the study of the state, including public finances.

Public finance is a category shaped by politics in the general sense, based on political principles, while the study of the national budget is a technical framework for the procedures concerning public finance and public wealth. Both are organic parts of statecraft. Both are organic parts of statecraft. They provide the economic and legal organizing principles of and framework for state operation. Using its specific instruments, legislators build rules and record the current practice in rules to facilitate continuity, efficiency, transparency and controllability.[26] As the role of the state appreciated, also in Hungary, a thoroughly grounded scientific methodology was required to assist its operation. The theory of the state, or statecraft, an interdisciplinary borderland of law and economics, comprises public law, public (government) finances, the study of the national economy, e-government, the academic specializations of public service professions, the organization of public administration, public administration management and public service communication.[27]

Figure 1: Scientific framework for the taxonomy of new type Hungarian public finances



Source: Lentner, 2015a

The crisis of the neoliberal regime required an increase in the role and significance of statecraft. A strong and active state's public finance relations built on a good theoretical grounding and its transparent general government system provide the basis of sound state operation. Within the theory of the state, the study of public finances is an academic field that comprises various disciplines that have been expanding as a result of the crisis.

The banking mechanisms, institutions, and regulatory and supervisory structures, included in the category of banking, i.e. the parts traditionally falling within the fundamental discipline of finance are close to the domain of state studies. This is because without government and international involvement, cross-border regulation, efficient supervisory control, occasional budgetary support and influence, private banking is incapable of operating as a going concern.

From another perspective, the state is given a new role in crisis management: in order to stabilize conditions in the wake of a crisis that has evolved and escalated, it is a reasonable expectation that a strong market regulatory and controlling power should focus its efforts on the financial markets and the banking institutions. The coordination, influencing and controls of business organizations can only be successful in the framework of a well-organized economic governance, i.e. according to clear public finance and transparent budgetary sub-systems.

The successes that have been following one after the other in the Hungarian national economy since 2010,[28] the developments seen in the international arena since 2007 and the periods that can be characterized by successes in Hungarian history are always based on a proactive role undertaken by the state. Therefore the criticisms of the changes that have taken place in Hungary are correct in this context, and may not be directed at the manner of public finance administration, as the latter is adjusted to the international environment according to a logic that organically connects to and is built on the historical past while also meeting the current social demand.[29] Most of the criticisms may only relate to the speed of changes.[30] Nevertheless, it is a fact that the neoliberal market economy took the deepest roots in Hungary from among the countries of the post-Soviet area. Hungary saw the fastest setting up of an operating mechanism for a raw neoliberal market economy and a deregulated state not matching the economic and social endowments.[31] Any change, or in other word, recovery from the crisis is only possible if a nearly organic condition is created, i.e. if the unfitting, inorganic elements are abandoned as soon as possible.[32] This procedure started in 2010 with the creation of the management model built on burden sharing[33] and governmental economy engineering, which was then reinforced in 2013 by massive central bank support to make Hungary one of the fastest-growing countries that could simultaneously maintain financial stability.[34]

Conclusions and summary of the Hungarian model

Fiscal consolidation, which included setting things straight in the central budget and at local councils, and then with the involvement of the central bank, corrected things for families and businesses indebted in foreign currency, managed to create stable financial and political conditions suitable for governance. Fiscal policy focuses on the expansion of solvent demand, primarily through income regulation. Widening the scope of taxpayers (international businesses, banks), adjusting taxes to tax payment capacity, and the moderation of the tax burdens of residents are simultaneously present in fiscal policy. Tax cuts for domestic participants (personal and corporate income taxes), a broad family benefit system and governmental economy engineering (use of government instruments to help market acquisition, economic policy of opening to the East and to the South) increase liquidity, revenues and capitalization, which, in turn, improve the national economy's value creation capacity. Ensuring the permanent relocation of foreign companies in Hungary (through the conclusion of strategic agreements) serves the balancing of economic growth. The government regulation of public utility service prices, and the repurchase of public utility service providers into national ownership show heavily etatist features. The monetary policy means used after 2013 for bridging the gaps created by the crisis also follow the trend, are hyperactive and serve the public good in the broad sense of the word.[35]

In a recovery from the crisis, increased government influence is justified. This can be evidenced by examples from the international arena and from the previous periods of the Hungarian economy (see the historical retrospection). The speed of changes in Hungary after 2010 is conspicuous, and this is explained – in a mental attitude arising from historical disadvantages – by the several centuries-long lack of independent national governance, a long series of unsuccessful economic reforms, wars of independence and efforts at secession and liberty, which are followed by increased demand for success. Success entails the improvement of the country's economic potential, which in turn leads to higher living standards and a stronger voice in foreign policy. In other words, the depth and speed of changes seen in Hungary in the past few years are driven by centuries-long failures and the resulting demand for rise and strengthening. An analysis of more recent periods reveals that the failure of the change of regime in Hungary (between the 1980s and 2010) and the negative developments feeding through to Hungary from the global crisis can only be offset by a quick transformation of the economic method and the educational approach to a methodology that differs from the previous one (Zéman, 2016:202–207). The quickest possible way to achieve results is to push the previous models that caused failure to the background. The fact that society supports these efforts – through the electorate's permanent political mandate – is a concomitant of the Hungarian model. Neither the Soviet-type planned economy built on excessive public centralization, planned economy, exclusive state ownership, nor the neoliberal market economy model that replaced it and was applied in deviation from the Hungarian requirements and peculiar features are viable in Hungary for the future. However, a model that exercises government influence reasonably and supports the operation of the various market participants and households holds out the promise of success. Simultaneously, we find economic growth, inflation at a historic low, budget equilibrium, and surplus in the balance of payments and the foreign trade balance.

PSZ 2017. angol.szam_beliv_v16.indd 33 2017. 04. 06. 7:28:54

Notes

1 This study was written in the Wekerle Sándor Scientific Workshop of Public Finances. National University of Public Service, Institute of Public Finance, Budapest.

2 This had not been characteristic of FED even before the crisis, as it always had multiple monetary objectives and the struggle against inflation did not take precedence over other goals. After 2008, unemployment rose and boosting economic growth were given higher emphasis in the US central banking policy.

3 Including the European Central Bank, and the National Bank of Hungary after 2013. In terms of monetary objectives and instruments, FED has "never" had a single objective supported by assigned instruments.

4 See the list of the most important books and articles – published on this topic and worked out in conservative economic workshops – at the end of this study, well justified by the methodological pluralism following the crisis. See Csaba, 2013.

5 In the opinion of the author as a researcher. The monetary institution is not an organization meant to centralize public funds (it does not collect taxes and is not included in public finances), but it is part of public finances and an institution that supports fiscal policy while retaining its independence. Without interfering with its independence, it supports the government's anti-crisis policy, and thus its activity performed in the interest of public good has a more complex dimension than a mere focus on the moderation of inflation.

6 For more details, see Kolozsi–Lentner, 2006:39–41.

7 The termination of longer-term, preferential lending to SMEs based on the central bank's base rate weakened their competitive positions and even their survival chances. Financing the total government debt from the free market resulted in an increase in interest costs and unreliability due to external financing.

8 With the central bank's contribution, as for example, in the case of families having foreign currency loans.

9 For a description of the public finance system during the change of regime, see Lentner, Csaba: Main Propositions of the Methological Part (Chapter I) in Lentner, 2013a:518–526. and Lentner, 2014b. For more details on the comprehensive taxonomy of consolidation, see Lentner, 2015c:447–461.

10 For more details, see Lentner, 2015b:297–311.

11 On the level of households, for example, by making part of the central bank's reserves (nearly EUR 10 billion) available for the conversion of foreign currency loans of families to forint loans. Replacement of the loans of businesses indebted in foreign currency with forint loans in the framework of Funding for Growth tier 2, and reducing government debt and the interest on commercial loans by cutting the refinancing base rate.

12 Actual actions were only taken in 2015 and later. For more details, see Lentner, 2015e.

13 A new management was appointed at the head of the central bank, and in addition to the standards prevailing during the previous decades, they also promote economic development and financial stability.

14 USD 1 is worth approximately HUF 287.66 at the MNB's rate on 6 February 2017.

15 The central bank's base rate cut started after the 2010 general elections and expressly from the date the new government delegated members to the Monetary Council.

16 For further details see Kálmán, 2015:125–138.

17 For further details see Kolozsi, 2015:290–305.

18 Hungary was released from the EU's excessive deficit procedure, and since then its budget deficit has been permanently below 3 per cent.

19 In fiscal terms, in order to "favour" domestic businesses on a wider scale, and in the case of the central bank, promote market-based lending after the phasing-out of the Funding for Growth Scheme, reduce lending risks and provide an impetus to economic growth through lending to SMEs, the National Bank of Hungary launched the Growth Support Scheme to assist banks in transition to market lending. The Growth Support Scheme comprises the phasing off stage of the Funding for Growth Scheme and the Market Lending Scheme. The direct support mechanisms of the Hungarian public finance system should be replaced by indirect instruments, and the "reinforced" economic participants – indirectly

PSZ 2017. angol.szam_beliv_v16.indd 34 2017. 04. 06. 7:28:55

supported by the public finance system – should be able to meet the challenges among market conditions. Compare the period after the Quantitative Easing (QE) in FED's case.

[20] Decentralization, privatization and management are the elements of the outdated New Public Management.

[21] In other words: the operation of banks and businesses.

[22] US sub-prime mortgage market crisis, and the mass bankruptcy of banks, production and service providing companies. The lack of market coordination and efficient control. Greed, rapacity and the subordination of corporate operation to considerations related to profit on the markets left without regulation. See Bánfi–Kürthy–Bánfi, 2011:191–210.

[23] By analogy of the French etatist state model.

[24] The author's definition: Centralization, Nationalization, Public Good.

[25] This only applies to those parts of the mentioned fields that tackle state operation, fiscal, monetary and control procedures. To mention an incorrect example: world economy or micro-economy transferred from business sciences as curricular items are not part of state studies, unless they focus on state operation and the related effects.

[26] This may be performed through motions made by representatives or government submissions, which may then become statutes. Or it may be coded on chiselled diorite monoliths (Hammurabi), but the essence is the same. They are technical instruments in the operation of the state machinery. The economic dimension of taxation is a technical instrument, as taxpayers basically pay taxes according to the fiscal requirements set by public finances rather than their economically optimum tax payment capacities. The incumbent political force and its intent and values are the ultimate power that shapes public finances. Thus this is no organic bottom-to-top procedure, just as "political society is in no way an outcome of a contract between individuals making efforts at association. There has always been a social order from the very beginning..." (Abélés, 1990). This means that things are predetermined. Law and economic management track, arrange the order into rules, and execute.

[27] This list does not endeavour to be exhaustive, but gives an overview of the new kind of thinking.

[28] Similarly to the prevention of a state bankruptcy, create financial stabilization, and then restarting economic growth, increasing employment and solvent demand, cutting sovereign debt, economy management without IMF loans etc.

[29] In other words, they are implemented in adjustment to the country's economic and social past and present demand, while also following international examples.

[30] This is my subjective position.

[31] Hungary was kept above the water by loans granted from IMF, the WB and the ECB in the amount of USD 25 billion. Between 2008 and 2010, essentially "the crisis stagnated".

[32] I have never considered the complete in-depth introduction, without any transition, of the neoliberal market economy of the Anglo-Saxon type, or at least the one that evolved there, and experimenting with it for two decades, adjustable to the Hungarian environment that wished to change regime at the end of the 1980s (a collapsed Soviet-type planned economy in a country previously chopped to one-third of its territory after centuries of Habsburg influence and despotic or subordinated public finances, and no longer than only a one thousand and one hundred years of presence in the Carpathian Basin in a public administrative space of the Western model preceded by thousands of years of presence in Asia, all these traceable in recollections and in genetics).

[33] In a simple language "burden sharing" is the levying of taxes on international companies and banks according to their financial capabilities.

[34] Growth and simultaneous (financial and price) stability may provide good basis for the permanent sustenance of the model that has been built, especially if the social attitude (legitimation – Rodrik's model) remains supportive.

[35] The central bank's corporate responsibility has also changed, and has been expanded. In a broad sense it can be said that it serves public benefit using the monetary instruments at its disposal, its loans for growth and its self-financing scheme. In this topic, see our studies on commercial and central banking CSR: Lentner–Szegedi–Tatay, 2015a:95–103. and Lentner–Szegedi–Tatay, 2015b:35–47.

PSZ 2017. angol.szam_beliv_v16.indd 35 2017. 04. 06. 7:28:55

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Árpád Kovács

Rule-Based Budgeting: The Road to Budget Stability[1]

The Hungarian Solution

Summary

Starting from the macro-economic processes of public finance, this article examines the road to reaching financial stability and sustainable economic growth. It outlines the role played by rule-based budgeting in this process. It introduces the regulatory and institutional solutions and explains how, as a logical consequence of being part of a framework, this service can become a useful aspect of financial policy by implementing the respective regulations of the system and of annual budgetary practice. It reaches the conclusion that "elevating" the major stipulations of the rule-based budget framework and the operational rules of the institution safeguarding the implementation into the Fundamental Law of Hungary in 2001 was unavoidable from the aspect of strengthening fiscal responsibility. The article deals with the linkages of the Stability Act, the major characteristics of the work done by the Fiscal Council and the body's recommendations made in the last few years. Finally, it illustrates with some data the improvement of fiscal (public finance) stability supported by rule-based budgeting.

Journal of Economic Literature (JEL) code: B15, E62, H15, H61, H63, L38, P48
Keywords: fiscal policy, crisis management, debt management, fiscal stability

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PSZ 2017. angol.szam_beliv_v16.indd 39 2017. 04. 06. 7:28:55

Introduction – The essence of rule-based budgeting

It is common knowledge that in the course of implementation of the goals of fiscal policy in order to reach a lasting position of near budgetary (public finance) balance position and the financial viability of social services, it is of decisive importance to maintain the measure of state redistribution at the level required to reaching these goals. The maintenance of state redistribution at the required level is also a primary condition for the regional and global competitiveness of the entire national economy, both from the aspect of the long-term decrease of government debt and also, ultimately, in terms of the sustainability of socioeconomic development.

Lack of financial stability paralyses, or can paralyse, the social-economic functioning of a country within a few years. That is why regaining and maintaining this stability has become a strategic issue across the globe and has required new solutions, rules and institutions. The so-called *rule-based fiscal policy* framework that was first applied in the economic crisis-ridden states of Latin America and then, from the 1980s onward worldwide, and thus also in Europe, fits this target system (Kutasi, 2012).

The so-called "rule-based fiscal policy" means more than the regulatory compliance[2] of the preparation and implementation of budgeting, as this dictates the fiscal responsibility framework via the rules of budgetary policy, procedural-transparency regulations and – additionally – via the institutional mechanisms that represent the guarantee of observing these rules (Kutasi, 2012). The system used in practice is made up from these regulations and mechanisms – in harmony with the specific features of the given country (Ódor, 2014).

From the middle of the 2000s it became obvious in Hungary too that in order to prevent expenditure overruns that diverged from economic performance it was not enough simply to be more disciplined when it came to the implementation of the current budget. Regaining and maintaining financial stability became a strategic issue that required new constitutional stipulations that uniformly regulate public money matters and high level legal norms that rely on these new stipulations. The Hungarian efforts to put the finances of the country on a solid basis from the second half of the past decade, together with the cessation of expenditure overruns, successfully served this purpose when, five years ago, these goals were incorporated in the Fundamental Law of Hungary[3] and institutionalised in the Stability Act[4].

This article focuses on introducing these regulations and is then followed by a detailed analysis of the road to regaining fiscal stability.

Sketchy international outlook

Reasons for introduction and principles of rule-based budgetary practice as a therapy

Expenditure overruns have occurred in a long line of emerging and developed countries in the past few decades and, as a consequence, the problem of sustainability and growing debt has been accompanied by bank crises[5] (Antal, 2004; Bod, 2013; Győrffy, 2009; Muraközy, 2010).

PSZ 2017. angol.szam_beliv_v16.indd 40 2017. 04. 06. 7:28:55

Governments of several countries chose to introduce rule-based budgeting in the hope that it could help to confine balance-related tensions and *create lasting finance-ability,* growth and sustainable development. To this end, they incorporated into constitutional stipulations the proportions of the expenditure and revenue sides of the budget as well as the acceptable degree of indebtedness – in the form of numerical regulations, planned alongside a set rule of procedures and institutionally controlling the budget (Kopits, 2007; 2013).

In practice this meant that they:

– are employing fiscal policy regulations (for example, identifying expenditure ceilings to maintain a balanced budget),

– introduced fiscal-procedural regulations (for example, medium-term budget planning, and the obligatory compensation of expenditures),

– validated transparency norms (for example, accrual approach accounting, and reporting systems),

– established institutional guarantees to promote transparency and the observance of regulations and their macro- and micro-economic "supervision" (for example alongside the Supreme Audit Institution of the given country or – possibly within this institution – the operation of a parliamentary organisation and/or fiscal council that gives an opinion on the budget and that is independent from the government).

International experiences of applying this system have shown that its consistent operation could reverse the trend that throughout the last decades has been manifested in a long line of emerging and developed countries in the form of budgetary over-spending, the unsustainability of the budget and the growing government debt (Oblath–Szapáry, 2006).

Solutions in international practice

Some countries had already introduced rule-based budgeting *before the 2008 crisis* and they established independent fiscal institutions (see Table 1).[6]

It is apparent that they were using elements of the rule-based method in very different ways (Jankovics, 2012). Most frequently, however, the general balance requirements emerge and we can also find more concrete stipulations, such as setting a limit (ceiling) concerning indebtedness and calling for medium-range planning (Kopits, 2013). The method of calling for an independent institution can be different as well: in most cases it occurred with a simple law or political guideline (agreement), but in the case of Poland, for example, it was through the constitution. The countries of the euro area fixed the requirements in an agreement.[7]

A diverse picture has also enfolded in the EU Member States *in the period following the 2008 crisis.* From the "picture taken" on 1 January 2016, we have separately examined the individual countries belonging to the groups that accessed the EU before 2004 (see Table 2a and 2b) and those that accessed the EU from 2004 onwards (see Table 3a and 3b) (Adema, 2008). As a consequence of the crisis, the number of countries that have introduced the stipulations of rule-based budgeting has also increased among *the countries that had accessed the EU earlier.*[8]

PSZ 2017. angol.szam_beliv_v16.indd 41 2017. 04. 06. 7:28:55

Table 1: Functions and responsibilities of independent fiscal institutions guarding the observance of rule-based budgeting in the EU Member States prior to the 2008 financial crisis

	Country	**DK**	**BE**	**LV**	**SE**	**BG**	**EE**	**PL**	**UK**
	Date of the introduction of fiscal rule	**1962**	**1989**	**1990**	**1997–98, 2007**	**1998**	**1998**	**1998**	**1998**
Fiscal political rule	Deficit limit					X			
	Structural surplus or deficit		X		X				
	Expenditure limit		X		X				
	Current balance								X
	General balance	X	X	X			X		
	Efficacy studies								
	Medium-term planning	X							X
	Debt limit							X	X
	Stabilisation fund					X	X		
Authority	Public finance level	X	X	X	X	X	X	X	X
	National (central, federal)		X						
	Sub-national governments		X					X	
Basis of establishment	Constitution							X	
	Law	X	X	X	X				
	International agreement								
	Political guideline, agreement				X	X	X		X
Public law rating	Independent or parliamentary organisation	X	X	X	X	X	X		X
	Belonging to the executive branch							X	
Sanctions IFIs can use	Veto right								
	Loss of reputation	X	X	X	X	X	X	X	X
	Legal							X	
	Financial								

Abbreviations of the listed countries: DK – Denmark, BE – Belgium, LV – Latvia, SE – Sweden, BG – Bulgaria, EE – Estonia PL – Poland, UK – United Kingdom

Source: DG-ECFIN/IFI websites/Kopits, 2007; 2013/the author's compilation

PSZ 2017. angol.szam_beliv_v16.indd 42 2017. 04. 06. 7:28:55

Table 2a: Functions and responsibilities of independent fiscal institutions safeguarding the observance of budgeting on 1 January 2016 in the EU-15 country group

	Country	SE	UK	FR	DE	IE	PT
	Date of the introduction of fiscal rule	**1997–98, 2007**	**1998, 2010**	**2013**	**2010**	**2011**	**2012**
Fiscal political rule	Deficit limit				X	X	X
	Structural surplus or deficit	X					
	Primary expenditure limit	X					
	Current balance		X				
	General balance			X	X	X	X
	Efficacy studies						
	Medium-term planning		X				
	Debt limit		X	X			
	Sustainability						
Authority	Public finance level	X	X	X	X	X	X
	National (central, federal)	X	X	X	X	X	X
	Sub-national governments				X		X
Basis of establishment	Constitution				X		
	Law	X		X		X	X
	International agreement						
	Political guideline, agreement	X	X				
Public law rating	Independent or parliamentary organisation	X	X	X	X	X	X
	Belonging to the executive branch						
Sanctions IFIs can use	Veto right						
	Loss of reputation	X	X	X	X	X	X
	Legal				X		
	Financial						

Abbreviations of the individual countries: SE – Sweden, UK – United Kingdom, FR – France, DE – Germany, IE – Ireland, PT – Portugal – fiscal rules recommended by the EU for the countries of the euro area
Source: DG-ECFIN/IFI websites/Kopits 2007; 2013/the author's compilation

PSZ 2017. angol.szam_beliv_v16.indd 43 2017. 04. 06. 7:28:55

Table 2b: Functions and responsibilities of independent fiscal institutions safeguarding the observance of budgeting on 1 January 2016 in the EU-15 country group

	Country	FI	DK	BE	AT*	NL	EZ
	Date of the introduction of fiscal rule	**2010**	**1962, 2010**	**1989**	**2012**	**1945**	**2015**
Fiscal political rule	Deficit limit						X
	Structural surplus or deficit						
	Primary expenditure limit						
	Current balance						
	General balance	X	X	X	X	X	X
	Efficacy studies					X	
	Medium-term planning		X			X	
	Debt limit				X		X
	Sustainability				X		
Authority	Public finance level	X	X	X	X	X	X
	National (central, federal)	X	X	X	X	X	X
	Sub-national governments			X	X	X	
Basis of establishment	Constitution						
	Law	X	X	X	X	X	
	International agreement						X
	Political guideline, agreement						
Public law rating	Independent or parliamentary organisation	X	X	X	X	X	X
	Belonging to the executive branch						
Sanctions IFIs can use	Veto right						
	Loss of reputation	X	X	X	X	X	
	Legal						
	Financial						X

Abbreviations of the individual countries: FI – Finland, DK – Denmark, BE – Belgium, AT – Austria, NL – The Netherlands, IT – Italy, EZ – fiscal rules recommended by the EU for the countries of the euro area
Source: DG-ECFIN/IFI websites/Kopits 2007; 2013/the author's compilation
**In Austria there are two institutions operating, one is Fiskalrat (Fiscal Council) functioning on the technological background of the Central Bank of Austria, the other is Budgetdienst (the Fiscal Council of the Parliament)*

We have to note that in October 2015 the European Commission established the *Independent Fiscal Institution of the Union,* the European Fiscal Board[9], as an opinion-giving body that plays an advisory role. Its activities, mandates and examinations were limited to the countries of the euro area. According to the resolution, the new body will work independently from the national and European institutions, but in cooperation with them.[10]

PSZ 2017. angol.szam_beliv_v16.indd 44 2017. 04. 06. 7:28:55

Table 3a: Functions and responsibilities of independent fiscal institutions safeguarding the observance of budgeting on 1 January 2016 in the countries of the EU-13 country group (encompassing the countries that accessed the EU in the period of enlargement, 2004–2013)

	Country	**BG**	**EE**	**CY**	**PL***	**LV**	**LT**
	Date of the introduction of fiscal rule	**1998**	**1998**	**2014**	**1998**	**1990**	**2014**
Fiscal political rule	Deficit limit	X					
	Stabilisation fund	X	X				
	Primary expenditure limit	X					
	General balance		X	X	X	X	X
	Debt limit				X		
	Sustainability			X			X
Authority	Public finance level	X	X	X	X	X	X
	National (central, federal)	X	X	X	X	X	X
	Sub-national governments				X		
Basis of establishment	Constitution				X		X
	Law			X		X	X
	Political, agreement	X	X				
Public law rating	Independent or parliamentary organisation	X	X	X		X	X
	Belonging to the executive branch				X		
Sanctions IFIs can use	Veto power						
	Loss of reputation	X	X	X	X	X	X
	Legal				X	X	

**The IFI of Poland that is functioning as a governmental organisation has been "accepted" by the OECD as part of the group of such organisations by inviting them to their meetings. However, the EU does not regard it as an independent fiscal institution and the Poles do not get invitations to the so-called ECFIN meetings*

Source: DG-ECFIN/IFI websites, Kopits 2007; 2013/the author's compilation

Twelve of the 13 countries *that accessed the EU in 2004 or later,* operate rule-based fiscal regulatory mechanisms, together with the independent institutional guarantees ensuring the observance of these rules. The system was already set up prior to the outbreak of the 2008 crisis in four countries while in another five – among them in Hungary – it was introduced in the period 2009–2012.[11]

The picture is mixed with respect to the utilisation of the elements of rule-based budgeting as well as the functions and responsibilities of the individual fiscal institutions.[12] One "novelty", however, stands out and this concerns us. This is the application of the veto right (we will deal with this in more detail later).

PSZ 2017. angol.szam_beliv_v16.indd 45 2017. 04. 06. 7:28:55

Table 3b: Functions and responsibilities of independent fiscal institutions safeguarding the observance of budgeting on 1 January 2016 in the countries of the EU-13 country group (encompassing the countries that accessed the EU in the period of enlargement, 2004–2013)

	Country	**HU**	**HR**	**MT**	**RO**	**SK**	**SL**
	Date of the introduction of fiscal rule	**2009**	**2011**	**2015**	**2010**	**2012**	**2009**
Fiscal political rule	Deficit limit						
	Stabilisation fund						
	Primary expenditure limit						
	General balance		X	X	X	X	X
	Debt limit	X	X		X	X	X
	Sustainability			X			X
Authority	Public finance level	X	X	X	X	X	X
	National (central, federal)	X	X	X	X	X	X
	Sub-national governments						
Basis of establishment	Constitution	X				X	
	Law	X		X	X		X
	Political, agreement		X				
Public law rating	Independent or parliamentary organisation	X	X	X	X	X	X
	Belonging to the executive branch						
Sanctions IFIs can use	Veto power	X					
	Loss of reputation	X	X	X	X	X	X
	Legal	X					

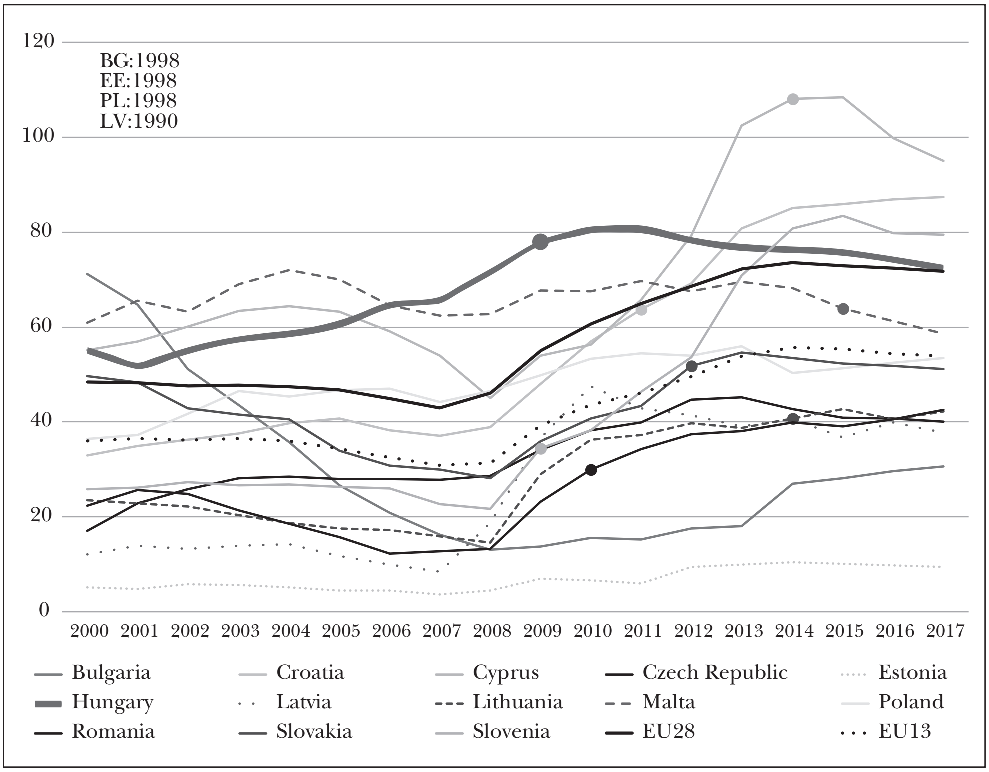
Source: DG-ECFIN/IFI websites, Kopits 2007; 2013/the author's compilation

Let us end the rather sketchy international outlook with the question of whether *financial management has become more disciplined* in the budget sector with the entry of the fiscal rules and institutions (fiscal councils). It is a fact that in the majority of the countries, following the introduction of a stricter system, the rate of government debt began to decrease (see Figure 1), and economic growth also started, more powerfully in the group of the Visegrád countries. Although the financial system of some Southern European states can, from time to time, be operated with the help of their own "forced solidarity", the practise of rule-based budgeting has brought certain results here too.

Accordingly, we can clearly reach the conclusion that the strengthening effect on discipline of favourable, problem-solving financial management can be demonstrated. This can be directly experienced mainly in the gradual relief of the burden of indebtedness. We should note, however, that the degree of the contribution of rule-based budgeting to the strengthening of fiscal stability strongly depends on the ability

PSZ 2017. angol.szam_beliv_v16.indd 46 2017. 04. 06. 7:28:56

Figure 1: Government debt to GDP of certain member states of the European Union and the date of creation of their independent fiscal institutions



Source: EUROSTAT, 2014–2016: Forecasts based on the National Convergence Programmes

of society and the political leadership to recognise the capacity, socio-economic will and, naturally, the authorisations in constitutional law of the institutions safeguarding the observance of this set of rules.[13]

Domestic fiscal policy in the past decade and a half

Problems in managing public finance and the human factor

First of all, let us see why and how we reached the recognition in the middle of the 2000s that, in order to establish stability in fiscal (budgetary) policy in Hungary it was unavoidable to introduce stricter regulations and the consequent control of their functioning.

After the turn of the millennium it was not only Hungary that was facing more and more unmanageable public finances, overspending and, as a consequence, deepening problems of indebtedness that led to the undermining of the financial stability of the country. However, the situation was different for us in that the overlap of the political

PSZ 2017. angol.szam_beliv_v16.indd 47 2017. 04. 06. 7:28:56

and economic cycles and the processes through which they strengthened or weakened each other – the effort to maximise votes – have resulted in expenditure overruns and the ensuing indebtedness, and most likely they played a larger role than in other countries with similar fates[14] (Karsai, 2007). Therefore, before we deal with the introduction of rule-based budgeting to Hungary, it is worth briefly looking beyond our borders.

It is obvious that in the system of relations of financial policy outlined in the introduction, reaching the desired goals depends not only on establishing the appropriate rules, but also on their disciplined observation and enforcement. But in this process the *human factor and the ability of society to recognise its interests and its will to follow these rules* play important roles without which the financial stability of a country can scarcely be realised (Kovács, 2016a).

Following the transition to democracy in Hungary, the fiscal policies followed by subsequent governments were characterised by bargaining mechanisms, with a planning and financial management procedure that was built on political promises and dogmas. This presented an obstacle for public finance stability and sustainable development (Antal, 2004; Csaba, 2007; Karsai, 2007; Lentner, 2008; Matolcsy, 2008; Muraközy, 2010 and others).

Consequences measurable by financial indicators

From time to time (mostly in years close to the elections) the *public finance deficit* has "skyrocketed"; in 2002 and in 2006 it was close to 10 per cent of the gross domestic product (GDP) (see Figure 2).

The continuous increase of the *measure of government debt expressed as a proportion of GDP (government debt rate)* up to the introduction of the rule-based fiscal policy in 2010 was a direct consequence of the high deficit level (see Figure 3).

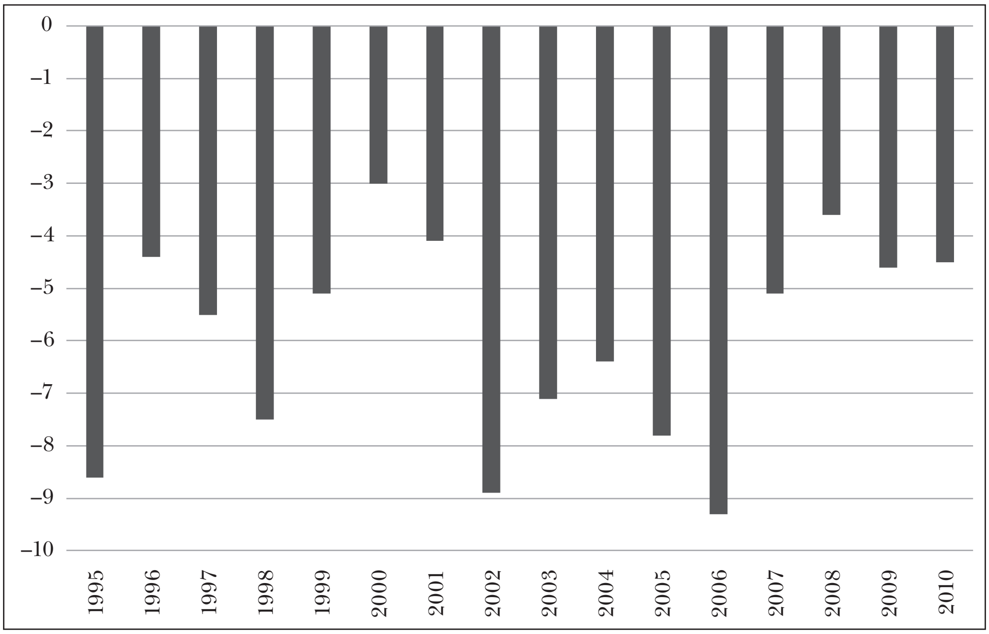
In the first half of the 1990s and then, following a temporary decrease, in the 2000s, the country was heavily burdened not only with the paying back of the soaring *government debt* but also the very expensive *financing* of the debt (debt service, i.e. the interest rate). "In the period of 1993–1999 in Hungary the expenditure on interest exceeded the expenditure on education, culture and health care" (György–Veres, 2016). To this we can add that, even in the years following 2010, servicing the debt tied up the same amount – i.e. 8-9 per cent – as that used for financing health care and was scarcely less than the 10–11 percent dedicated to education.

The peaking – especially when compared to the neighbouring countries and also to the OECD average – of *state redistribution* at close to 50 per cent of GDP, was the direct consequence of our fiscal policy (Figure 4).

It was inevitable that the huge amount of *withdrawn income* (and more specifically, the high degree of tax centralisation) that was necessary for state redistribution, encouraged tax evasion that, as a consequence, led to a reduction in the number of taxpayers, the erosion of the tax base and even to higher tax rates. As a result, *private sector investments* have shrunk. Companies being forced out of the credit market also contributed to this trend.

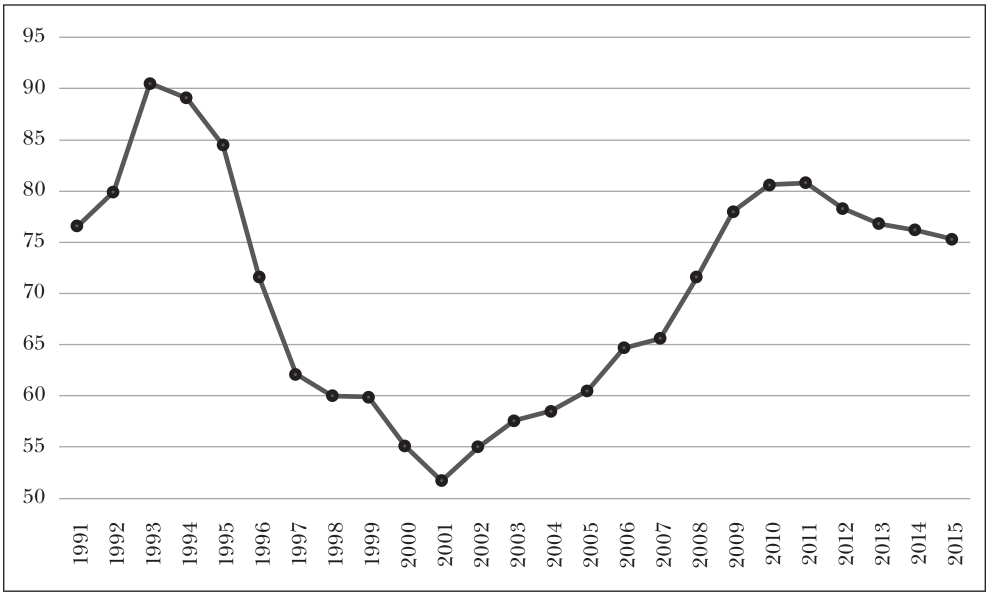
PSZ 2017. angol.szam_beliv_v16.indd 48 2017. 04. 06. 7:28:56

Figure 2: Hungarian public finance deficit from 1995 to 2010 calculated according to EU methodology (percentage of GDP)



Source: Eurostat, Edited by the FC Secretariat

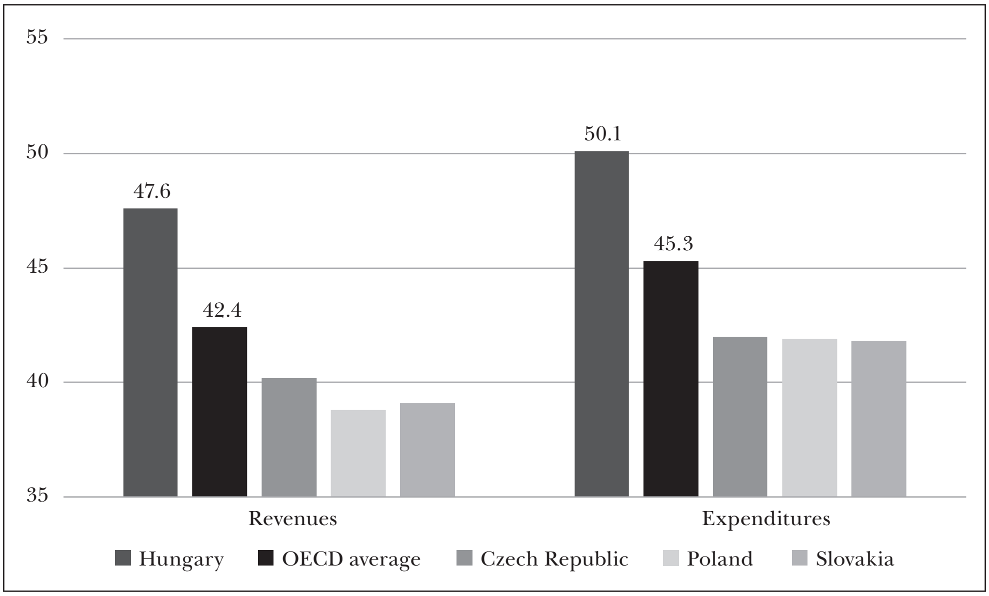
Figure 3: Government debt to GDP from 1991 to 2015



Source: Eurostat, edited by the FC Secretariat

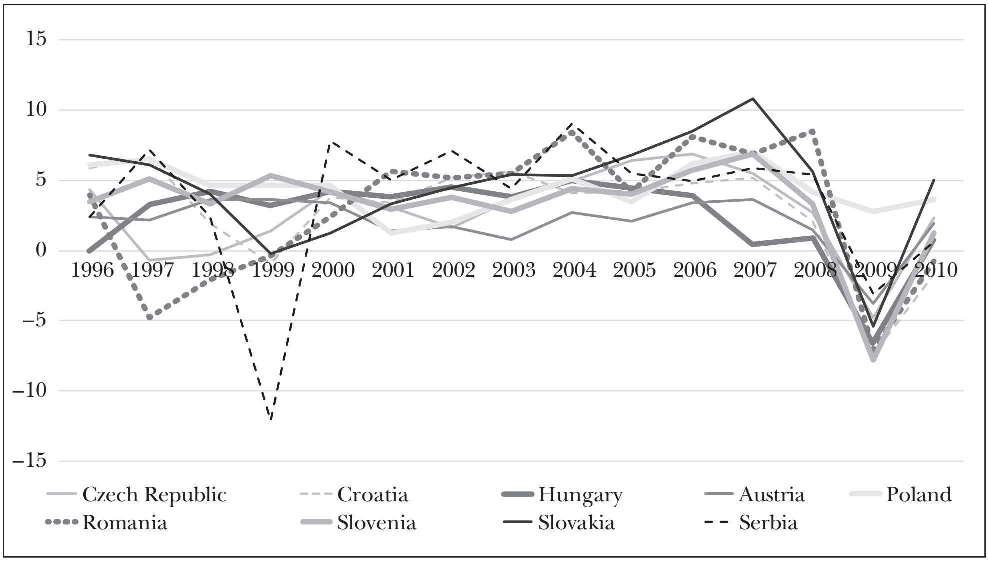
PSZ 2017. angol.szam_beliv_v16.indd 49 2017. 04. 06. 7:28:56

Figure 4: The degree of the revenue centralisation and redistribution of public finance in the Visegrád countries (2014) and the OECD average (Consolidated revenues and expenditures to GDP)



Source: OECD, on the basis of Zoltán Cséfalvay, partially edited by the FC Secretariat

Figure 5: Economic growth of Hungary and the neighbouring countries in the period 1996–2010 (change compared to the previous year, per cent)



Source: Eurostat, European Commission, edited by the FC Secretariat

The aforementioned reasons appearing in Hungary together with a number of other factors, like ever-decreasing productivity, led to a *more moderate growth, and occasionally even to recession,* compared to the neighbouring countries, and the level of growth could only be maintained by the continued involvement of external sources i.e. indebtedness (see Figure 5).

Courage was missing from the public finance reforms – consolidation attempts – announced by the governments of the period in the aftermath of the transition to democracy. Lack of social acceptance and support played a role in their failures or – at best – half-successes, as well as the lack of adjustment to the economic viability (taxpaying ability) of the country when it came to a powerful structural transformation and the tasks undertaken by the state. Furthermore, they did not set requirements to promote the more efficient utilisation of public funds.

The above-mentioned oversized public finance and the subsequent "greed" and inefficient system of operation exerted a negative effect on the national economy and this also contributed to the declining *competitiveness* of the country.[15]

Despite the excessive weight of public finance people experienced a continuous worsening of the level of public services and thus their quality of life, i.e. their expectations have not been met despite the promises given in the election campaigns (Kovács, 2016a). In addition, the economic crisis of 2008 that started in the money markets and expanded to a general crisis further weakened our position thanks to the already weak situation of the Hungarian economy.

Introducing rule-based budgeting in Hungary – Antecedents and institutional solutions

By 2006, following the deepening problems of Hungarian public finance that were endangering its sustainable financing and damaging the competitiveness of the real economy, it had become obvious that the budgetary practice followed ever since the transition to democracy had excluded the possibility of stepping on of the path towards sustainable development. The change could not be deferred any longer; a genuine change was needed in fiscal policy. However, the question was what should be the contents of such a change.

Balancing on the edge of fiscal unsustainability led to the recognition that in order to maintain the long-term sustainability of public finance, the direction of government had to insure, already in the short term, a regulation that was consistent and appropriate for the selected scenario as well as fiscal planning in the financial system that was "thinking" in the longer term, and independent control overseeing the observance of the regulations.

Dual search for a solution (2006–2007)

Experts were seeking solutions in two directions regarding the character of the regulations required for fiscal sustainability, as well as the institutional guarantees of their observance.

PSZ 2017. angol.szam_beliv_v16.indd 51 2017. 04. 06. 7:28:56

The *theses on modernising public finances* elaborated by the State Audit Office of Hungary assumed that in order to have significant change, the whole management of public funds would have to be regulated and made transparent and accountable. However, the agreement concerning the necessity and usefulness of comprehensive redefinition proved to be insufficient, owing to political divisions and the circumstances of a coalition government burdened with internal debates.

The other professional initiative focused on the most significant cause – the prevention of expenditure overruns – and regarded the adoption of the elements of *rule-based budgeting, which were* already successful in international practice, as appropriate for solving domestic problems too.

Accordingly, the development of the framework for *rule-based budgeting* was launched on the initiative of the State Audit Office of Hungary and the Central Bank of Hungary.

By the end of year 2008, and in the shadow of the threat of state bankruptcy and the pressure of borrowing from the IMF–EU, the *Act on Cost-Efficient State Management and Fiscal Responsibility* was born. Owing to its conception as an intervention mechanism that set limits on expenditure, this act was also referred to as the "Ceiling Act". The act limited the grand total of budget expenditure for the following year (the plan for the year 2009 had to be equal to the provision for 2008, but later it could be increased by half of the expected rise in the real value of GDP). Besides this, they established complicated rules concerning the plannable balance of the budget and the envisaged extent of government debt.[16]

There were also two different plans for the *Fiscal Council and its organisation.* Although there was agreement on the idea that the chairman of the body should be an authority representing the head of state, there were different ideas concerning who should be the members of the body. One plan held that the members should be the incumbent presidents of the two financial institutions, i.e. the State Audit Office of Hungary and the Central Bank of Hungary, both institutions being independent from the government. According to this plan a secretariat with a small staff would take care of the general and organisational tasks, as professional support for the decisions made by the Council would be ensured by the SAO, which would check the foundations of fiscal planning at both the macro- and micro-economic levels as it could rely on its independent research staff, and the Central Bank with its existing, and traditionally high-level, capacity for macro-economic analysis.[17]

The other solution was significantly different from the above plan. In this second concept, apart from the authority representing the head of state, members of the body would be selected from experts nominated by the heads of the SAO and the Central Bank of Hungary. The secretariat would consist of a large number of staff, be financed by an independent budget and have significant expertise in macro-economic analysis.

In the end, the second plan was included in the "Ceiling Act" and this prevailed until the end of 2010 (Török, 2011). Then, from 2011, there was a return to the first plan, with the conditions of the transition being regulated by the 2011 Budget Act.[18]

PSZ 2017. angol.szam_beliv_v16.indd 52 2017. 04. 06. 7:28:56

Following the 2010 general elections, the new Government – enjoying a two-third majority in the Parliament – undertook the tasks of reviewing the whole of the legal system, and within this public finance, and setting up a new legal framework. This solution opened a new chapter, appropriate to the importance of the issue, with regards to the regulation of the rule-based budgeting system.

The Fundamental Law of Hungary and the Stability Act on rule-based budgeting

The *Fundamental Law of Hungary,* which was passed on 18th April 2011, dedicated a separate chapter to public finance. This chapter lays down the budget-making role of the National Assembly. Additionally, it states that the management of public finance shall be done in a transparent and accountable way, by keeping in mind the requirements of legality, expediency and efficiency. It also sets up a barrier for indebtedness, not only with regard to overall public finance but also, separately within it, to local authorities.

The Fundamental Law also defined the annually plannable extent of government debt when it created the *government debt rule.*[19] According to this rule the National Assembly cannot pass a central budget act which would result in government debt exceeding half of GDP. As long as government debt exceeds half of GDP, the National Assembly can pass only a central budget act that contains the requirement to decrease government debt to GDP.

The Stability Act established a government debt rule *not only regarding the planning and passing of the budget but also concerning its implementation.* It states that as long as government debt rule exceeds half of GDP – with specific exceptions – no borrowing can take place in the course of the central budget implementation and no such financial obligations can be made as a result of which the proportion of government debt to total gross domestic product would increase compared to the previous year.

The Fundamental Law of Hungary elevated the Fiscal Council (in short: the Council or FC), which oversees the observance of fiscal stability, to become one of the conditions of the functioning of the Constitution. The Council is a body supporting the legislative work of the National Assembly and carries out its duties and tasks subordinated to the Fundamental Law and other laws. Among these tasks the FC participates in the preparation of the central budget bill; as an organisation supporting the legislative work of the National Assembly, on the one hand *it examines – gives an opinion on – the foundations of the central budget,* while on the other hand it *gives its preliminary consent to the passing of the central budget bill* in the interest of the observance of the government debt rule. The Council was granted a role as an independent fiscal institution with the above-mentioned duties and sphere of authority – i.e. the so-called *right to veto – together with the accompanying responsibility.*

This solution exceeds the practice of the majority of EU countries where – as we explained above – the work has mainly an awareness–raising and advisory character, not involving direct responsibility and tends towards a macro-economic analysis and technical forecasting with various reporting rights (that, in a limited way, might be strengthened by the relationship of the given institution to the SAO or the Parliament) (Domokos, 2012; 2015).

PSZ 2017. angol.szam_beliv_v16.indd 53 2017. 04. 06. 7:28:56

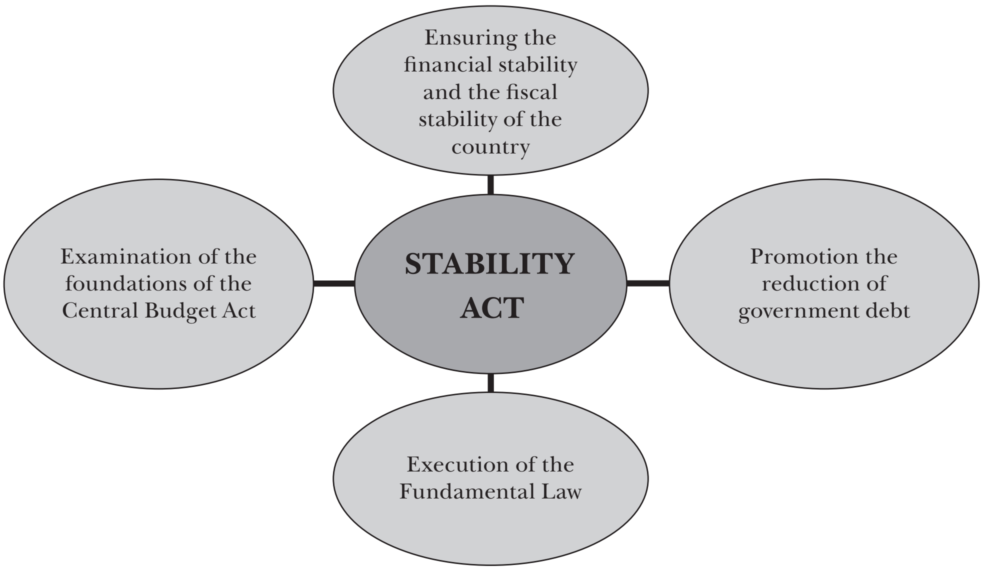
The framework for the Council's duties defined by the Fundamental Law was further detailed by the Stability Act (see Figure 6).

It is the Stability Act that sets forth in detail the rules of procedure for the implementation of the *mandatory duties* of the Fiscal Council, including the duties of the Government, first and foremost by focusing on the process for enacting the budget bill. Thus, if in the course of formulating its opinion on the budget bill the FC expresses its lack of consent, then the Government shall have to confer again and reach agreement with the Council. The procedural rule concerning the provisional consent of the Council with regard to the bill's accordance with the government debt rule is even tougher: if the Council resorts to using its veto right and rejects giving its provisional consent then the final voting shall have to be postponed and the procedure be continued until the Council gives its consent.

In addition to the above, the main duties of the Council are to express an opinion every six months on the implementation of the central budget act and the expected trend of government debt.

The FC monitors the macro economy and the implementation of the budget in the context of longer term macro-economic processes. For this purpose – just as when expressing an opinion on the budget – the Council relies on the analysis capabilities of the SAO and the MNB, and also on the work of research institutes, external experts, professional forums and advisory bodies.

Figure 6: Tasks of the Fiscal Council according to the Stability Act



Source: www.kormanyhivatal.hu/download/3/de/20000/6 Stabilitási törv.pdf

PSZ 2017. angol.szam_beliv_v16.indd 54 2017. 04. 06. 7:28:56

With regard to the *other, non-mandatory duties* of the Fiscal Council, the Stability Act states that it can give its opinion on any issues that are related to the planning and implementation of the budget, the utilisation of public funds, and the state of public finances. From a broader perspective, satisfying social and professional/media interests fits within these duties, as well as asking for the opinion of economists, and responding to information requests from international organisations, cooperating with the independent fiscal institutions of other countries, and, likewise, the promotion of the stability of public finances using the tools of publicity (the Council's resolutions, annual work plan, other documents, and research used for the FC's work are available on its website).

Activities of the Fiscal Council and the balancing of public finances

The activities of the FC and the tools at its disposal – not least the body's strong authority for promoting fiscal discipline, but also the guarantee of its presence –, *have contributed to the balance-oriented budgetary policy*, as a result of which the excessive deficit procedure (EDP) against Hungary was terminated in 2013, and the benchmarking parameters of public finance management have been realised, on the basis of which it became possible, in 2016, for international credit rating organisations to return Hungary to investment-grade status.

Some decisive resolutions of the Fiscal Council can be linked to this process:

– In 2012, the FC objected to the macro-economic trajectory and the targeted deficit in the 2013 central budget bill. As a consequence, a new proposal was made that amended the macro-economic background, the targeted deficit and included additional revenue (thus concerning the tax system) and expenditure-affecting measures.

– In 2013, in its opinion on the 2014 central budget bill, the FC identified risks both on the revenue and expenditure sides. Thus it considered it justified that strict financial management is followed at all levels of public finances to ensure that balance requirements are met.

– In 2014, in the case of the 2015 central budget bill, the FC focused its attention on the necessity of "fending off" those external conditions that threatened the implementation of the macro-economic trajectory.

– In 2015, with regard to the 2016 central budget bill, the Council pointed out that the observance of the government debt rule (the debt formula stipulated by the Stability Act) was facing challenges (as a result of these challenges both the balance and the growth of public finances were in danger) and recommended the amendment of the formula. The National Assembly adopted a new government debt rule, also as a consequence of the FC proposal.

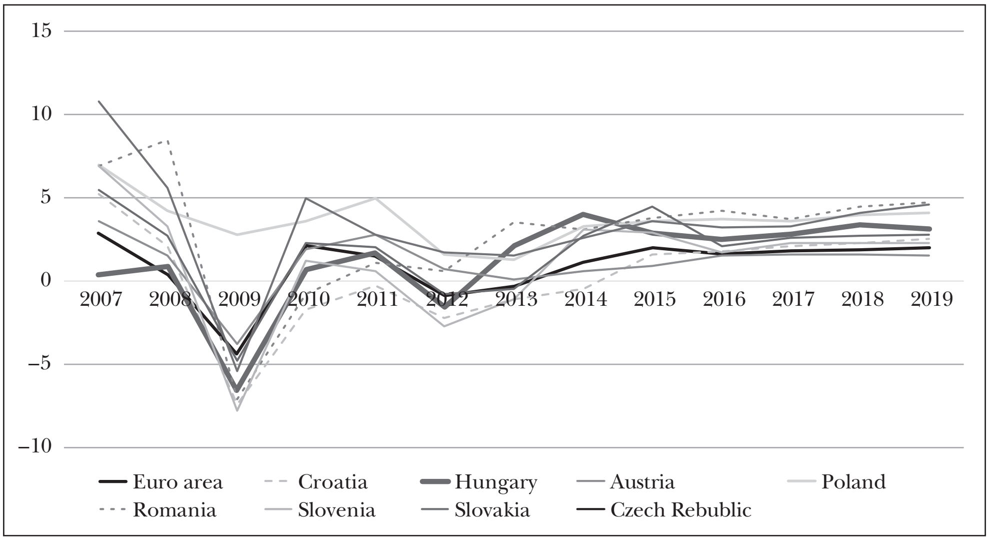
– In 2016, the Council gave a positive evaluation of the 2017 central budget bill thanks to the step taken towards a balanced budget (the separation and deficit of the operational and accumulation budgets was shown only in case of the latter). At the same time the FC called the attention to the fact that the requirement regarding the so-called structural deficit had not been met.

PSZ 2017. angol.szam_beliv_v16.indd 55 2017. 04. 06. 7:28:56

The stability of Hungarian finances as the basis of growth

Growth determining the stability of the country and public finances has been present since 2013. It should be stressed that "the years of 2014 and 2015 were the first two years, ever since the early 1990s, when the Hungarian economy was able to grow without being followed by the growth of government debt and the external debt of the economy" (György–Veres, 2016:380). It is auspicious that economic activity has strengthened and that economic growth in the region exceeds the average of the euro area (see Figure 7).

Figure 7: Economic growth in the countries of Central Eastern Europe and of the euro area



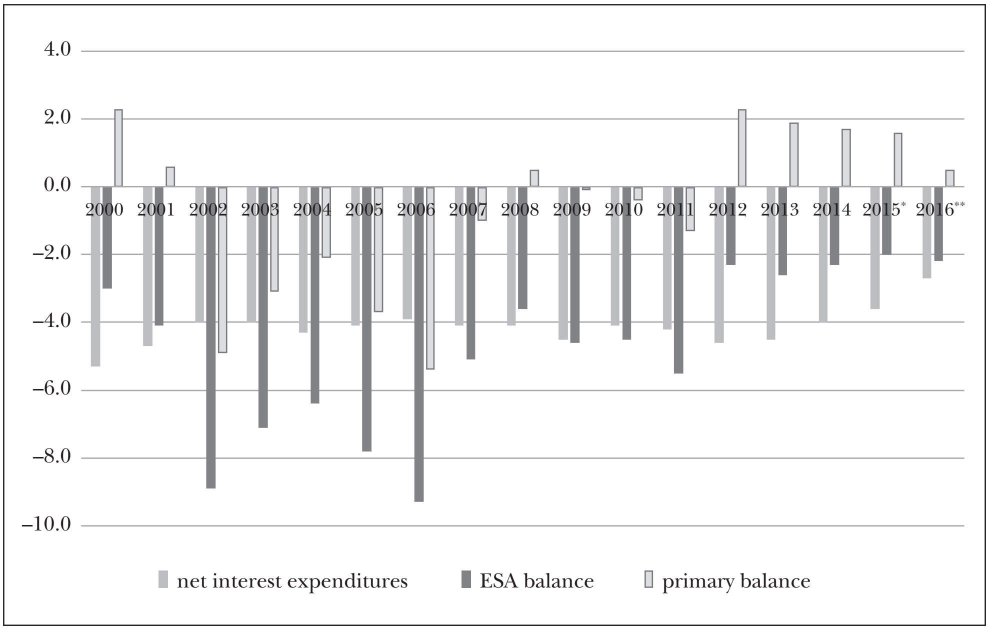
Source: 2016 spring forecast of the European Commission

The improvement of the government debt balance at the same time stimulates growth both in Hungary and in the neighbouring countries. It is the success of our rule-based budgetary policy that it is manifested not only in the decreasing trend in the public finance deficit but also in the fact that ever since 2012 our primary balance has been continuously positive, in contrast to the previous years when we were able to produce such a favourable result only for a year (Figure 8).

As a result of the marked improvement in the effectiveness of revenue collection, the adequate control of expenditures and the subsequent improving of the deficit indicators, after 2010 the government debt rate has been improved every year (as show in Figure 3). With the improving balance, the costs of financing the budget decrease. Cheaper financing then liberates resources for the economy and for society and thus represents a factor for growth. From the aspect of the "vulnerability" of the country, the spectacular fall of the ration of foreign currency within government debt is especially favourable (see Figure 9).

PSZ 2017. angol.szam_beliv_v16.indd 56 2017. 04. 06. 7:28:56

Figure 8: Hungary's budget deficit, net interest expenditures, and primary balance to GDP

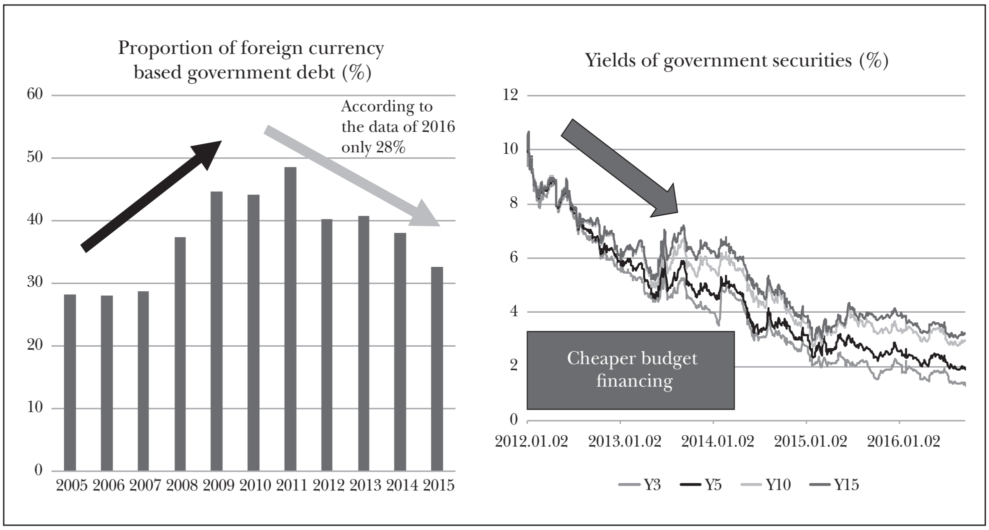


** The previously expected -1, 6% deficit is even more favourable*

***Expected data for year 2016*

Source: MNB, on the basis of Eurostat, edited by the FC Secretariat

Figure 9: Hungarian government debt denominated in foreign currency and the yields of government securities



Source: ÁKK

PSZ 2017. angol.szam_beliv_v16.indd 57 2017. 04. 06. 7:28:56

Instead of a summary

The characteristic of the "Hungarian model" that was renewed in 2011 is that, in order to prevent the earlier fiscal indiscipline, the FC was granted constitutional authority (right to veto) on the acceptance of the budgets (and their respective amendments). Apart from this it is also a characteristic feature of the Council that thanks to is budget-related constitutional authority, the body primarily deals with the stability risks of the current and the following year, utilises medium-term outlook and forecast data t, and does not bring them to the level of a corporate decision.

Generally speaking, the Hungarian system can successfully function not only because of its strict regulations, simple and transparent principles for fighting government debt and overseeing the observance of these regulations, but also because of its solutions, its effect on mitigating expenditure overruns, its awareness raising and confidence-building strength and its durability. In this way, it can contribute to the stabilisation of the country, to its sustainable development, the improvement of the country's economic competitiveness and, ultimately, the advancement of the nation and the citizens of the country (Kovács, 2016b).

By the application of the elements of rule-based budgeting and the operation of the Fiscal Council, and also owing to the confirmation of the related requirements in the Fundamental Law and the Stability Act that made the regulations more transparent and consistent, the balance of public finances in the years following 2011 has clearly improved with respect to the deficit and debt indicators. Fiscal stability makes it possible for public finances to increasingly contribute to economic development. Competitiveness indicators[20] even today lag behind those of the Visegrád group of countries. Among a series of weaknesses, however, those related to the low effectiveness, excessive consumption and lack of financial stability of Hungarian public finances are no longer present today. These serious and determinant factors were responsible for the withdrawal of resources necessary for the economy and the dramatic fall of competitiveness in the 2004–2010 period.

The improvement of our balance situation affects our national competitiveness in a positive way. Further continuing the idea of linking competitiveness to the material and intellectual progress of our citizens, one must agree with a definition from Magdolna Csath that: "the economy is competitive when the abilities of the nation are useful and in the longer run keep gaining strength continuously, and when companies produce high added value, and as a consequence of these factors the standard of living and quality of life of the individuals keep improving" (Csath, 2016:5–6.).

Concerns the answer to the question "how to proceed" let me invoke once again the thoughts of László György and József Veress: "After having fended off direct dangers we can start developing those efficiency-improving and innovative factors that are able to set a solid foundation for competitiveness and economic growth […] first of all developing the following fields: vocational training, adult education, higher education, innovation, optimisation of the coordinating mechanisms of the economy and decreasing of the bureaucratic and administrative burdens of market operators" (György–Veress, 2016: 380).

Disciplined fiscal policy and making the work of public finance supply system more effective and efficient must contribute continuously to the future success of our national economy. There are plenty of tasks still to do for the Fiscal Council by contributing to the strengthening of fiscal responsibility.

Notes

1 The author thanks László Kékesi and Sándor Varga, advisors to the Chairman of the Fiscal Council, for their contributions to writing this article.

2 We can also regard the Maastricht criteria as obligatory and uniformly used "numerical and procedural rules". Let's think about the stipulated 3 per cent deficit limit or the goal of keeping government debt at 60 per cent of GDP, the obligatory decrease of the part of the deficit leading to it or that of the part above the limit by 1/20th annually and the independent fiscal institution of the EU Commission, the European Fiscal Board established as an advisory body of the EU zone countries. Members of this body were appointed in October 2016, a year after its establishment, by the EU Commission and it started working in practice following this.

3 Paragraph (1) of Article N of the Foundation of our Fundamental law ("Hungary shall observe the principle of balanced, transparent and sustainable budget management.") and Articles 36, 37 and 44 of the chapter The State.

4 Act CXCIV of 2011 on Hungary's Economic Stability.

5 The introduction and application of rule-based budgeting has a wide range theoretical literature. Additionally the European Commission, and lately the cooperation forum of the independent fiscal institutions of the EU countries have also published documents. This chapter was prepared using these materials.

6 Rule-based budgeting and financing based on it carries the better harmony of tasks and resources and undoubtedly mitigates the cyclic nature of the budget (Kopits, 2013). The lessons of the crisis complemented this "classic function" by proving that the introduction of rule based budgeting can be one of the tools of crisis management (Reinhart–Rogoff, 2010; Kovács, Á., 2013).

7 As regards the constitutional rating of institutions overseeing the observance of relevant rules, independence from the government is a generally prevailing requirement, although we see Poland as the "odd one out" where the institution was established as part of the executive power. A well-known consequence is loss of reputation/credibility as a sanction applied by fiscal institutions. In the case of Poland we can see the option of legal sanctions (for example the renegotiation of the budget), while financial sanctions (for example, the suspension of EU resources) can be used in the countries of the euro area (Franco, 2011).

8 Stricter fiscal rules were applied after 2008 and institutions were dedicated to overseeing the observance of such rules in Germany, Ireland, Portugal, Finland, Austria and Italy. The system was further enhanced in the countries that already had such institutions (in Sweden in 2007, in Denmark and the United Kingdom in 2010).

9 By its Resolution No. 8000 issued on 21 October 2015 the European Commission decided to establish the institution, while a decision on its member was made only a year later, in October 2016.

10 Due to the short time that had passed since its establishment, naturally we don't yet have evaluable experiences regarding its operation and the perception of the body about its mission. The cooperation and consultation forum of the independent fiscal institutions of the EU countries that was created about one and a half years ago as a self-contracting and professional-consultation forum is looking for opportunities to establish a mutual exchange of experiences with the European Fiscal Boards as soon as possible to share best practices.

PSZ 2017. angol.szam_beliv_v16.indd 59 2017. 04. 06. 7:28:56

[11] The Czech Republic does not use any elements of the rule-based fiscal framework. The fact that, for political reasons, the former Czechoslovakia never received external resources and the transition to democracy took place in a country that had a relatively developed economy, low living standards but minimal level of indebtedness all played an important part is this. The situation is somewhat similar in Poland, where they had been successfully using the fiscal policy and procedural regulations prior to the crisis and they do not see the need to establish an IFI.

[12] As regards the concepts of the professional backgrounds of independent fiscal institutions, their constitutional status has no international (European) "best practice". What is important is the capability of institutions to maintain rules, which can be realised in the various countries by lining up constitutional instruments of differencing strengths, by different values of trust and credibility (prestige), by relying on professional support of different organisational backgrounds, and by various constitutional and institutional tools. The guarantees to keep the budget deficit in control and to prevent expenditure overruns, and the rules created with the aim of limiting investment expenditures, (Benczes–Váradi, 2011) can be interpreted together with the state organisation and fiscal system of the given country (Török, 2011). There are a number of examples in international practice in which analyses serving as the foundation of the body's decisions are provided by experts from the business sector or other, independent organisations – SAI, central bank, etc. Among the countries of the European Union France, Finland, Lithuania, Latvia and Italy rely on their respective SAIs while the Slovakian and Austrian IFIs chose their Central Banks as a background. In the case of the latter, however, we also have to note that in Austria there is an additional institute with a parliamentary background that oversees rule-based budgeting.

[13] Such can be, for example, when the IFI prepares the macro-economic forecast that serves as the basis of the budget bill, gives its opinion on the budget bills and the defined parameters (government debt to GDP, deficit ceiling, etc.).

[14] In 2006 Gábor Karsai wrote: "The amplitude of domestic political cycles in Hungary appears to be more powerful than what is usual in the older member-states of the EU. Very likely part of this is the consequence of the greater tensions caused by the transformation process. The other reason is the consequence of more modest democratic traditions. […] As regards the Hungarian economic and privatization policy we clearly have to differentiate between the declared principles and practice expressed in the election campaigns, and the government programme and the laws. This has two important elements. On the one hand, the processes often went on without parliamentary regulations." (Karsai, 2006:510)

[15] Naturally the problem is manifested in a far wider context however, discussion of this – especially the impact assessment of the factors of production efficiency – exceeds the frame of the present article).

[16] Act LXXV of 2008.

[17] In order to ensure the technical conditions for the operation of the secretariat with a small staff it can be attached either to the SAO or the Central Bank of Hungary, although it can be also expedient if the Office of the National Assembly supplies the technical background for the operation. There are examples of each solution in international practice.

[18] The changing concepts of institutional building and grasp of mission exceed the frame of the present article. A more detailed explanation can be found in the following document: "The Fiscal Council in the Hungarian Fundamental Law, Draft of Institutional Development and the European Practice" (Kovács, 2016b).

[19] Paragraphs (4) and (5) Article 36 of the Fundamental Law. In Hungary government debt was concretised by the Stability Act. According to the original wording that came into law in 2015 and was used for the first time for the 2016 central budget, the planned amount of government debt by the end of the following year was able to grow by the amount of half of the difference between the growth rate of inflation and real GDP. However, this was unenforceable and thus this requirement was amended (the movement of economic growth and inflation in opposite directions would have resulted in a restraint on growth). As a result of the 2015 amendments this rule is valid only in cases of an inflation target exceeding 3 per cent and, at the same time, economic growth predicted above 3 per cent. In any other case, the goal is set at reaching at least a 0.1 per cent decrease in the debt indicator. At the same time, the decrease in the debt indicator can be even larger by reaching the goal set by the public finance law, i.e. by reaching

PSZ 2017. angol.szam_beliv_v16.indd 60 2017. 04. 06. 7:28:56

the targeted budget deficit in the medium term. Diversions from the above requirements are allowed only in cases of the introduction of a special law, to the extent of mitigating the consequences of the factors calling for the introduction of such law, or, in the case of a lasting and significant recession of the national economy, and only to the extent necessary to restore normal conditions.

[20] Attila Chikán wrote: "Quite a strong correlation exists between productivity and competitiveness. It is rather unlikely to be wrong when we say that one of the important factors of Hungary's significant falling behind is that in the rank of 33 OECD countries merely five countries are behind us and our country's indicator does not reach half the level of the data for the USA data and 60 per cent of the OECD average. A general lagging behind is inevitable with such real outputs. It is an especially regretful fact that the productivity growth rate of productivity is also showing a downward tendency" (Chikán, 2014).

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Supporting Good Governance in SAI's Audit Planning

Summary
Supreme audit institutions (SAIs) must conduct their audits where and when this is most needed, and where the greatest added value is generated. In line with the principles of good governance, when planning audits, in addition to risk analysis results, SAIs ideally also take social expectations into account. The support of good governance is treated as a priority, moreover, the audit focus of SAIs is also impacted by the focus of public management.

The aim of this study is to present the selection methodology supporting audit planning, as well as the characteristics of risk analysis through international examples. The study first presents the key phases and features of the planning processes of supreme audit institutions, while also pointing out how planning can support good governance. Planning comprises several interrelated phases, including the selection of audited areas, the definition of methodology, the preparation of audit programmes and resource planning. In line with the requirements of international standards, SAIs apply risk analysis in the various phases of planning. This section will also present a new trend, namely social participation.

According to its Strategy adopted by the Hungarian National Assembly, the State Audit Office of Hungary (SAO) considers as its mission to promote the transparent and sound management of public finances with its value creating audits performed on a solid professional basis, and thus to contribute to good governance. The goal of the SAO's audits is to provide well-founded, professional and objective answers with regard to current economic and social problems, by focusing on appropriate issues at the appropriate time. For this purpose, the SAO renewed its planning system from 2011. The second part of the study presents the planning processes of the State Audit

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PSZ 2017. angol.szam_beliv_v16.indd 64 2017. 04. 06. 7:28:57

Office, developed on the basis of international standards. In order for the audits of the State Audit Office to support good governance to the greatest possible extent, the various planning phases have a hierarchic structure and rely heavily on information from the organisation's risk database.

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Planning processes of supreme audit institutions

SAI planning for good governance

One of the expectations against supreme audit institutions (state audit offices) is that they must conduct audits in areas where there is a relevant social need for this, and where such audits generate the greatest benefit for society. The function of planning processes is first and foremost to select areas within state involvement in general, the auditing of which helps fulfil the above criteria, thereby supporting good governance, the well-managed state and efficient state management. In addition, certain planning tasks also arise in connection with any given audit, such as the planning of the audit objective, its method, key issues, resource requirements, as well as supporting activities.

As such, SAI planning is a complex, multi-phase process which forms a hierarchic system from strategic planning through resource plans and the creation of operative audit plans all the way to feedback. This chapter presents the key steps of planning, primarily based on INTOSAI[1] standards (ISSAI 200, 300, 400).

Strategic planning

The strategy is the long-term (multi-year) plan of SAI activity, which sets out the key tasks of the institution as well as its ethical requirements, values, priorities, and the directions and main objectives of the given period.[2] This strategy is prepared in line with the institution's mission as well as with legal regulations and the government's strategy papers. The strategic plan serves as a foundation for the annual plans of the period ahead, and as such, strategic planning defines audit topics and audit criteria (the method used by the state audit office to set out the audit directions of the period ahead depends on both political-statutory environment as well as established traditions). These are all necessary to align annual plans with one another, and for audits to generate the greatest added value possible while supplementing one another.[3]

The selection of audit topics and criteria depends on strategic priorities. The primary goal of selection – in addition to limited audit capacities and expenditures – for audits is to contribute to improving state operation to the greatest extent possible. This contribu-

PSZ 2017. angol.szam_beliv_v16.indd 65 2017. 04. 06. 7:28:57

tion may take on a number of forms, such as the saving of public funds, the support of decision-making, the improvement of effectiveness and transparency, etc. The objectives of selection criteria vary depending on what type of audit they serve as basis for.

– The objective of financial audits is to determine whether the information presented in the financial statements of a given organisation comply with the applicable financial reporting and regulatory framework, thus helping to increase the confidence that the intended users have in such financial statements. One of the objectives of selection may be to cover as much of public spending as possible by auditing the most significant programmes, i.e. those that impact financial equilibrium the most.[4]

– Compliance audits are a specific audit type designed to determine whether the activities, operations, financial transactions, information and data constituting the subject of the audit are in compliance, in all material respects, with the regulations and requirements relevant to the audited entity. During the definition of selection criteria, one of the objectives may be the selection of organisations and programmes where potentially irregular operation represents a considerable macro-economic risk, and where regularity audits (by raising awareness on their operation) provide useful information for decision-makers as well as other stakeholders.

– The objective of performance audits is to constructively support the efficient, effective and economical spending of public funds, as well as the management of and task performance related to national assets. Another goal is to uncover factors potentially hindering financial management and task performance as well as the enforcement of the requirements of effectiveness, efficiency and economy; and to point out how these could be reduced (these audits typically examine the realisation of the 3E-s: effectiveness, economy and efficiency). The goal in this case is to select systems and programmes, the auditing of which represents substantial added value for their effectiveness, efficiency or economy (ISSAI 3000). Added value could mean, for example, the support of parliamentary/governmental decision-making or contribution to the improvement of the management of the audited entity.

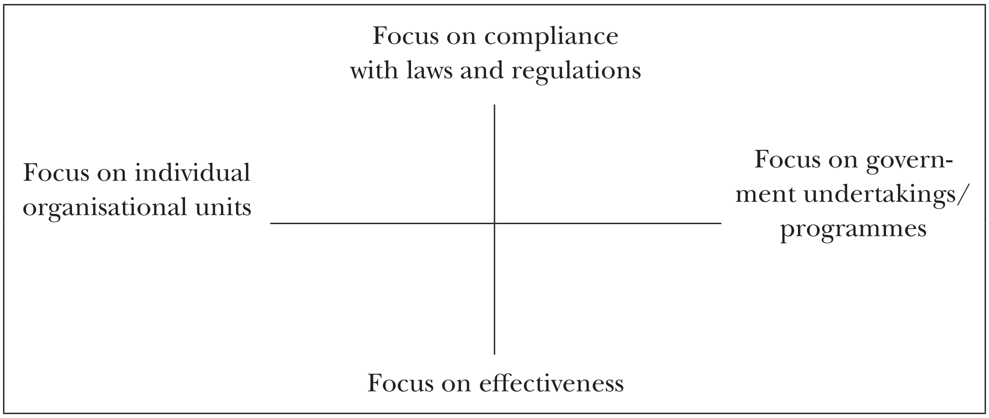
It is, therefore, clear that the objective during the planning of all audit types is to create the greatest added value possible, however, the form of this added value varies at the given audit types (more reliable statements; improvement in terms of compliance; more effective, efficient and economical operation).

The strategy paper also sets out the so-called audit orientation, considered to be one of the most important characteristics of SAI activity. The figure below related to the planning priorities of performance audits helps to outline the audit orientation.

Through its (performance) audits, the state audit office may decide to examine the regularity of the audited organisation/area/process, thereby supporting the enforcement and implementation of legal regulations (focus on statutory compliance, vertical axis). When the state audit office primarily wishes to contribute to the modernisation of state operation, it then focuses its audits on various aspects of performance (focus on effectiveness, vertical axis). Audits may also move along a wide spectrum in terms of the audited area as well, as – based on its strategic decision – the state audit office may examine only government bodies or only govern-

PSZ 2017. angol.szam_beliv_v16.indd 66 2017. 04. 06. 7:28:57

Figure 1: Options for audit orientation



Source: INTOSAI: ISSAI 3000

ment programmes involving several sectors, or it may also define its own "portfolio of audited entities" somewhere between these two end-points (movement along the horizontal axis).

The form of public management also affects the priorities of SAI audits. As stated in ISSAI 3000, "in countries where public management is mainly concerned with means and less involved with ends, audits also tend to focus on whether rules have been observed and enforced rather than whether the rules serve or are seen to serve their intended purpose".

Certain conditions must also be met in respect of the area for audit (process, programme, organisation) in order to generate the highest added value possible, e.g. the given area must be significant (but at the same time auditable) from an economic, public finance, social or public policy aspect (ISSAI 100). These conditions are also usually defined by strategy papers.

Annual planning

The annual plan[5] lists and presents the audits to be carried out in the given period (audit objective, method, audited area, risks, key audit questions, etc.). The annual plan is prepared in harmony with the audit priorities set out in the strategy as well as with macro-economic and risk analyses and the requirements stipulated by legal regulations, while also taking into account 'anticipated demand' for audit reports (in other words, on which forums and by which socio-economic players the report is expected to be best utilised). The objective of planning, therefore, is to select the areas, programmes and organisations to be audited in the coming period, and to determine the order of audits depending on capacity. (At the European Court of Auditors, this phase is called 'programming', in line with EU terminology.) The annual plan serves as the foundation for operative planning.

PSZ 2017. angol.szam_beliv_v16.indd 67 2017. 04. 06. 7:28:57

Audit planning

Audit planning comprises the formulation of the specific audit strategy and the preparation of the audit plan. In addition, complex audits are also substantiated by analyses and preliminary studies. The plan must provide answers to the questions: what is audited, why is it audited and what is the purpose of the audit?

Based on INTOSAI standards, it is in this phase that the objectives, scope, method and criteria of the given audit must be formulated in detail; this is where audit questions must be drafted and the sample to be audited is to be defined and where the documents supporting the audit (e.g. background information, analyses, etc.) must be prepared.

The resource plan serves the professional, objective and smooth implementation of the audit. This resource plan defines the required human and physical resources as well as the schedule of the audit, and also provides all other information needed for the audit.

Feedback

After the completion of audits, it must be ensured that all the experiences that may improve planning quality are processed and fed back into planning processes.

Role of risk analysis in SAI planning

Supervisory, (sectoral) management and audit duties are part of the core activities of numerous institutions, and performing these is likewise supported by risk analysis, which points attention to the riskiest areas, topics, processes and organisations. Typical examples include the system of macro-economic analyses carried out during budget planning, and the planning and monitoring of sectoral governance and supervisory activities (Domokos et al., 2015).

Audit planning creates a unique situation in terms of both the objective of risk analysis and the persons implementing the analysis. Within planning, the analysis of audit subjects' risks (which analysis supports the selection process) can be distinguished logically from the evaluation of risks threatening the conduct of the audit. In both cases, the risks are analysed by the audit organisation, but the risks themselves can arise in the audited organisations in the former, and in the auditing organisation in the latter case. In the case of selection, the analysis and risk-bearing roles are separated, therefore, risk management also takes on a unique interpretation in respect of audit activity. On the one hand, the risks of the various areas, processes, activities and organisations are analysed in the interest of the assessment of selection, sampling and inherent risk. On the other hand, the risks of the planning and selection processes and the risks of conducting the audit that may arise at the audit organisation must also be identified (e.g. auditor numbers and time limits may not be sufficient, audit evidence may be incomplete, the auditor fails to uncover a material error).

PSZ 2017. angol.szam_beliv_v16.indd 68 2017. 04. 06. 7:28:57

When risk analysis is performed during planning in the interest of selecting audit topics and organisations, then this risk analysis entails the collection of necessary, relevant and reliable data and information, as well as the entire process of identifying, analysing and assessing potential risks (indicators, effects, probability). In such cases, risk analysis is not performed in order to plan the risk management measures needed within one's 'own' organisation, but is instead directed at mapping out the areas and processes that bear the greatest risk, and at identifying and assessing risks present in auditable persons (organisations or private individuals). Where analysis involves a population (e.g. central subsystem, entrepreneurial partnerships) with a great number of elements, the main purpose of risk analysis is to sort the elements according to the specified risk criteria, i.e. to establish a kind of risk "ranking" in the interest of selecting the riskiest elements.

Pursuant to INTOSAI standards, the foundation of the planning work processes of supreme audit institutions must be laid down by risk analyses. As an example of the practice applied by supreme audit institutions, Domokos et al. (2015) present the risk analysis used by the European Court of Auditors. According to this, state audit offices conduct risk analysis during

– the selection of audit priorities and areas,
– the analysis of the controls and measures of the audited entities, and
– the definition of the issues and scope of the audit.

In addition, in order to conduct the audits, the risk related to the audit activities must also be managed.

When selecting audit priorities and areas, the goal of risk analysis depends on the audit directions set out in the aforementioned SAI strategy. If the state audit office, for instance, wishes to support the enforcement and implementation of legal regulations, its risk analysis supports the selection of areas, the irregular operation of which represents high risk in respect of e.g. the feasibility of the budget, the accomplishment of fiscal objectives, the successful implementation of various governmental programmes, the effective operation of organisations or the provision of public services. If the state audit office wishes to primarily support the renewal of public management through its audits, risk analysis then lays the foundation for the selection of areas where a shortfall is observed in respect of effectiveness-efficiency-economy, and which thereby hinder the achievement of the performance targets of the government.

Where analysis may involve a population (e.g. budget lines, multiple business associations, projects) with a great number of elements, the key goal of risk analysis is to sort the elements according to the specified risk criteria, i.e. to establish a kind of risk "ranking" in the interest of selecting the riskiest elements.[6]

When assessing regularity and financial statements, SAI auditing – similarly to all audits – cannot provide complete assurance of uncovering all deviations. Instead, the objective should be the so-called reasonable assurance, which in practice typically represents an audit risk of 5 per cent. Audit risk is the opposite of audit assurance: the risk of drawing an erroneous conclusion that is still tolerated by the auditor. In practice, audit risk is unavoidable. Audit risk can be calculated as follows.

PSZ 2017. angol.szam_beliv_v16.indd 69 2017. 04. 06. 7:28:57

audit risk = *inherent risk* (arising from the nature of the audited organisation) * *control risk* (depending on the controls of the audited organisation) * *detection risk* (the risk that the auditor fails to detect certain deviations).

This is why the state audit office, through the risk analysis of the controls and measures of the audited organisation, seeks to identify the organisational processes where significant (residual) risk (existing in spite of the controls that are in place) threatens the accomplishment of organisational goals. The audit is able to generate the greatest added value by assessing these processes and by pointing out the deficiencies of these processes.

The definition of the issues and scope of the audit depends on the nature and magnitude of residual risks. In this particular phase, risk analysis supports the establishment of audit procedures, including sampling and the planning of control tests.

Risk analyses related to performance audits are different from the methods applied at financial regularity audits, as in this case the risks threatening the realisation of the 3Es must be assessed (ECA, 2013).

New directions; citizen participation in SAI audits

From time to time, new trends appear within the planning processes of supreme audit institutions. In the recent period, international literature has become increasingly focused on the analysis of the benefits and disadvantages of citizen participation (e.g. the 2014 study by Baimyrzaeva and Kose). Citizen participation is when, during the selection of audit topics, SAIs also discuss audit topics suggested by citizens or citizen groups, which are then taken into account when compiling audit plans. This aspiration is in line with the principles of good governance as, by involving citizens in decision-making processes, it reinforces the transparency of governance as well as the confidence placed in governance. In addition, SAIs also understand what citizens are focused on, e.g. what processes they consider risky or where they observe wastefulness.

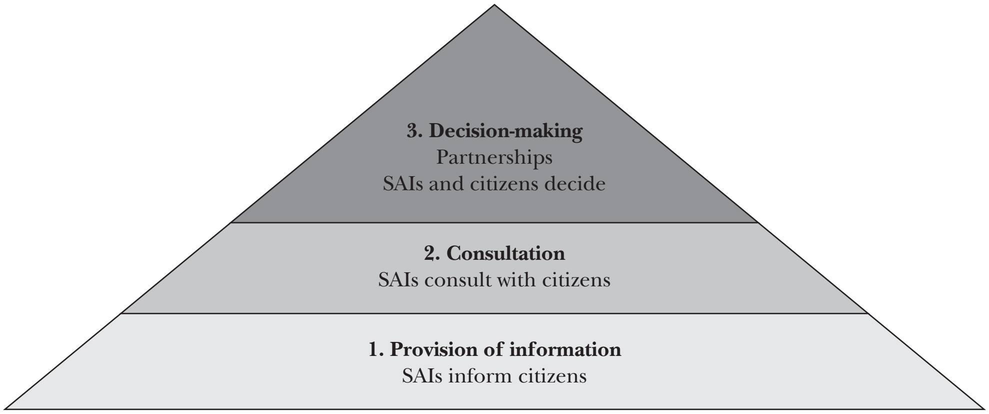
The UN/INTOSAI symposium of 2011 also focused on citizen participation in the activities of supreme audit institutions. The results of the questionnaire survey conducted among state audit offices served as the basis for the discourse (United Nations, 2013).

According to the level of citizen engagement, state audit offices can be classified into one of three groups (see Figure 2). The largest group is Group 1, where one-way communication is typical: SAIs respond to requests, hold presentations and provide information to the public, as well as distribute audit reports on their websites and through the media or conferences. They only involve experts in their activities (such as planning). In the view of SAIs in Group 1, citizens engagement compromises the independence of the organisation.

SAIs in Group 2 support two-way communication. They monitor information communicated by the media as well as topics debated in parliament. They regularly conduct public opinion surveys. They may also consider suggestions from members

PSZ 2017. angol.szam_beliv_v16.indd 70 2017. 04. 06. 7:28:57

Figure 2: Classification of state audit offices (according to the relation between SAIs and citizens)



Source: United Nations, 2013

of parliament, different parties, factions, trade unions, employers' organisations and other non-profit organisations. A few also pay attention to opinions posted on social networks, or may consult with professional organisations or bodies. Based on these criteria, the SAO falls into Groups 1 and 2.

SAIs in Group 3 consider citizens as partners in the various phases of their activity, and during this activity they actively use the various media channels (surprisingly, most of these are SAIs of developing countries). As far as planning is concerned, they can suggest topics, organisations or areas to be audited. According to South Korean experiences (Kim, 2014), based on their interests and priorities, citizens primarily suggest topics related to their subsistence (permit and licencing, construction, transportation and environment) and these make up almost half of all audit requests. Despite the high cost of the implementation of participation, the positive effects of requests made by citizens that affect the operation of the public sector balance out related costs (64 per cent of participation audit requests have resulted in material consequences). Another important benefit is that participation significantly contributes to enhancing the transparency and impartiality of public institutions.

At the same time, risks arising parallel to the more extensive use of participatory auditing must also be mentioned, risks such as the appearance of personal interests in recommendations (individual citizen interests or the political and economic interests of certain groups). These risks can and must be managed, for example by accepting recommendations that focus on public interests, filtering recommendations based on committee assessments or setting a minimum number of applicants in respect of a given issue.

In addition, the measurement of the effectiveness and utilisation of participation is also essential in the interest of the increased utilisation of the benefits of public participation.

PSZ 2017. angol.szam_beliv_v16.indd 71 2017. 04. 06. 7:28:57

Audit planning processes at the State Audit Office of Hungary

The theoretical background of the audit planning

Concept of a strong, active and well-managed state

The financial crisis has clearly shown that decreased role of the state in areas that have key importance from an economic perspective (such as public services), and the enforcement of interests of specific market player carries numerous social and economic risks (G. Fodor–Stumpf, 2007). The marketisation processes appearing in certain state subsystems may lead to certain social groups swiftly lagging behind, as well as a drop in competitiveness. At the same time, the division of decision-making responsibilities in governance also generates further problems: it undermines the transparency and auditability of performance, and weakens accountability (Frivaldszky, 2010).

As a possible answer to these problems, the ideal of the strong and active state, in other words 'a well-managed state' was formulated, which strives to accomplish the goals of good governance through a reinforced state role. The well-managed state, on the one hand, establishes the framework conditions that are essential for socio-economic development, and on the other, assumes the tasks – as well as the responsibility – of good governance. Along this train of thought, and on account of the experiences of the negative consequences of indebtedness, starting from 2010 the creation of a new public management system commenced in Hungary. The neoliberal economic policy concept (liberalisation, deregulation, participation) has been replaced by an economic policy that focuses on the protection of national interests, and which increases and strengthens the role of the state. The legal regulations required for the operation of the well-managed state have been created.

The operation of the state which has a strong economic role requires stable financial foundations and macro-financial equilibrium, and at the same time it also became necessary to revise the tool-kit of the auditing of public spending and the management of public assets. The stability of public finances assumes independent, professional and regular public auditing and control systems. It was by keeping these objectives in mind that the Hungarian public finance system was renewed, a highlighted and strategic element of which was the reinforcement of the system of public finance controls (Domokos, 2014).

The framework and tools of the auditing of public finances

In addition to creating the constitutional guarantees needed for economic renewal, for the reduction of public debt and for keeping public debt at bay, basic provisions related to the auditing of public finances, to the State Audit Office and the Fiscal Council have also been included in the Fundamental Law within the topic of public finances. The Fundamental Law stipulates the so-called debt rule, according to which

PSZ 2017. angol.szam_beliv_v16.indd 72 2017. 04. 06. 7:28:57

the National Assembly may not adopt an Act on the central budget as a result of which state debt would exceed half of the gross domestic product. As long as public debt exceeds half of the gross domestic product, the National Assembly may only adopt an Act on the central budget which provides for state debt reduction in proportion to the gross domestic product.

National Assembly has adopted a new law to ensure the economic stability of the country and the sustainability of its budget, to ensure the independent opinion on the status of the execution of the act on the central budget and for the purpose of facilitating the reduction of public debt (Act CXCIV of 2011 on the Economic Stability of Hungary). The Stability Act also stipulates regulations limiting the generation and increase of public debt, and states that the Fiscal Council shall examine whether the bill on the central budget complies with the public debt rule.

The revised legal environment, therefore, limits the leeway of public overspending through the debt rule, and through having this rule monitored and enforced by the Fiscal Council. As such, the Fiscal Council is tasked with guaranteeing macro-financial equilibrium. The State Audit Office plays an important role in supporting the work of the FC, through its analyses that also make use of audit experiences.

The new legal regulations afforded a substantial constitutional role to the State Audit Office, the country's supreme financial-economic audit organisation. The new SAO Act reaffirmed the independence of the State Audit Office in several aspects; widening its scope of authority, expanding its toolset and increasing its transparency. The starting point of the work of the SAO is the Fundamental Law and the SAO Act, from which all SAO activities (audits, analyses, advisory activity) can be derived. The constitutional provision aimed at the reduction of public debt is particularly important during the planning of SAO work. As Domokos (2014) emphasises, the State Audit Office defines its audit plan in consideration of this; indeed, this is one of the focal points of numerous audits and analyses, and the SAO makes recommendations and performs advisory tasks in the interest of accomplishing this goal.

The State Audit Office, therefore, first and foremost pays special attention to areas of the public sector that significantly impact the level of debt-to-GDP ratio, in other words the changes of public debt and gross national product. The central budget is a priority area, and the SAO provides an opinion on the substantiation of the planning of the budget as well as the feasibility of revenue appropriations; and it also audits the execution of the budget, which in turn allows for the comprehensive and systemic review of a significant part of public finances. The auditing of the management of public debt is also a task allotted to the SAO. As the indebtedness of local governments and business associations, majority-owned by local governments or the state, greatly contributes to the increase in public debt, the State Audit Office pays increased attention to auditing these areas as well.

The SAO conducts audits at multiple levels: at governmental, middle management and organisational levels alike. In order to accomplish the targets aimed at reducing debt, the compliant operation of organisations using public funds is essential. The State Audit Office is entitled to conduct regularity audits in all areas where public

PSZ 2017. angol.szam_beliv_v16.indd 73 2017. 04. 06. 7:28:57

funds are utilised, and where the law only sets out rules of procedure. The legal regulations, therefore, guarantee the audit powers of the SAO, and also create the necessary guarantees (for example, the obligation of the audited entities to cooperate and take measures).

During the planning of audits, an important aspect is that audits, by focusing on appropriate issues at the appropriate time, support the promotion of the transparency and sound management of public finances. The reports can be utilised at multiple levels, which is why the SAO takes the various levels of utilisation into account already at the audit preparatory phase. It is equally important that planned reports are still current and topical at the time of publication, otherwise these reports cannot be utilised appropriately. As such, legislative work can only be supported by a well-timed and well-focused audit report, and this is why the legislative schedule must also be taken into consideration during planning.

During the audit planning process, the State Audit Office applies several selection methods in line with the various planning and audit phases. Consequently, it uses and analyses different types of information during the definition of audit priorities or specific audit topics, when selecting audit sites or during the preparation of the audit programme. When gathering information, it is an important aspect that the utilisation of such information should adequately outline the risks that threaten the responsible and high-quality financial management of public funds and national wealth.

Below, our study presents the selection methods used in various planning and audit phases, along with the range of information used in these phases, based on the legal regulations concerning the SAO, the contents of internal regulations and the annual reports of the SAO.

Determination of audit priorities

The audit priorities that serve as the basis for semi-annual audit planning processes are defined by the so-called strategic control team operating within the State Audit Office.[7] When defining priorities, the strategic control team takes into account legal provisions, the contents of the SAO strategy, the National Assembly's legislative schedule, strategic planning documents, the decisions of the State Reform Committee, the activities of the EU Commission and the European Court of Auditors as well as information culled from the SAO's risk analysis system. It also takes into consideration whether any significant or major changes have occurred in the legal framework or infrastructure of the given area.

Article 43 of the Fundamental Law and Act LXVI of 2011 on the State Audit Office of Hungary (Act on the SAO) establishes the scope of authority and tasks of the SAO as well as the mandatory audits. Within its scope of activities set out by law, the SAO shall conduct audits pursuant to decisions taken by the National Assembly.

The SAO strategy states that state audit office audits must generate added value, and must lead to perceivable savings in the utilisation of public funds. The fight against fraud and corruption and the establishment of an integrity-based admin-

PSZ 2017. angol.szam_beliv_v16.indd 74 2017. 04. 06. 7:28:57

istrative culture are also indicated as priority goals. It is a strategic objective of the SAO that its resources not tied up by audits conducted pursuant to statutory provisions and with the frequency set out by law, be focused on conducting systemic, holistic approach audits in the interest of the transparency of the complex processes of public finances. The SAO places great emphasis on audits relying on and related to one another, as by shedding light on certain key areas of public finances from multiple perspectives, it is able to contribute good governance as part of its advisory activity.

An important aspect during the definition of audit priorities is the significance of the given area or the activity of the given organisation regarding the changes of the public debt ratio, public deficit, tax revenues or the management of national wealth. The auditing of the absorption of EU funds that have particular significance in respect of social and regional convergence; and the auditing of large distribution systems and supervisory authorities are of particular importance. Also important is the auditing of areas that realise given social objectives that are significant from a social perspective, such as for example higher education, research and development, national data protection systems, public transportation and minority self-governments.

The frequency of the audits performed by the State Audit Office is determined by law or, in the absence of relevant statutory provisions, by the President of the State Audit Office.

Medium-term audit concept

The medium-term audit concept establishes the directions, objectives and focal areas of SAO with a time horizon of 3-4 years. With the creation of the concept, no unaudited areas ('grey areas') remain, and by defining medium-term audit directions and through holistic audits and analyses, the SAO is able to exponentially assist the utilisation of its work. The concept is an integral part of the medium-term institutional strategy of the SAO, into which semi-annual audit plans are closely integrated.

The SAO's audit activity is essentially determined by the statutory requirements prescribing the execution of certain tasks with a pre-defined frequency, which tie up substantial resources. Every year, the SAO audits the execution of the annual budget of Hungary as well as the activities related to the exercise of proprietary rights over state property; along with the review of the local government decree on revenues due to and shared by the Municipality of Budapest and the Budapest district local governments annually, and provides an opinion on the bill on Hungary's annual budget. Within the framework of final accounts, the effectiveness of tax collection is also audited, which is of key importance in respect of the generation of public deficit and public debt. Every second years, the SAO audits the financial management of parties and party foundations that receive budgetary subsidies. The audit tasks related to the financial management and task performance of local governments are regularly integrated by the SAO into its audit plans.

PSZ 2017. angol.szam_beliv_v16.indd 75 2017. 04. 06. 7:28:57

The improvement of the public debt ratio[8] as a constitutional objective – with a focus on macro-economic risks – is a central element of the SAO's medium-term audit concept. With that in mind, the SAO places special emphasis on auditing the organisations whose activities exert the greatest impact on changes in the public debt ratio. Another option of improving the public debt ratio is to increase GDP ("to grow out of public debt"). The state redistributes close to 50 per cent of GDP among players of the economy, therefore, how effectively and efficiently incomes are withdrawn in the form of taxes and other incomes of public authority and then redistributed as grants, investments and public services is a primary audit aspect. In this respect, the SAO pays particular attention to the auditing of public funds used in the areas of education and research; to the auditing of state investments and energy supply, and to the auditing of organisations supervising compliance with market regulation mechanisms and related legal regulations. As the "auditor of auditors", the results of the work of the SAO may be exponentially important, as its findings can be utilised to make the activities of auditors more regular and effective.

Selection of audit topics

The SAO's risk analysis division prepares specific audit topic suggestions in line with audit priorities, in accordance with internal regulations, and by taking information from the SAO monitoring system into account. As part of monitoring, it performs the following activities.

– It monitors publicly available data and information, and organises these into a database.

– It monitors and records indications and audit experiences received from supervisors, supervisory and other managers as well as from organisational units.

– It processes and records announcements of public interests and prepares monthly reports.

– It processes information concerning the sites of completed audits and audits still in progress, and keeps such information up-to-date.

– It processes daily press review reports from a risk aspect (concerning the SAO, audited entities or audit topics), records such reports and prepares monthly reports.

– It monitors the recommendations made by Members of Parliament as well as the discussions and text analyses of committees.

– It processes economic reports (e.g. Századvég monthly monitor, MFB Periscope) and analyses.

Topic suggestions – which contain the risk summary, the type of audit and the organisations affected by the audit – are approved by the President.

Definition of the focus and key issues of the audit

Preliminary studies are prepared for approved topic suggestions. A preliminary study is an audit document that lays the foundation for the preparation of audit pro-

PSZ 2017. angol.szam_beliv_v16.indd 76 2017. 04. 06. 7:28:57

grammes, which presents all relevant information concerning the topic, detects the risks, determines the objective, hypothesis and type of a possible audit, its period, the organisations involved, its expected utilisation and the expected costs.

During the preparation of preliminary studies, the results of preliminary risk analysis, publicly available information and statutory provisions must all be taken into account, and in individual cases, information provided by the audited entity upon the request of the SAO. The preliminary study, finalised by taking the reviewer's opinion into consideration, is approved by the President.

Semi-annual audit plan

The State Audit Office carries out its audit activities on the basis of its audit plan approved by the President, which plan is published and forwarded to the National Assembly in semi-annual planning cycles. When compiling the audit plan, the SAO takes into account the audit tasks commenced in the preceding period that are still in progress, as well as those to be implemented in the given period pursuant to statutory obligations.

Pursuant to the provisions of the Act on the SAO, the semi-annual plan may include mandatory and timely audits, such as the auditing of the execution of the central budget, the taxation and other revenue collection activities of the state tax authority and local governments, the utilisation of campaign funds, the legality of the financial management of political parties, the activities related to the exercise of proprietary rights over state assets and the financial management of the National Bank of Hungary. Further topics defined by the State Audit Office are carried out depending on the available capacities of the SAO.

Preparation of the audit programme

The programme of the given audit is prepared after the preliminary study has been approved. In line with the focus questions set out in the preliminary study, the auditors drafting the audit programme define the detailed audit questions and set out the range and volume of the data to be audited. If sampling is required, the type and method of sampling and the size of the sample is determined using statistical methods. The IT-based substantiation of audit programmes, along with data planning and data preparation, is also realised in this phase. The targetedness of the audit programme plan is examined by the organisational unit responsible for risk analysis.

In respect of the same topic and organisational scope, the SAO conducts audits based on updated audit programmes and by enforcing rolling planning principles. These programmes may also be supplemented, for example, by modular programme elements related to the given topics, but which manage special focal areas.

The audit programme is approved by the President.

PSZ 2017. angol.szam_beliv_v16.indd 77 2017. 04. 06. 7:28:57

Site selection

Thematic audits are audits conducted on the basis of standard audit programmes with the possibility of the comparative evaluation of the given area, for example, of the most important areas of the operation of local governments and of companies majority-owned by local governments and the state; while as a method of organising audits, it greatly improves the efficiency of organisation. During thematic audits, therefore, the SAO prepares an independent report on multiple audit sites using the same audit programme. Audit sites may be selected on a risk basis, by sampling (full, representative, layered) or using other statistical methods, depending on the given audit objective. The selection of sites is facilitated by an analysis prepared by the unit responsible for risk analysis, which is based on information from the risk analysis and assessment system. Risk analysis is primarily conducted by taking the following factors into consideration.

– Information culled from the master database of budgetary institutions and the company database of business associations.

– Financial and financial management information available on organisations, e.g. annual budgets, annual/semi-annual institutional budgetary statements and the analyses prepared on the basis thereof.

– Balance reports and annual flash reports.

– Audit data of organisations, and the findings, recommendations and experiences of past SAO audits.

– Information received from the risk-warning system.

– Announcements of public interest.

– Results and experiences of SAO analyses

– Results of the SAO Integrity Survey, corruption vulnerability data, information related to integrity protection organisational tools.

This is followed by the preparation of a risk summary, which contains the essential information and risks pertaining to the selected sites (e.g. concerning the institutions selected for institutional thematic auditing). The risk summary is approved by the President.

The cost-benefit analysis of the audit, capacity planning

When planning audits, in addition to anticipated benefits, the SAO also takes audit-related costs into account. There are numerous procedures aimed at cost reduction and more effective resource utilisation within the SAO, including for example, the system of audits relying on and related to one another,[9] or the introduction of follow-up audits based only on electronic data supply.

The human resource planning of audits ensures that resources of appropriate quality and quantity are available, and that arising risks are managed (ranking of audit assignments, risk warnings, potential plan amendments).

PSZ 2017. angol.szam_beliv_v16.indd 78 2017. 04. 06. 7:28:57

Monitoring of utilisation

After the completion of the audit, the SAO tracks the obligation of the audited entity to take measures (to cooperate), the experiences of which are also channelled back into the organisation's risk monitoring system.

The experiences of the utilisation of the report are collected, recorded and analysed continuously by the SAO, which also uses the results of the analysis during its planning processes.

Methodological revision in planning

In areas highlighted in the medium-term audit concept, even regularity audits are able to point out fundamental deficiencies, the elimination of which could lead to substantial savings in public spending. Even though it is not the SAO's task to criticise the professional content of state policies and the way public functions are carried out, it may however audit and assess effectiveness, in other words

– whether – pursuant to legal provisions – impact studies had been prepared prior to a given state intervention (such as a tax relief or a developmental programme);

– whether regulation is comprehensive;

– whether the objectives and performance criteria had been clearly defined and whether data collection, measurement and assessment is performed on the basis thereof;

– whether the system of monitoring, auditing and assessment of implementation had been put in place;

– whether the structure and operation of the internal control system is suitable to detect and correct the risks, errors and deficiencies observed within systems and institutional operation, and to assess the measures taken in the interest thereof.

As one of the cornerstones of its independence, the SAO establishes its own professional audit guidelines and methods by following the international standards of INTOSAI. The revision of the international audit standards adopted by INTOSAI at the end of 2013 provides an opportunity for the SAO to update its audit methodology for the three main audit types, namely compliance, financial (before 2015: regularity and financial regularity) and performance audits.

The State Audit Office uses a holistic approach to audit the performance of the institutions of the central subsystem, during which it evaluates the establishment of the requirements of effectiveness, efficiency and economy, as well as compliance with these criteria. The SAO's performance audits are aimed at improving the effectiveness and efficiency of the performance of public tasks and accomplishing quantifiable savings. In addition to the regular spending of public funds, another expectation is for such funds to be used effectively, in which management performance plays an important role. Consequently, it is highly significant to assess the institutional application and effectiveness of management performance evaluation during the auditing of central

PSZ 2017. angol.szam_beliv_v16.indd 79 2017. 04. 06. 7:28:57

subsystem organisations. The SAO wishes to take on a leading role in preparing the methodological principles required for management performance evaluation.

This renewal allows for the evaluation-type performance audits, which, in addition to assessing an institution's operation and the effectiveness and efficiency of its investment activity and projects, also evaluate its social utility, utilisation and expediency. It represents a risk during the planning of these audits if the indicators and data required for evaluation are not available, or if the accountable managers of institutions and projects are not obligated to enforce effectiveness and effectiveness aspects, and for this reason, the role of preliminary data collection and risk analysis takes on increased significance.

The SAO also strives to utilise the experiences of the final accounts audit. During final accounts, uncovering the risks that impact the financial regularity of audited entities can lay the foundation for the planning of the audits of these institutions. Audits based on final accounts can help improve the quality and efficiency of SAO audits, and the same time, the SAO strives to create optimal conditions for cooperation with the audited entity and to reduce its audit-related workload.

Conclusions

Audits by supreme audit institutions create added value, the size of which greatly depends on the assessment of which areas institutions spend their scarce resources on and what methods they opt for when carrying out their audits.

Planning processes are equally characterised by constraints and a high degree of freedom. The constraints are primarily set out in legal regulations by stipulating mandatory audits and by defining areas that can only be audited with limited powers. The principles of planning processes are established by internationally accepted standards (INTOSAI). The determination of audit directions and methods is also strongly influenced by the management 'style' of the state. In countries where public management focuses primarily on the tools of execution, audits tend to inspect compliance with regulations, rather than whether the regulations serve or perceivably serve the objective set.

In addition, supreme audit institutions have considerable independence in respect of both audit topic selection and the planning processes of the various audits. The guiding principle, however, is that planned audits should generate the greatest added value possible. Consequently, state audit offices must clearly articulate what they consider to be significant added value and with what tools and methods they are able to achieve this. This is laid down in the highest level planning document, namely the institutional strategy. The transparency and applicability of the strategy supports annual planning and also ensures the harmony of annual plans.

The audit planning of the State Audit Office is a multi-phase process; the substantiation, transparency and comprehensiveness of which is insured by process-integrated controls in each phase. Planning primarily relies on information from the monitoring system that records risks, which gathers state audit office experiences and knowledge

PSZ 2017. angol.szam_beliv_v16.indd 80 2017. 04. 06. 7:28:57

as well as outside information in a structured manner. The SAO's monitoring system contains innovative elements, such as for instance, the text analysis of debates at the National Assembly, risk warnings from the media monitoring system as well as data from the Integrity Survey developed to measure corruption vulnerability.

In the future the planning processes of SAI audits could include methods that could fundamentally reshape audits. These may include citizen participation, the utilisation of the results of network research as well as the results of comparative analyses based on electronic data requests and supported by assessment software. It is important, however, that the new risks generated by these new initiatives are recognised and managed by the State Audit Office, and for the SAO to regularly evaluate the effectiveness and efficiency of new methods.

Notes

[1] ISSAIs are the standards issued by the International Organisation of Supreme Audit Institutions (INTOSAI).

[2] Strategic goals may include increasing the utility of audits, increasing the ratio of public fund usage covered by audits or the improvement of auditor capacity.

[3] An example of hierarchic strategic planning is the practice used by the GAO (the US government accountability office, the supreme audit institution in the United States), which employs economic, social, etc. forecasts, the analysis of future challenges and macro-level risk analyses to set out the SAI's 4 key strategic goals, broken down into a further 20 strategic objectives, the 96 performance targets ensuring these and the more than 300 related tasks (www.gao.gov/products/GAO-14-1SP).

[4] The performance of financial audits is often set out in legal regulations and, therefore, planning leeway is narrower than in the case of performance auditing for example.

[5] The State Audit Office of Hungary prepares semi-annual plans.

[6] In terms of international examples, we must mention the GAO's risk assessment activity and its most important public product, the High Risk Series (which is reviewed every two years), which lists the federal programmes and areas most vulnerable to risks of fraud, abuse, waste and mismanagement, and also lists areas that are most in need of transformation or renewal (www.gao.gov/highrisk/overview#t=0).

[7] The preambles of the semi-annual plans set out the priorities based on which the given period's audit topics and areas are selected (see for instance, the SAO's audit plan for the second half of 2015) www.asz.hu/storage/files/files/Angol_portal/Audit_plans/2015_second_half_audit_plan_en_final.pdf?download=true.

[8] The quotient of nominal public debt and generated gross domestic product (GDP).

[9] In the framework of this, the SAO harmonises the data requests and on-the-spot checks of multiple audits.

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PSZ 2017. angol.szam_beliv_v16.indd 82 2017. 04. 06. 7:28:57

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László Domokos – Magdolna Holman

The Methodological Renewal of the State Audit Office of Hungary in Light of the Protection of Public Funds

Summary
The change in international standards unfolding from 2007, the independence and transparency criteria applying to supreme audit institutions and the enhanced enforcement of objectivity and professionalism requirements called for the methodological renewal of the State Audit Office. Auditing guidelines and standards define the fundamental principles and norms adhered to by the SAO, which provide the basis for the quality of its audit work and reports. These principles and norms provide the framework that enables the auditors of supreme audit institutions (SAIs) to preserve their independence and the probity of their work. The effects of the renewal apply to and are felt in some form in all audit phases and organisational levels. By developing its new, quality-driven operations and by completing its methodological renewal, the State Audit Office has become a supreme audit institution which, as a professionally indispensable constitutional organisation enjoying the trust of Hungarian citizens, can support the operation of a well-managed state.

Journal of Economic Literature (JEL) code: H6, H83, Z1
Keywords: methodological renewal, SAO, public funds, auditing methodology, ISSAI

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PSZ 2017. angol.szam_beliv_v16.indd 83 2017. 04. 06. 7:28:57

The audits of the State Audit Office of Hungary

"The only thing that is constant is change" (Heraclitus)

Before addressing the methodological renewal, we must look at the reasons and targets of our audits, and what the methodology actually supports. The State Audit Office of Hungary is the supreme financial and economic audit institution of the National Assembly. Acting within its functions laid down in the law, it audits the implementation of the central budget, the management of public finances, the use of funds from public finances and the management of national assets. It carries out its audits according to the criteria of legality, expediency and efficiency. The fundamental rules governing the utilisation of public funds are enshrined in Hungary's Fundamental Law. The Fundamental Law states that every organisation managing public funds is required to publicly account for its management of public funds, and that public funds and national assets shall be managed according to the principles of transparency and the purity of public life.

In accordance with its institutional strategy, the mission of the State Audit Office of Hungary (SAO) is to promote the transparency and regularity of public finances with its value creating audits performed on a solid professional basis, thus contributing to "good governance". The mission of SAO is to contribute through its audits to the legally compliant, successful, effective and cost-effective task performance of public entities and their employees, and other entities using public funds and thus to enforce expectations of the public sector's operation. With its findings, recommendations and analyses based on its audit experience, the State Audit Office of Hungary assists the National Assembly, its committees and the work of the audited entities, thus contributing to well-governed state operations.

Our aim is to create added value with our audits:

– to drive change in the domain of public finances,

– to support accountability and transparency to spur public representatives to use public funds responsibly and continuously improve their performance,

– to contribute to the compliant and effective discharge of tasks and activities by audited entities, and

– to share the know-how, knowledge and evaluations acquired during audits (SAO, 2015a:7).

A fundamental expectation regarding SAO audits is that it should conduct audits in matters and areas that most need to be audited. It focuses its audits on areas where they create the most value added.

In 2011, with the adoption of the Act on the State Audit Office of Hungary[1], the National Assembly reinforced the guarantees of the independence of Hungary's supreme audit institution, the State Audit Office of Hungary. Simultaneously, the State Audit Office of Hungary commenced its organisational renewal from the aspects of accountability, transparency, quality control, ethical expectations and SAI utility. The contents generated by audits allow the enforcement of these requirements. All of this

PSZ 2017. angol.szam_beliv_v16.indd 84 2017. 04. 06. 7:28:57

against a continuously changing backdrop, where new areas and new requirements constantly emerge. "The only thing that is constant is change", said Heraclitus. Both the audits and the methodologies providing the framework for audits must adapt to these changes. Consequently, the methodologies cannot themselves be set in stone. New areas and new requirements constantly emerge, and the audits need to be carried out in a new environment. At the same time, audits by SAIs within the public sector are always conducted in a setting where the government and other public sector entities use taxpayer and other public funds. They are responsible for the utilisation of these funds. As a result, public entities are accountable for their performance and the regularity of their spending.

The topic of the need for methodological renewal should first be approached from the perspective of the role of methodology itself. It should be clear that the methodology applied is primarily the guarantee for ensuring objectivity, professionalism and uniformity within the life of the audit organisation. This criterion is supplemented, in the case of the State Audit Office of Hungary, by a series of independence guarantees, one element of which is the independent creation of our methodologies. Under its statutory mandate, the State Audit Office of Hungary works out the professional rules and methods of its audits for itself, and makes these rules public. This is a key statutory provision, guaranteeing independence in terms of the documentary framework forming the basis of the execution of all the tasks and enabling the prevalence of international fundamental transparency principles to the greatest extent.

The methodology provides a guarantee for all users, acting as a safeguard that a specific type of audit is carried out by the State Audit Office of Hungary among all audited entities objectively, professionally and according to the same methodological criteria. A uniform methodological framework is a guarantee for impartiality. This is why INTOSAI[2], the international body of supreme audit institutions makes a priority of the matter. This brings us to one of the fundamental reasons warranting methodological renewal. When renewing the fundamental professional principles of auditing, the State Audit Office of Hungary used the fundamental auditing principles developed by INTOSAI as guidance, which set public sector auditing on common professional grounds worldwide. The State Audit Office of Hungary has introduced and continues to introduce the renewed fundamental professional principles of auditing in accordance with the changes unfolding on the international scene.

The set of INTOSAI international rules

The Strategy of the State Audit Office of Hungary states that its set of professional rules of auditing would be renewed taking into account the ISSAI[3] standards and guidelines adopted by INTOSAI, also taking into account the Hungarian legal framework, while reviewing and further developing its auditing practice and methods, effective professional rules of auditing and preparing the lacking professional auditing methodological documents.

PSZ 2017. angol.szam_beliv_v16.indd 85 2017. 04. 06. 7:28:58

The auditing standards, which define the fundamental rules of audits (INTOSAI Auditing Standards), were adopted at the 1992 annual INTOSAI Congress. Since then, the global organisation has updated its set of professional regulatory documents several times. The 2007 annual Congress of INTOSAI adopted the current framework of professional rules of auditing (Blegvad, 2007:11), which defined the ISSAIs' four-level hierarchy and decided on the creation of INTOSAI GOVs (Guidance for Good Governance). INTOSAI classifies its professional guidelines, referred to as ISSAIs, into four levels:

1. Founding Principles, the Lima Declaration (ISSAI 1, 1977)
2. Pre-requisites for the Functioning of SAI[4]
3. Fundamental Auditing Principles
4. Auditing guidelines

The four-digit group of INTOSAI professional rules includes auditing guidelines linked to the application of the general Fundamental Auditing Principles and those linked to special areas (e.g.: IT audit – ISSAI 5300-5399, Corruption Prevention – ISSAI 5700-5799).

Figure 1: Prerequisites for the Functioning of Supreme Audit Institutions

Serial number	Address
ISSAI 10	Mexico Declaration on SAI Independence (2007)
ISSAI 11	INTOSAI Guidelines and Good Practices Related to SAI Independence (2007)
ISSAI 12	Value and Benefits of SAIs – making a difference to the life of citizens (2013)
ISSAI 20	Principles of Transparency and Accountability (2010)
ISSAI 21	Principles of Transparency – Good Practices (2010)
ISSAI 30	Code of Ethics (1998)
ISSAI 40	Quality Control for SAIs Implementation guidance and tools (2010)

Source: State Audit Office of Hungary.

Figure 2: Fundamental Auditing Principles

Address	From 1992, from 2001	From 2013*
ISSAI 100	Basic Principles	Fundamental Principles of Public-Sector Auditing
ISSAI 200	General Standards	Fundamental Principles of Financial Auditing
ISSAI 300	Field Standards	Fundamental Principles of Performance Auditing
ISSAI 400	Reporting Standards	Fundamental Principles of Compliance Auditing

**Reviewed at the ISSAI Harmonisation Project launched by the XX INCOSAI in 2010, and new level 3 ISSAIS were adopted in October 2013 in Beijing*

Source: State Audit Office of Hungary

INTOSAI GOVs are guidelines pertaining to internal control systems, accounting and governance responsibility in an effort to promote effective management, and generally aim to foster the implementation of good governance.

New auditing approaches and the renewed professional auditing methodology

The most important qualitative requirements of SAI audits are substantiation and reliability, which can and must be attained using modern audit methods and the highest auditing assurance attainable under the circumstances. The main objective of professional regulation is to create a uniform and consistent, quality-centric set of requirements to create a reliable and objective basis for SAI audits, the work of auditors, the assessment of work performances and the quality-controlled execution of audits. The methodology provides a framework for answering numerous questions, including one of the most complex ones: *"How?"*.

The methodological renewal of the State Audit Office of Hungary is the result of a multiple step process. The first step was to identify and define the framework within which legislation, guidelines, international standards and the related strategies had to be processed. The four-level system of the professional rules of SAI auditing was created factoring in all of these elements. In terms of the contents of the hierarchical levels, we progress from fundamental principles comprehensively defining operation to the individual types of audits. This has two consequences. For one, the system is a top to bottom system, and secondly, it is a comprehensive hierarchical regulatory structure that defines the entire organisation. Emphasizing this fact is important, as we are dealing with the operation of the organisation as a whole, rather than the methodology of individual subprocesses. It is in light of this that the main steps and directions of the methodological renewal can be best understood.

The renewal of the methodological background of SAO audits began with the adoption of the new Act on the State Audit Office of Hungary, effective as of 2011, which reaffirmed the independence of the State Audit Office of Hungary in several aspects, and widened its powers, expanded its instruments, increased its transparency, and put an end to the era of audits without consequences. The constitutional status and independence of the supreme audit institution ensure that the institution delivers objective, unbiased findings and selects its audits and methods at its discretion.

The hierarchy of the governing international professional standards was set up in 2011–2012 which, at the same time, was a period of continuous preparations for the Hungarian application of the standards. Then, in 2013–2014, our organisation prepared for developing the general, as well as audit-specific fundamental auditing principles. The State Audit Office of Hungary actively participated and continues to participate in the crafting of ISSAIs and cooperates in the sharing of experience drawn from practical application and of professional know-how. These activities are performed through the working groups set up within the framework of INTOSAI[5] and EUROSAI[6].

PSZ 2017. angol.szam_beliv_v16.indd 87 2017. 04. 06. 7:28:58

The State Audit Office of Hungary adopted the names and contents of the new professional rules of auditing, as well as the range of documents constituting the new system of these rules in April 2013, in accordance with the Fundamental Auditing Principles developed by INTOSAI and renewed in 2013. The State Audit Office of Hungary, after processing and interpreting the ISSAIs, drafted the methodological auditing documents taken into account the Hungarian legal environment and the factors influencing the circumstances of audits. When drafting methodological guidelines, it considered all of the professional guidelines from among the full methodological range of relevant ISSAIs that could be integrated into the Hungarian auditing environment and to the mandate of the State Audit Office of Hungary. Moreover, when processing the international standards, the State Audit Office of Hungary also drew on its own auditing experience in order to allow the use of the methodologies as "live" documents in the execution of tasks across all types and phases of audits.

INTOSAI formulated that SAIs should help their respective governments improve performance, enhance transparency, ensure accountability, maintain credibility, fight corruption, promote public trust, and foster the efficient and effective receipt and use of public resources for the benefit of their peoples. It is in alignment with this objective that the State Audit Office of Hungary drafted the Hungarian system of the professional rules of auditing. Moreover, the Hungarian model determines the fundamental principles and strategic goals that serve as a compass for us in supporting good governance and a well-governed state, whether it is about the definition of objectives, the selection of audited entities, the planning of individual tasks or the evaluation of the results (Domokos–Pulay–Pályi–Németh–Mészáros, 2016:19–20).

The principle of accountability can only be enforced if the relevant competences and responsibilities can be identified, and the processes related to public funds are regulated, transparent and easy to monitor, so our priority task is to create transparency in the utilisation of public funds. The requirement of high quality is an integral part of all activities of the State Audit Office of Hungary, which must be integrated into the strategy, culture and operational procedures of the organisation. On this point, the process is once again a process overarching the entire organisation, just like in the case of methodological renewal. The highest level of professional quality cannot be achieved without the simultaneous renewal of the quality management system and the audit methodology. The SAO, in line with the relevant international standards, has incorporated the requirement for quality in all of its activities and processes, and every auditor has an obligation to enforce the fundamental principles of quality-driven operation in the course of their task performance. The prerequisite of the methodological renewal spanning the entire organisation was to lay the foundations of quality-driven operation ensuring objective and professional implementation.

The first of professional auditing methodological documents to be drawn up, the *Fundamental Principles of SAO Audits* addresses both the general public (intended users of public funds, taxpayers) and auditors, thus supporting the transparency of the SAO's activity. These define the types of audits applied by the State Audit Office of Hungary, which may be, according to their function and subject matter, compliance

PSZ 2017. angol.szam_beliv_v16.indd 88 2017. 04. 06. 7:28:58

audits, performance audits or financial audits (SAO, 2015a:9–10). The renewal and the July 2015 introduction of the fundamental auditing principles marked the end of the SAO's profound methodological changeover.

By introducing *"compliance audits"*, the SAO has established a broader audit-specific background compared to regularity audits in the area of the audit of the regularity of public spending. While regularity audit includes the auditing of adherence to current rules (e.g. legislation, regulations, agreements), propriety audits are a type of compliance audits that are performed where legal provisions cannot be applied as a criterion, or where there are clear deficiencies in legislation to be able to judge certain issues. In the course of propriety audits, the audit is conducted along the general fundamental principles governing proper financial management within the public sector (SAO, 2015c:5).

Performance audits are a type of SAO audits intended to establish whether the management of public funds and public assets complies with the principles of effectiveness, efficiency and economy, and whether there is room for improvement. Their aim is to support cost-efficient, effective and successful utilisation of public funds and the financial management of and task performance using national assets. These audits identify any factors potentially hindering the attainment of the criteria of cost efficiency, effectiveness and success shaping financial management and task performance (SAO, 2015b:4–5).

Financial audits aim to assess whether the information published in the financial statements of an organisation comply with the applicable financial reporting and regulatory framework, contributing to the reinforcement of trust in such financial statements among their intended users.

To directly support the work of auditors, we have elaborated a set of rules and guidelines to be adhered to when executing audits. These guidelines are a supplement to the Fundamental Auditing Principles.

Special methodological guidelines

The State Audit Office of Hungary has general powers in auditing the responsible financial management of public funds. The audits increasingly facilitate transparency, accountability and accounting for public funds in the financial management of public property. In terms of consistent accounting, the audit of the execution of the central budget and of final accounts plays a prominent role. The State Audit Office of Hungary carried out its – statutory – audit assignments in accordance with statutory requirements. In line with the provisions of the Act on SAO, the State Audit Office of Hungary is required to audit final accounts on an annual basis.

It was defined among the strategic goals of the State Audit Office of Hungary that, for more efficient and effective final accounts audits, it should develop an audit model that is different in approach, contents and procedures from the one used before and that it should continue to support the National Assembly in its work and in making substantiated decisions. The SAO's implementation of this strategic goal resulted in the renewal of the methodology for final accounts audits, which was published on the

PSZ 2017. angol.szam_beliv_v16.indd 89 2017. 04. 06. 7:28:58

SAO's website in January 2015.[7] The changed accounting system – since the adoption of the earlier methodologies – of public finances was one of the reasons that called for a framework for the drafting of the document. (As of 1 January 2014, new financial and budget accounting rules came into force, under which budget accounting consists of cash-based budget accounting and accrual-based accounting). Moreover, the renewal of the international standards on auditing also played a part. The State Audit Office of Hungary formulated the methodology of final accounts audits with a view to being able to obtain a substantiated opinion during the audit procedures on the execution of the budget as a whole. The audit provides a comprehensive and objective view on the reliability of data included in the annual final accounts bill. The audit covers five main areas: centrally-managed appropriations, social security funds, extra-budgetary funds, chapter-managed appropriations and appropriations related to EU grants, and central budgetary institutions.

The ISSAI standards and guidelines and the State Audit Office of Hungary' professional rules of auditing are public and accessible for all on the State Audit Office of Hungary's website, through Figure 3.

Figure 3: The system of professional regulations of SAO auditing

<table>
<tr><th colspan="4">System of documents that represent the theoretical basis of audit-specific regulations</th><th>Governing ISSAI</th></tr>
<tr><th>Level 1</th><th colspan="3">Lima Declaration</th><th>ISSAI 1</th></tr>
<tr><td rowspan="5">Level 2</td><td rowspan="5">The principles of SAO operation</td><td colspan="2">Items guaranteeing independence</td><td>ISSAI 10</td></tr>
<tr><td colspan="2">SAI's principles of transparency and accountability</td><td>ISSAI 20</td></tr>
<tr><td colspan="2">Principles of ethics</td><td>ISSAI 30</td></tr>
<tr><td colspan="2">Principles of quality-driven operation</td><td>ISSAI 40</td></tr>
<tr><td colspan="2">Principles of the utilisation of SAI work</td><td>ISSAI 12</td></tr>
<tr><td rowspan="8">Level 3</td><td rowspan="8">Fundamental principles of SAO audits (SAI auditing standards)</td><td rowspan="4">Fundamental principles of SAO audits</td><td>General auditing principles</td><td>ISSAI 100</td></tr>
<tr><td>Financial auditing principles</td><td>ISSAI 200</td></tr>
<tr><td>Fundamental principles of performance auditing</td><td>ISSAI 300</td></tr>
<tr><td>Fundamental principles of compliance auditing</td><td>ISSAI 400</td></tr>
<tr><td rowspan="4">Implementation guidelines</td><td>Implementation guidelines for financial auditing</td><td>ISSAI 1000</td></tr>
<tr><td>Implementation guidelines for performance auditing</td><td>ISSAI 3000, 3100, 3200</td></tr>
<tr><td>Implementation guidelines for compliance auditing</td><td>ISSAI 4000, 4100</td></tr>
<tr><td>Other guidelines</td><td>Other INTOSAI guidelines</td></tr>
</table>

Source: State Audit Office of Hungary

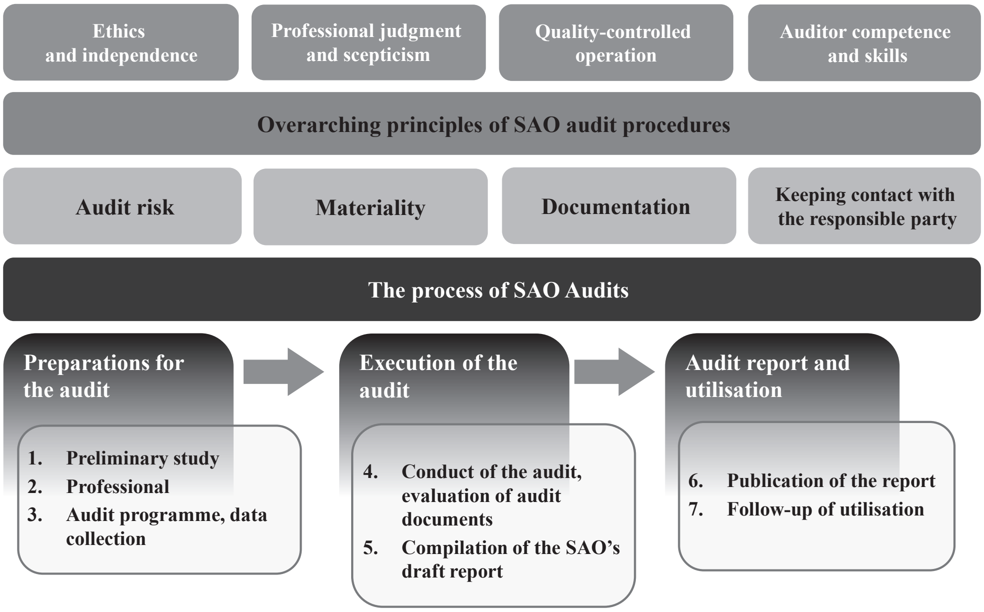
Some of the audits launched from the second half of 2015 were conducted by the State Audit Office of Hungary according to the renewed Fundamental Auditing Principles, striving to gradually build individual audit types upon each other. The regu-

PSZ 2017. angol.szam_beliv_v16.indd 90 2017. 04. 06. 7:28:58

lated, orderly, responsible and compliant operation of audited entities is the starting point for applying performance audits.

Figure 4 presents the link between the fundamental principles of SAO audits and the seven-phase audit process.

Figure 4: Fundamental Principles of SAO Audits



Source: State Audit Office of Hungary

The execution of all seven phases of the audit process, from audit planning through the implementation thereof, to the formulation of findings and recommendations and the utilisation thereof, is aimed at supporting the regular, effective, efficient, accountable and transparent utilisation of public funds and the development of the public finance system, and at ensuring that national assets are as safe as possible.

Audit criteria

State Audit Office of Hungary audits are programme-based. This means that the audits are conducted on predefined subjects on the basis of predefined criteria adapted to the type of audit. The audit criteria allowing the evaluation of the subject matter of the audit assignment are the benchmarks serving as the basis of the evaluations. This is why it is a fundamental requirement when defining criteria to factor in their importance, completeness, reliability, comparability, acceptability, availability, understandability and objectivity, as well as the type of audit. The criteria are predominantly defined on the basis of legislation, public law organisational regulatory tools, standards, fundamental principles and best practices, but the State Audit Office of Hungary also defines some of the criteria. Clearly defined criteria ensure objective evaluation performed on the basis of the audit.

Risk analysis

The shortcomings, discrepancies or misstatements in the subject matter, the probability thereof and the risk of their impact should be factored into audits and evaluated (SAO, 2015a:15). Every audit therefore begins with a risk analysis. Risk analysis relies both on internal and external data sources. (External data sources include: official, publicly accessible databases, financial reports and data, National Assembly committee minutes, National Assembly notices, information from the press, reports; internal data sources include experience drawn from earlier and pending audits, public and internal surveys, integrity surveys). The identified risks and their potential impacts must be kept in mind continuously during the conduct of the audit. For example, the risk analysis of the controls and measures of the audited entity is intended to identify the organisational processes presenting a significant risk to the achievement of the organisation's objectives in spite of the controls in place. Risk analysis contributes to outlining the questions and scope of the audit, devising the audit procedures and designing sampling and control tests.

It is of public interest that the State Audit Office of Hungary audits the areas most in need of auditing, while using an optimal level of audit resources. Thus the definition of audit topics, as well as the selection of the specific audit sites linked to the audit topics is preceded by thorough preparatory work, supported by the continuous processing of the information necessary for topic selection and risk analysis. To select audit priorities and areas, the riskiest areas, topics and processes are mapped out in the course of risk analysis, and risks are identified and evaluated. Where analysis involves a population with a great number of elements, the key goal of risk analysis is to sort the elements according to the specified risk criteria, i.e. to establish a risk "ranking" in the interest of selecting the riskiest elements (Domokos–Nyéki–Jakovác–Németh–Hatvani, 2015:11).

Statistical methods

The State Audit Office of Hungary endeavours to achieve a high degree of certainty in each of its audits, so the fundamental principle of planning audit procedures is to ensure that the audits provide reasonable assurance in the identification of irregularities, unlawful measures or compliance shortcomings. At the same time, reasonable assurance also means that the information forming the subject matter of the audit complies with the pertaining audit criteria in all material respects.

In the course of audits, we often have to interpret a large set of information (or population in statistical terms) to achieve the audit objectives or to conduct the detailed direct audit procedures defined in the audit programme from some perspec-

PSZ 2017. angol.szam_beliv_v16.indd 92 2017. 04. 06. 7:28:58

tive, to form an opinion on it. In such cases, we must always assess the proportion of applying the audit to the entire population (e.g. financial records consisting of several hundreds of thousands of items, or a set of paper-based accounting records) relative to the available resources and the value added created by the audit. In an effort to achieve a high level of assurance while effectively utilising the available resources, the State Audit Office of Hungary – within the available methodological framework – applies procedures used in statistic analyses, that is, statistical methods, and proceeds according to their rules. Statistical methods are used for the preparation of analyses and risk analyses, for determining the sample to be audited and at the final stage of work processes, during evaluation. When applying these methods, it is important to keep in mind the reliability of the population, selection of the appropriate procedures and distinction of characteristic and value-based matters.

Sampling procedures and evaluations on the basis of the samples, and the resulting findings and conclusions thus constitute a key element in the execution of SAO audits. The underlying concept of audit sampling is to restrict the audit to a prudently selected subset of the entire population rather than auditing each item of the population, and to obtain audit evidence suitable for making conclusions about the entire population by examining specific characteristics of the selected items. Just like every phase of the audit, every activity, procedure and sampling is governed by a set of requirements. Sampling is considered successful from the perspective of the audit if the findings based on the items of the sample are the closest to the ones that would be made if examining the entire population, and is considered effective if these findings are achieved with the least amount of effort (that is, the smallest sample size still acceptable). This fosters the effectiveness and success of audit work. The ISSAI standards defining the fundamental principles of the various audit types also prescribe the careful selection of data collection and sampling methods.

According to the requirements of general Fundamental Auditing Principles, auditors must substantiate their findings and conclusions with sufficient appropriate evidence (SAO, 2015a:17). The data, documents and information provided by the audited parties and serving as the basis of evidence must originate from a "reliable source" and be documented, complete, authentic, usable and transparent to both the audited and the auditing party.

IT applications

Another fundamental criterion of SAO audits alongside transparency is the reliability of data in order to establish correct findings. The management of public funds, the financial management of public assets, the discharge of statutory (public) tasks and reporting on these activities are increasingly supported by IT tools and applications. The quantity of electronic data, information and documents is growing nearly exponentially. The rapidly changing information and communication culture impacts the performance of state tasks and the organisation of public administration. The development of infocommunications channels, tools, services and competencies con-

PSZ 2017. angol.szam_beliv_v16.indd 93 2017. 04. 06. 7:28:58

tributes to the effectiveness of state operations. Simultaneously, however, electronic information systems and processes represent an increasing risk in processes related to public funds. Therefore the reliability, closed nature and regulated and compliant operation of IT systems have become key factors.

The reliability and protection of such data, information and records and the generation and handling environment of electronic information are therefore increasingly incorporated into our audits. Not every area and element of this is governed by legal provisions; therefore, there is a need for the application of propriety and effectiveness criteria. Our audit methodologies also support the auditing of this domain.

Today, IT audits are two-directional: they may either be control audits or process audits. For one, organisational controls must adequately support IT task performance. Secondly, IT applications and their controls must adequately support the compliant and reliable execution of tasks. As a result, ensuring the safety, confidentiality and integrity of IT applications is currently inevitable, alongside the existence and verification of input, processing and output controls to guarantee reliable output data.

During our audits we also strive to take advantage of the latest information technology and technical facilities. One way of doing this is designating a greater role to electronic channels in data supply and in communication. This has multiple benefits, as communication with the audited entity is controlled, traceable and searchable. The electronic data supply requested in the context of audits reinforced transparency both for the audited and the auditing party. The use of IT applications and audits also allows the quicker evaluation and processing of data, rendering the auditor's work more efficient.

What we audit

Pursuant to the Act on Public Finances[8], controls in public finances guarantee the compliant, cost-effective and sound financial management of public funds and national assets. For this very reason, public entities are accountable for their performance and not only the compliant, but also the expedient, effective, efficient and cost-effective utilisation of their funds.

The State Audit Office of Hungary's auditing mandate is broad, allowing it to audit other users of public funds besides the public sector, including any organisation that handles public funds or receives support from public funds, or utilises national assets for purposes linked to public interest and community needs. The compliant use of public funds is checked through broadly conducted, primarily thematic audits focusing on regularity. One area of regularity audits is the auditing of internal control systems. Any shortcomings in such systems necessarily represent a risk to the compliant use of public funds and compliant operation. Our audits therefore almost always focus on the presence of the control environment and its reliable operation as a priority. These matters constitute the fundamental element of essentially all of our audit programmes. Over the past years, the State Audit Office of Hungary has expanded its systematic audits to municipal and minority self-governments, as well as state and

PSZ 2017. angol.szam_beliv_v16.indd 94 2017. 04. 06. 7:28:58

local government owned business organisations, public service providers and central budgetary institutions, educational and healthcare institutions using public funds in the course of their financial management.

The budgetary institution's highest-ranking executive is responsible for enforcing efficiency, effectiveness and economy in the organisation's operations and to ensure that executives at every level of the organisation are aware of the objectives and tools for achieving them, and are capable of evaluating the results achieved. To make transparency and accountability an integral part of organisational culture, first and foremost, the commitment of the executives of entities utilising public funds/discharging public tasks is needed. The head of the budgetary institution is responsible for performing public functions in accordance with the provisions of legal regulations, the deed of foundation and the provisions of the internal policy as well as for fulfilling the obligations stipulated by law for the institution. The prerequisite for transparency and accountability's the fulfilment of the requirements defined in legislation, the clear definition, communication and traceability of and accountability for responsibility relations.

The fundamental objective of controls established and operated within public finances is to operate control systems that ensure the regularity, economy, transparency, efficiency and effectivity of the financial management of public funds and national assets. This objective cannot be achieved without reinforcing the internal control system within the public sector or without the compliant, reliable and effective operation of individual control activities and internal audits.

Our audit experience (Domokos–Németh–Jakovác, 2016:17–24) confirms that the prerequisite for the efficient management of public funds and for the underlying planning process is that indicators (substantiated by data available over time and reflecting reality) are put in place for capturing and measuring the effectiveness (approaching targets) and efficiency (resource utilisation) of public spending adequately. The main condition for conducting performance audits is:

– the availability of clearly defined performance indicators for performing evaluations;

– the definition of a target for the appropriate indicators to evaluate effectiveness; and

– the availability of data for monitoring developments and performance measures.

Performance audits should be conducted on the basis of performance indicators that are broadly accepted both on a societal and professional level including by the audited entity. To evaluate effectiveness, no other indicator can reasonably be used than the one defined by the organisation defining the objectives themselves.

Launching change

In line with its strategy, parallel to the organisational renewal and the rethinking of its quality control processes, the State Audit Office of Hungary enhanced its methodologies continuously, and in the second half of 2015 it commenced the migration to its new report format.

PSZ 2017. angol.szam_beliv_v16.indd 95 2017. 04. 06. 7:28:58

As a result of the methodological renewal and the enhancement of the quality assurance system, the SAO issued its first report in the new format in the second half of 2015. The new report format was primarily intended to render the reports more user-friendly and to improve their clarity and understandability. The overhaul of the format was based on the analysis of user requirements and international examples. The substantive elements of SAO reports are presented in a new order, equipped with informative titles and contents. Individual thematic units are clear and distinct. Thanks to the new editing format, users can reach the audit findings and conclusions faster, while the logical presentation of audit objectives, questions, answers, findings and conclusions, and their substantiation ensures easy tracking. The clearly focused, easy-to-overview and structured appearance, the use of visual elements and the improved electronic applicability are intended to ensure that the SAO's reports are easy to read, user-friendly, impressive, easier to utilise and more effective. At the same time, the gradual transition to the new format also serves the creation and reinforcement of a new type of audit approach; its new appearance is the culmination of the methodological development.

The adoption of the new Act on the SAO meant the end of the era of audits without any consequences. The three most important elements of this are highlighted in the following section. The first is the cooperation obligation on the basis of which the audited entity and its employees are required to cooperate.

The second is the obligation of the audited entity to take action. According to the Act on the SAO, the head of the audited body must develop an action plan in response to the findings in the report and send that plan to the State Audit Office of Hungary within thirty days from the receipt of the report. Thanks to the new Act on the SAO, the recommendations stated in our reports are now utilised to a far greater degree, thus the State Audit Office of Hungary was able to impact the operation of audited entities and the level of regulation of their internal processes considerably more effectively.

The third is the system of follow-up audits which consists of evaluating whether the audited entity has implemented the tasks it undertook in its action plan. The result of this work is indicative of the regularity of the audited entity's operation. Follow-up audits provide feedback to decision-makers and the audited entities, and simultaneously support the compliant and effective utilisation of public funds. Follow-up audits help ensure that the State Audit Office of Hungary achieves veritable change through its audits in connection with the sound management of public finances.

Sharing good practices

The State Audit Office of Hungary continuously strives to disseminate good practices, through which unaudited local governments will also adopt the positive examples. To lay the groundwork for this effort, the State Audit Office of Hungary has decided to assume an active role in the promotion of the *good practices* identified in the context of its audits. We regularly host good practice conferences. At these conferences, besides showcasing SAO's audit experience, the heads of audited entities share their methods,

PSZ 2017. angol.szam_beliv_v16.indd 96 2017. 04. 06. 7:28:58

procedures and thought practices that may be useful for other organisations. Non-audited organisations also adopt good practices by voluntarily complying with rules.

The conferences primarily cover topics in which the State Audit Office of Hungary has extensive audit experience. The dissemination of good practices is particularly justified among local governments, as the tried and tested solutions of one local government can be adopted by hundreds or thousands of other local governments. For this reason, the State Audit Office of Hungary and the Ministry of Public Administration and Justice launched a joint further training programme in 2013, the aim of which was to strengthen the integrity of local governments, and the appropriate and efficient auditing of regulations and financial processes based on SAO's experience and the legal compliance supervision of government offices.

Self-test system

Pursuant to the Act on the SAO, the State Audit Office of Hungary has general powers in auditing the responsible financial management of public funds as well as of state and local government assets. This represents more than 10,000 potential audited entities. This volume cannot realistically be audited on an annual basis.

With a view to promoting the compliant use of public funds, the State Audit Office of Hungary, in the context of its public financial support and advisory function, also supports the regulation and regularity of the operation of entities and institutions using public funds through a system of self-tests created by the State Audit Office of Hungary. This is another way of ensuring the transparent and accountable use of public funds. We have compiled five self-tests based on the audit experience of past years. The self-tests provide support for the following areas: the regularity of the use of public funds by church institutions, the development of local governments' internal control systems, the regularity of the operation of local minority self-governments, the regular operation of central budgetary institutions, and the regular utilisation of European Union funding by budgetary institutions and business organisations.

Based on the self-tests, institutions can evaluate their activities and consequently improve the regularity of their use of public funds and public function performance, their governance, financial management and audit duties, their fulfilment of the related expectations, and the transparent and accountable use of public funds. The majority of self-tests are based on the elements of internal control systems, formulating questions on the control environment, risk management, control activity, information and communication and monitoring. Our thematic audits identify the type-errors and recurring deficiencies that can be effectively corrected by completing the self-tests created by the State Audit Office and feeding back the results, thus spreading good practices. The self-tests support the heads and financial managers, as well as the internal auditors of the organisations in discharging their tasks in accordance with the statutory requirements, thereby contributing to the regularity of public spending. This allows substantial progress in the improvement of the compliant operation of non-audited organisations and institutions.

PSZ 2017. angol.szam_beliv_v16.indd 97 2017. 04. 06. 7:28:58

Notes

[1] Act LXVI of 2011 on the State Audit Office of Hungary.
[2] International Organisation of Supreme Audit Institutions, composed of the supreme audit institutions of the member states of the United Nations.
[3] ISSAI – International Standards of Supreme Audit Institutions.
[4] Supreme Audit Institutions.
[5] European Organisation of Supreme Audit Institutions.
[6] On the sharing of our experience of the introduction of ISSAI on performance audits, see for example: www.aszhirportal.hu/en/news/implementation-of-performance-audit-guidelines-sharing-european-experiences.
[7] www.asz.hu/hu/az-allami-szamvevoszek-ellenorzeseinek-szakmai-szabalyai.
[8] Act CXCV of 2011 on Public Finances.

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PSZ 2017. angol.szam_beliv_v16.indd 98 2017. 04. 06. 7:28:58

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Márton Nagy – Pál Péter Kolozsi

The Reduction of External Vulnerability and Easing of Monetary Conditions with a Targeted Non-Conventional Programme: The Self-Financing Programme of the Magyar Nemzeti Bank[1]

Summary

In addition to its primary task of achieving and maintaining price stability, the Magyar Nemzeti Bank (Central Bank of Hungary – MNB) views the reduction of Hungary's external vulnerability as a key priority. For that reason in the spring of 2014 the central bank introduced the Self-Financing Programme, in the context of which its policy instruments were restructured in order to crowd bank liquidity out of the sterilisation instruments and redirect it to the market of liquid securities. The Programme has met its initial goals as the external vulnerability of Hungary has decreased significantly. Between spring 2014 and December 2016 the Hungarian government repaid EUR 11 billion of its foreign currency debt from forints, the foreign currency ratio of govern-

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PSZ 2017. angol.szam_beliv_v16.indd 99 2017. 04. 06. 7:28:58

ment debt lowered to around 25 per cent from the previous 50 per cent, while gross external debt decreased also significantly. While the primary goal of the Programme was to reduce Hungary's external vulnerability, the measures were also intended to facilitate the easing of monetary conditions in an unconventional way. The yield-impact of the Self-Financing Programme could be around 75–90 basis points which makes that the Programme supplemented the yield-effect of central bank interest rate cuts with a magnitude of one half of their effect between 2014 and 2016.

Journal of Economic Literature (JEL) code: E52, E58, H63, G21
Keywords: self-financing, monetary policy, financial stability

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Introduction

Hungary accumulated unsustainable debts before the crisis started in 2007, and a significant portion of the debts was denominated in foreign currency. In spite of the series of retrenchments initiated after 2006, the deficit of the budget remained high, and the government debt showed an increasing trend. Household savings decreased, the current account deficit was significant for years, and this led to huge external indebtedness, while the level of foreign currency reserves was dangerously low compared to external debts. The high level of indebtedness and the unfavourable structure of the debt can be considered as one of the main reasons why Hungary was hit hard by the global financial crisis.

The vulnerability of the Hungarian economy fundamentally determined the macroeconomic developments of the years following the crisis. The repayment of debts hindered internal demand for years, slowed down the recovery from the crisis and gradually demolished the long-term growth potential. This way the economic policy had to face the almost impossible task of performing a budgetary consolidation and laying down the foundations of sustainable growth at the same time.

The prolonged repercussions of the crisis and its escalation rendered Hungary's external economic and money market environment vulnerable. This rapidly changing, unconventional environment called for new, innovative monetary policy solutions. The turnaround in Hungary's monetary policy started in the summer of 2012 and gained momentum from March 2013. Since March 2013, the Magyar Nemzeti Bank has played an increasingly active role and has taken proactive steps to fulfil the mandates bestowed upon it in the MNB Act.[2]

One of these proactive steps was the introduction the Self-Financing Programme in the spring of 2014. The programme was intended to encourage banks to purchase liquid assets accepted as eligible collateral with a view to mitigating Hungary's external vulnerability by reducing the country's gross external debt. This study is presenting the concept and motivation, the structure, the phases and the results of the Self-Financing Programme.

PSZ 2017. angol.szam_beliv_v16.indd 100 2017. 04. 06. 7:28:58

Concept and motivation

At the outbreak of the crisis and in the years that followed, Hungary was counted among the countries that were considered vulnerable by international standards. The external fragility of the economy and excessive reliance on external foreign currency financing were among the main reasons. The main problem was that the crisis distorted the foreign currency composition of public debt: the share of foreign currency debt surpassed the levels seen in most European Union Member States by a large margin. Similarly, analyses and reports on Hungary identified its high external vulnerability as a key risk, the reduction of which had become one of the primary objectives of Hungarian economic policy by 2014.

Without prejudice to its primary objective, the MNB supports the maintenance and reinforcement of financial stability and the economic policy of the Government using its disposable instruments.[3] The concept aiming to reduce Hungary's vulnerability by financing government debt from internal funds is aligned with the MNB's objectives. A shift towards self-financing not only makes the funding of government debt safer, but the reduction of external and foreign currency debt will reduce the Hungarian economy's vulnerability, which benefits all economic agents. Lower external indebtedness can contribute to reducing debt-service costs by improving a country's risk perception and decreasing the risk premium, thus also indirectly fostering more sustainable economic growth. Lower external debt and a healthier debt structure may reduce the country's risk premium and contribute to reducing the costs of debt financing. Bringing down the economy's gross external debt is desirable as long as reducing foreign exchange reserves in a prudent way is possible, and therefore part of foreign exchange reserves can be used to further reduce the country's external vulnerability.

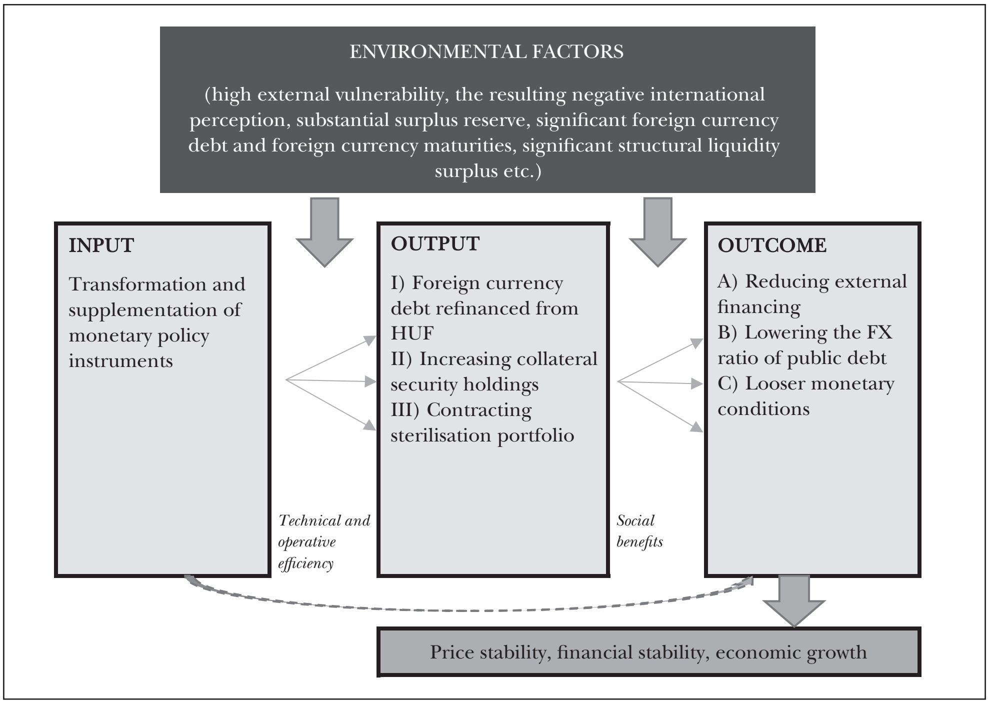
Reducing the external vulnerability is a relevant macro-economic objective. One possibility to achieve that objective can be via the modification of the operational framework of the monetary policy in the following way:

– As an unwanted consequence, central bank instruments with a good liquidity profile may encourage banks to adopt a liquidity management practice that relies far less on liquid securities and indirectly, this might increase external vulnerability. Indeed, in this case, bank liquidity will wind up in the central bank's balance sheet, while public debt is mainly financed by other sectors, especially by foreign investors, which may raise the level of external debt and increase the foreign currency ratio.

– When the central bank's liabilities side instrument is less liquid, by steering excess liquidity into liquid securities markets the central bank can play a more prominent role and contribute indirectly to the increase of the weight of domestic sectors and the decrease of external exposure. Another important aspect to consider is the fact that, if the external exposure entails increased foreign currency issuance, it may cause considerable sterilisation costs for the national economy due to the expansion of the central bank's balance sheet.

PSZ 2017. angol.szam_beliv_v16.indd 101 2017. 04. 06. 7:28:58

Figure 1: The Self-Financing Programme framework



Source: The authors' own editing, based on Mandl–Dierx–Ilzkovitz, 2008.

By transforming the liquidity profile of central bank instruments, the Self-Financing Programme can prompt banks to shift their funds towards liquid securities. Under the Programme, by modifying the central bank instruments the MNB raises, in a relative sense, the appeal of eligible non-central bank securities for banks and due to the specificities of the Hungarian securities market, this primarily affects government securities.[4] Modifications to the monetary policy instruments under the Self-Financing Programme facilitate the reduction of foreign currency debt and external debt and hence, the external vulnerability of Hungary. Indirectly and over the longer term, the Self-Financing Programme supports price stability and financial stability, as well as economic growth (Kolozsi–Hoffmann, 2016b:9–34).

Figure 2: Central banking instruments and external vulnerability

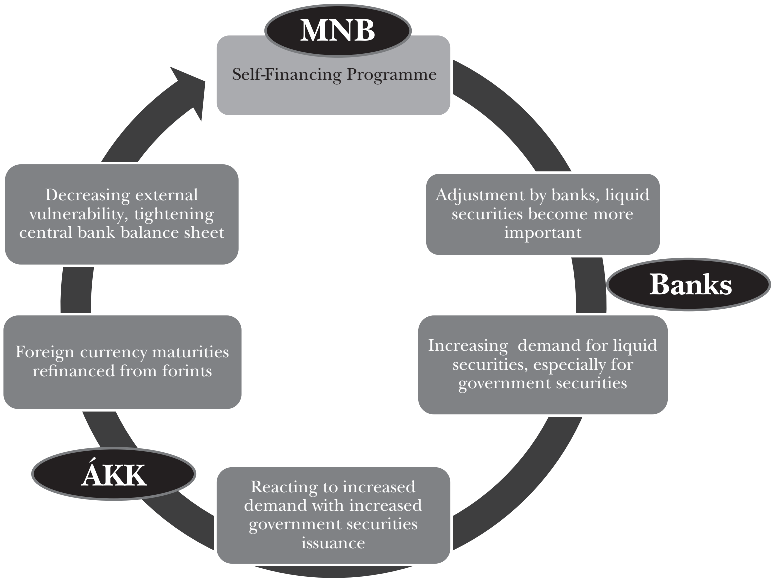
Source: The authors' own editing

PSZ 2017. angol.szam_beliv_v16.indd 102 2017. 04. 06. 7:28:59

The self-financing concept can be considered as cooperation between the MNB, the Government Debt Management Agency (ÁKK) and banks. In recent years and especially after 2012, several policy decisions were made with a view to reducing external vulnerability and improving the debt structure or furthering the achievement of these goals. The self-financing concept fit into these series of steps. It is important to see however that the self-financing concept is not a centrally coordinated programme, but rather a series of complementary measures and decisions. The success of self-financing depends, on the one hand, on the ÁKK's issuance of an adequate volume of forint-denominated government securities and on the other hand, on the ability of domestic investors to ensure the necessary, sufficient demand for such papers – this involves, in particular, the banking sector.

– It should be noted that, in addition to the natural consultation and cooperation between public stakeholders, individual members of the banking sector also voluntarily participated in the Programme. It is also important to underline that the Self-Financing Programme do not define any requirements regarding the investment of the banks' liquidity in particular assets.

Figure 3: Self-Financing Programme as cooperation between stakeholders



Source: Own figure

Parallel to the reduction in Hungary's external exposure, by 2014 the reserve holdings of the central bank increased significantly, and the resulting, marked improvement in reserve adequacy and accumulation of excess reserves[5] over and above short-term external debt allowed for the cautious, gradual reduction of the reserves. One way of utilising the foreign exchange reserves is for the state to renew the bulk of its

PSZ 2017. angol.szam_beliv_v16.indd 103 2017. 04. 06. 7:28:59

maturing foreign exchange debt in forint, as it carries out the necessary conversions at the MNB, against its forint deposits. The self-financing concept and programme of the MNB takes advantage of this possibility with the objective of reducing reliance on external funds.

Measures of the Self-Financing Programme

The specific measures of the Self-Financing Programme were aimed at "crowding" bank liquidity out of the MNB's sterilisation instrument and "shifting" liquidity from the central bank to the market of liquid securities. Announced in the spring of 2014, the declared objective of the Self-Financing Programme was to stimulate banks' purchases of domestically issued liquid securities in order to contribute to lowering the external debt of Hungary and improving the currency structure of financing. The MNB transformed its monetary policy instruments to encourage banks to invest their excess liquidity in liquid securities, which, due to the specificities of the Hungarian environment, primarily entailed a surge in the demand for government papers.[6]

In the context of the programme, the MNB worked to drive the excess liquidity of credit institutions out of the central bank and into the domestic securities market not only by reforming its existing, conventional instruments, but also by introducing new, unconventional instruments. In addition to crowding out bank liquidity, the MNB also supported banks' adjustment via instruments channelling banks' funds to the desired direction. The main such channelling instrument of the Self-Financing Programme was the conditional interest rate swap instrument (IRS),[7] which has grown to become the iconic element of the Programme. With the introduction of the IRS, enabling banks to manage their interest rate risks, the MNB supported the banking sector's adjustment to the reform of its monetary policy instruments by increasing their holdings of eligible securities.[8]

The measures adopted within the framework of the Self-Financing Programme between 2014 and the summer of 2016 can be divided into three phases. The Table 1 provides a brief summary of the important and relevant central bank steps as regards monetary policy effects.

Practically at the same time that the IRS tenders were terminated,[9] the MNB decided to gradually limit access to the main policy instrument. As a first step, from August 2016 the MNB accepts deposits under its three-month deposit instrument once a month instead of the prior weekly frequency. By reducing the frequency of tenders, bank liquidity will be dispersed over three series instead of the 13, which means a significant concentration of deposits. As a second step, from October 2016 the MNB imposed a limit on the amount of bank liquidity that can be placed in three-month deposits.[10]

The reduced frequency of the three-month deposit instrument's tenders and the capping of the same instrument from October 2016 mitigate money and capital market interest rates by rechannelling banks' excess liquidity to low-interest deposit facilities of the MNB and to the interbank market. These steps represented a new opera-

PSZ 2017. angol.szam_beliv_v16.indd 104 2017. 04. 06. 7:28:59

Table 1: Measures (1) crowding bank liquidity out of the sterilisation instrument and (2) redirecting bank liquidity to the market of liquid securities

	Measures	**Effectiveness**
First phase (April 2014 – June 2015)[11]	The form of the main policy instrument changed: the two-week MNB bill was converted into a two-week time deposit	From 1 August 2014
	A forint interest rate swap (IRS) instrument was introduced, in which the MNB would pay a floating interest rate against a fixed rate	From 16 June 2014
Second phase (June 2015 – January 2016)[12]	The three-month, fixed interest central bank deposit became the MNB's main policy instrument replacing the two-week deposit, available to banks without quantity restrictions	From 23 September 2015
	The two-week deposit facility remained a part of the MNB's instruments primarily for liquidity management purposes, but from the end of 2015 the MNB limited the amount to be held in the instrument to HUF 1,000 billion	From 23 September 2015
	The interest rate around the base rate available on the overnight standing facilities was made asymmetric	From 25 September 2015
	Traditional loan tenders' maturities were reduced to a half[13]	From 30 September 2015
	The optional reserve ratio system introduced in 2010[14] was terminated, and a uniform required reserve ratio of 2 per cent was applicable to all credit institutions[15]	From December 2015
Third phase (January 2016)	The MNB phased out the two-week central bank deposit in two steps[16]	April 2016
	Termination of IRS tenders	From 7 July 2016

tional framework of monetary policy and resulted a decline in market rates by crowding out excess liquidity remaining at banks from the policy instrument. As liquidity crowded out can flow into the interbank market[17] and the government securities market through the Bank's other existing deposit instruments, the resulting interest rate effect arises in these sub-markets, supporting the Bank's schemes to stimulate bank lending and its self-financing programme as well.

The stability of the base rate in itself is an important value, as a persistently unchanged interest rate level means greater predictability and better security of planning for market participants, thereby facilitating long-term economic decision-making (see Nagy–Virág, 2016). Bearing all this in mind, the MNB does not endeavour to reach the lowest possible base rate attainable in the short run, but aims at a sufficiently low base rate level, whose continued maintenance, facilitates the medium-term achievement of the inflation target.

PSZ 2017. angol.szam_beliv_v16.indd 105 2017. 04. 06. 7:28:59

In the above described situation, by stimulating liquidity flows in the banking sector, unconventional instruments are able to contribute more efficiently to the achievement of the MNB's objectives than a reduction in the base rate. With the base rate remaining unchanged, the MNB decided to limit the access to the three-month deposit facility in order to ease monetary conditions in a targeted way.

In July 2016 the MNB decided to limit the access to the three-month deposit facility. As a result of the crowded-out liquidity and the banking sector adjustment, a significant decline in yields may be achieved in the relevant financial markets, even with a stable base rate. As a result of a quantitative restriction on the three-month deposit, liquidity crowded out flows into other assets. Eventually, liquidity crowded out may flow through the interbank market into low-interest, overnight central bank deposits and to the government securities market, reducing yields in these market segments.

The amount of liquidity actually crowded out is determined by the quantitative limit on the three-month deposit as well as by developments in the banking sector's overall liquidity in the given period.

Results of the Self-Financing Programme

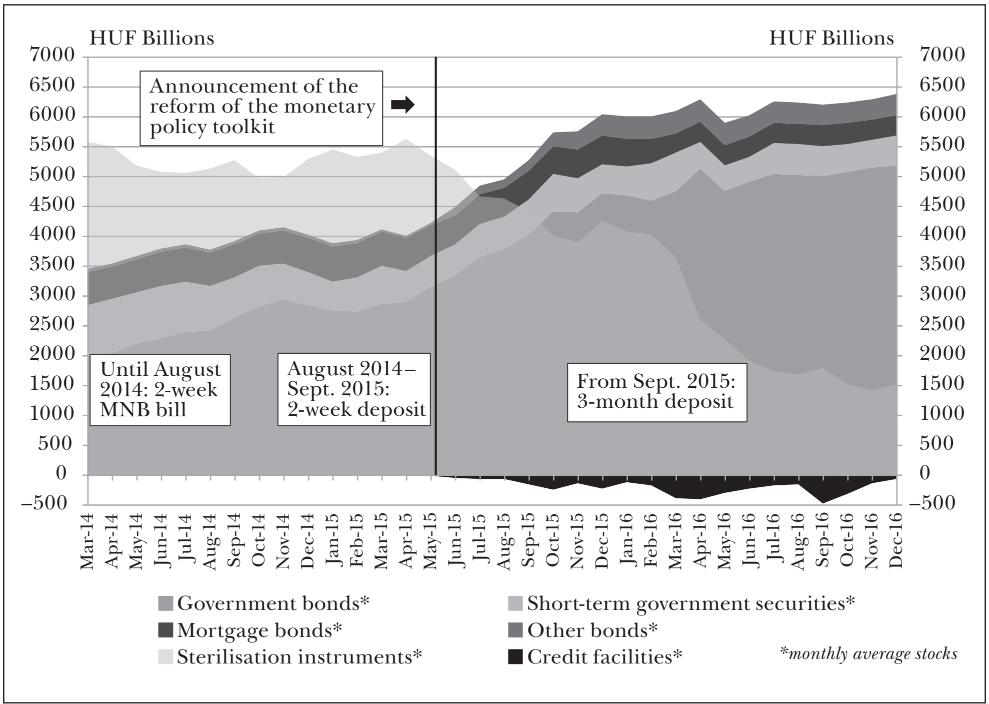
According to the impact mechanism of the Self-Financing Programme, banks' increased activity and demand in the liquid securities securities market can contribute to the refinancing maturing debt from forint issues and thus for reducing external vulnerability.

Increasing bankig sector's demand for liquid collaterals

Since the commencement of the Self-Financing Programme the banking sector's demand for liquid securities increased significantly. It is worth emphasising that apart from government securities, banks also have been using mortgage, corporate and other bonds in their adjustment in practice. This implies that banks' adjustment to the changes in the monetary policy instruments and in liquidity requirements was largely completed. During the Self-Financing Programme, the banking sector as a whole increased its demand for liquid papers, and the effect on banks participating in IRS tenders was especially remarkable. Developments in the banking sector's liquid securities portfolio largely reflect the purchases of banks taking recourse to the MNB's IRS instrument. The two groups' different behaviour suggests that the central bank's IRS instrument was mainly used by banks, whose compliance with the announced modifications to the monetary policy instruments and to the liquidity requirements entailed a significant degree of adjustment and hence considerable extra demand for liquid securities.

The Self-Financing Programme restructured the range of securities accepted in central bank operations as collateral. The conversion of the MNB bill to deposit in August 2014, the extension of the maturity of the main policy instrument and other central bank measures encouraged banks to adjust to the new framework by increasing their collateral portfolio in view of the contraction of central bank liquidity. On the whole, banks responded to the decline in the sterilisation portfolio by raising the volume of their other liquid instruments, which generated a substantial increase in their eligible collateral.

Figure 4: Eligible collaterals and central bank instruments held by counterparties



Source: MNB

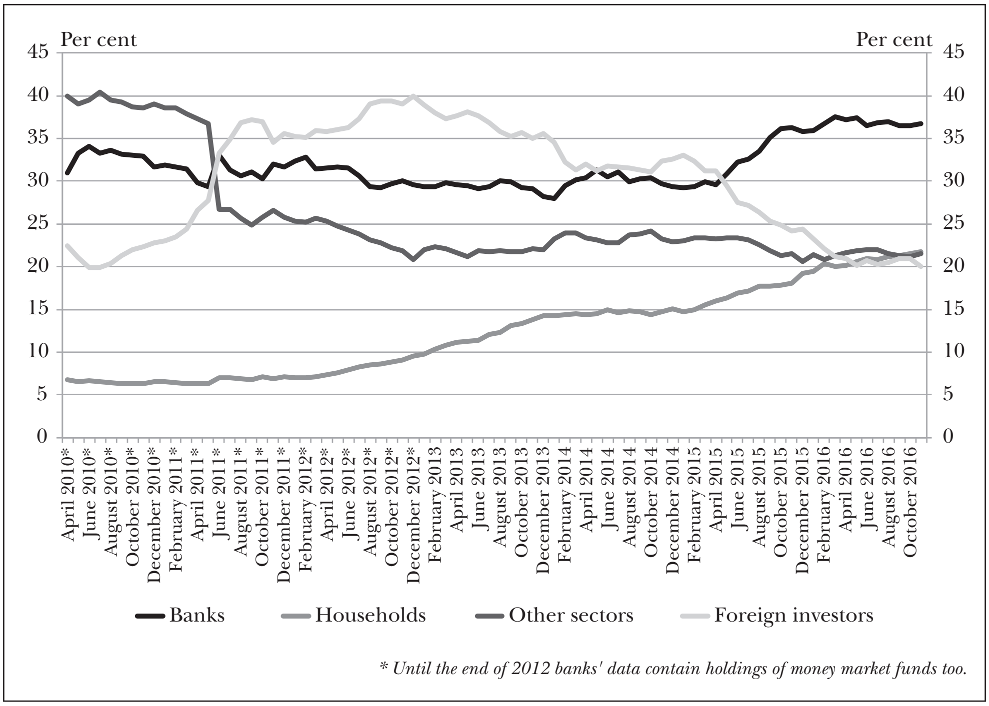
Credit institutions began to increase their holdings of liquid securities after the announcement of the Self-Financing Programme. Similarly, banks' demand grew significantly after the introduction of IRS tenders in June 2014 and after the conversion of the two week MNB bill into a deposit in August 2014. Banks stepped up their liquid securities purchases after the MNB's announcement on the continuation of the Self-Financing Programme and on the transformation of the main policy instrument on 2 June 2015, which – with the exception of a temporary decline typical of the end-of-year period – progressively boosted banks' holdings of liquid securities. Banks' demand for securities in 2016 Q1 was driven by the announcement of the phase-out of the two-week deposit – which had been announced for a limited quantity – and by the entry into force of the 100 per cent LCR requirement in April 2016.[18]

Regarding type, the increase in the holdings of liquid securities can be attributed, in an extended part to HUF-denominated, long-term, fixed-rate government securities.[19] The share of longer-term securities in banks' government securities holdings increased during the Self-Financing Programme, which improves the stability of government debt financing. As early as the end of 2014, the average remaining term of

PSZ 2017. angol.szam_beliv_v16.indd 107 2017. 04. 06. 7:28:59

banks' HUF-denominated government securities rose to 3.6 years from 2.8 years in the previous year, and by the end of 2016 it reached almost 4 years. Instead of non-residents, the domestic banking sector became the largest holding sector in the market of HUF denominated government securities.

Figure 5: Share of holding sectors in the market of HUF-denominated government securities



Source: MNB, securities statistics, nominal values

As the availability of sufficient liquidity is a prerequisite for lending, it is important to underline that although bank liquidity held in central bank instruments decreased in the wake of the Self-Financing Programme, this decline was offset by the purchases of eligible securities. This means that banks are capable of financing sound loan requests, and the Self-Financing Programme did not bring about any changes in this regard. In other words, the purchases of liquid securities (which are especially appealing from a liquidity standpoint) do not prevent banks from financing the real economy. The Self-Financing Programme may even lead to an acceleration in lending dynamics indirectly, via the reduction in external vulnerability.[20]

Repayment of foreign currency debt by forint issuances

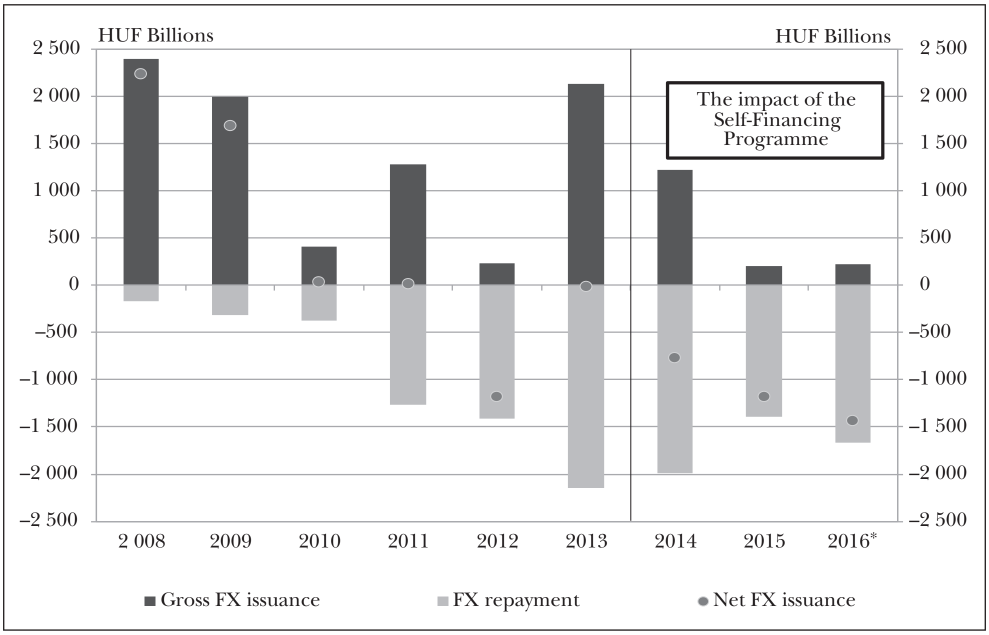
The financing of government debt from internal funds is primarily achieved through the reduction of foreign currency issuance, the repayment of foreign currency bonds

PSZ 2017. angol.szam_beliv_v16.indd 108 2017. 04. 06. 7:28:59

and maturing foreign currency debt from forint funds and increased forint debt issuance. All of this was made possible by domestic banks' additional demand for liquid securities. From mid-2014 the Hungarian government no longer needed to borrow, in net terms, foreign currency for performing its instalments of international loans and for the refinancing of maturing foreign currency bonds, as sufficient forint funds were available to finance the general government.

Through banks' increased demand for liquid collaterals and especially government securities, the foreign currency debt repaid by the Hungarian government from forint issues amounted to EUR 2.5 billion in 2014, EUR 3.9 billion in 2015 and EUR 4.6 billion in 2016. The higher supply of HUF-denominated government securities linked to the self-financing concept was made possible – in addition to the robust household demand – mostly by banks' heightened demand. The difference between foreign currency borrowing and repayments (net foreign currency issuance) of ÁKK stood at HUF –766 billion in 2014, HUF –1,185 billion in 2015 and HUF –1,440 bilion in 2016. This represents a sharp change compared to previous years: in the years preceding the announcement of the Self-Financing Programme, the net foreign currency issuance of the government was either positive or close to zero.

Figure 6: Foreign currency issues and redemptions of the government



Source: ÁKK

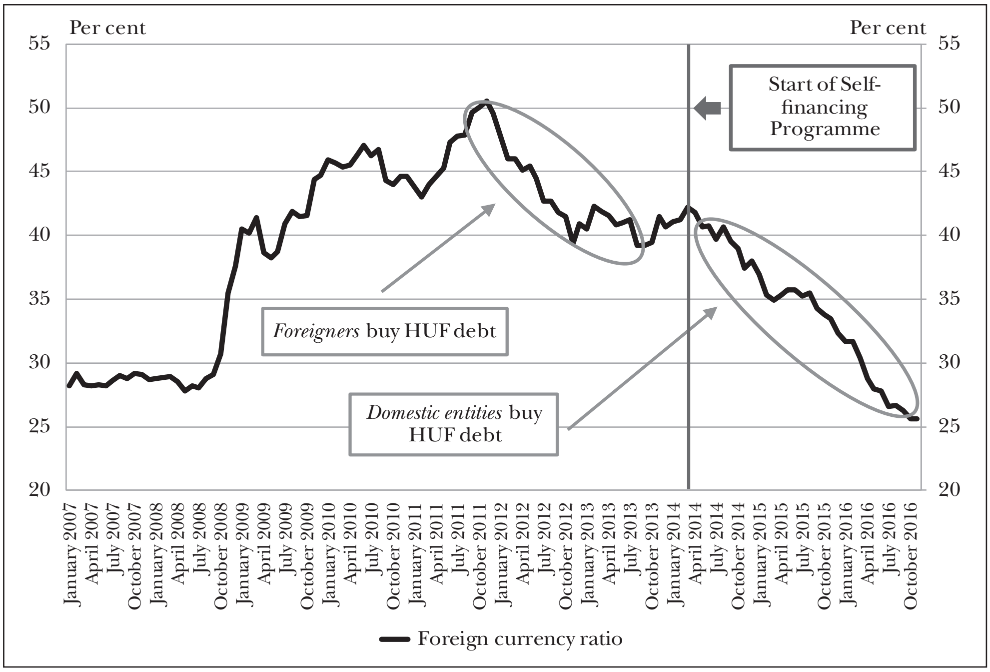
In 2014, net foreign currency issuance turned strongly negative. Net foreign currency issuance declined further in 2015 and the government repaid most of its maturing debt from forint funds. During 2015, in addition to rising bank demand, households' sharply increasing demand for government securities also contributed substantially to the fact that the bulk of maturing foreign currency debt was refinanced from forint funds. In 2016, government financing from internal funds continued: net foreign currency issuance fell to HUF –1440 billion, reflecting, for a significant part, the last instalment of the IMF/EU credit facility.

Declining external and foreign currency debt

Assuming that non-resident investors hold the bulk of foreign currency public debt owed to sectors other than households, any decline in foreign currency debt lowers the gross external debt of the government. The self-financing concept reduces the foreign currency ratio of public debt as it refinances foreign currency debt with forint debt.

In the context of the Self-Financing Programme, the foreign currency debt of non-residents decreased, and the forint debt of domestic banks and households increased; accordingly, Hungary's external vulnerability declined. Compared to 42 per cent in March 2014, the foreign currency debt ratio dropped to below 30 per cent in March 2016 before falling to around 25 per cent at the end of 2016.

Figure 7: Foreign currency ratio of central government debt



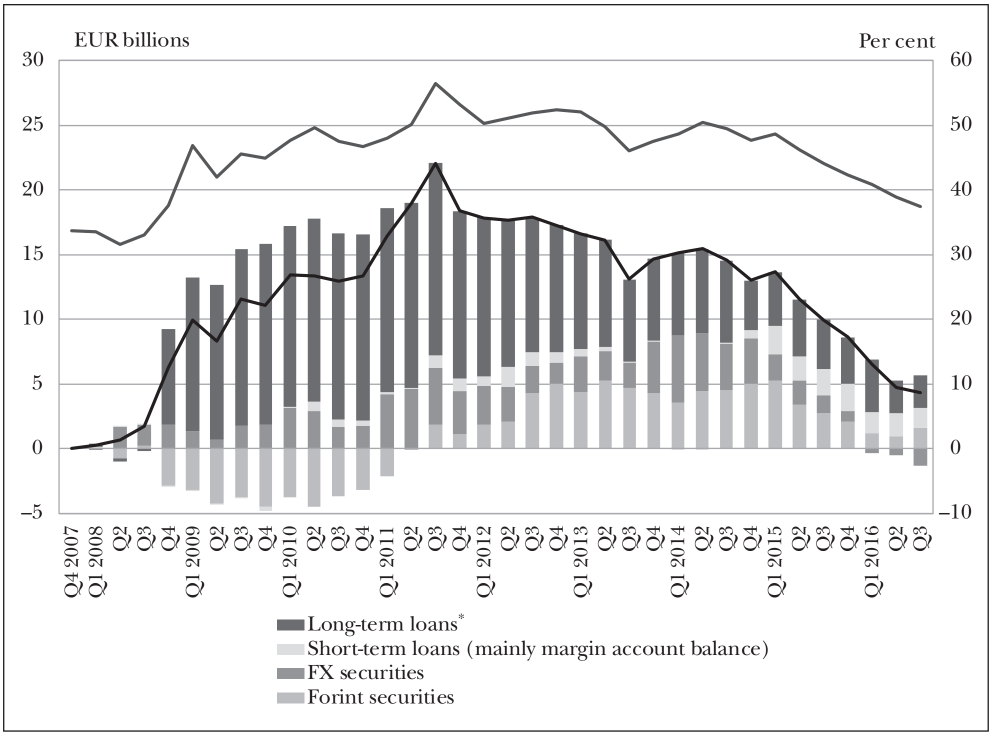
Source: ÁKK, 2016

The gross external debt of the general government began to decrease in 2014, with the decline accelerating in 2015. The net repayment of external foreign currency

PSZ 2017. angol.szam_beliv_v16.indd 110 2017. 04. 06. 7:28:59

debt continued, while non-residents also began to reduce their forint government securities portfolio. Nevertheless, the financing of the general government remained unimpaired with domestic participants' unprecedented surging demand for government securities stemming from banks' increased interest in liquid securities and from heightened household demand for government securities. The government, therefore, succeeded in reducing external foreign currency debt and forint debt simultaneously. During the period of the Self-Financing Programme, gross external government debt dropped from 50 per cent to nearly 40 per cent of GDP.

Figure 8: Decomposition of the gross external debt of the general government (cumulative transactions from end 2007)



**Long-term loans also include IMF–EU loans*
Source: MNB

Hungary's external vulnerability declined in 2016 and the adjustment of debt indicators continued as well. Net external debt fell to nearly 20 per cent of GDP, while the gross external debt-to-GDP ratio declined to below 70 per cent. Considering that short-term external debt declined to a greater extent than the decrease in FX reserves, the level of FX reserves at the end of 2016 of around EUR 24 billion is still well above the level expected by investors (according to the most relevant indicator, the Guidotti-rule).[21]

PSZ 2017. angol.szam_beliv_v16.indd 111 2017. 04. 06. 7:28:59

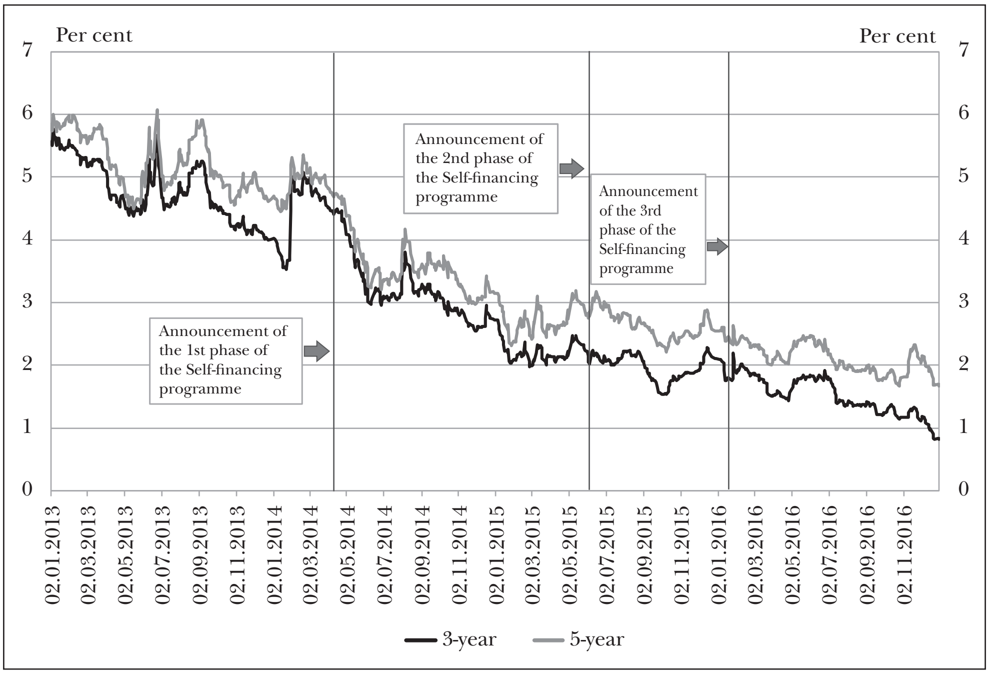
Easing monetary conditions

The primary objective of the MNB is to achieve and maintain price stability. Since 2001, Hungary has pursued an inflation targeting monetary strategy which means that the central bank sets an explicit inflation target as the ultimate goal. Since 2007, the inflation target of the MNB has been 3 per cent.[22]

With a view to achieving the inflation target and providing sufficient stimulus to the real economy, between August 2012 and June 2016 the MNB lowered the central bank base rate from 7 per cent to 0.9 per cent. Parallel with that targeted programmes were implemented. The Self-Financing Programme was such a targeted non-conventional programme with the declared purpose of complementing the MNB's easing cycles, aligning its measures with the trajectory of conventional monetary policy.

After the announcement of the different phases of the Self-Financing Programme, long-term yields decreased significantly. During the first phase of the Programme in April 2014 the decline was significant, and a decline was observed after the announcements in June 2015 and January 2016 as well.

Figure 9: ÁKK benchmark yields



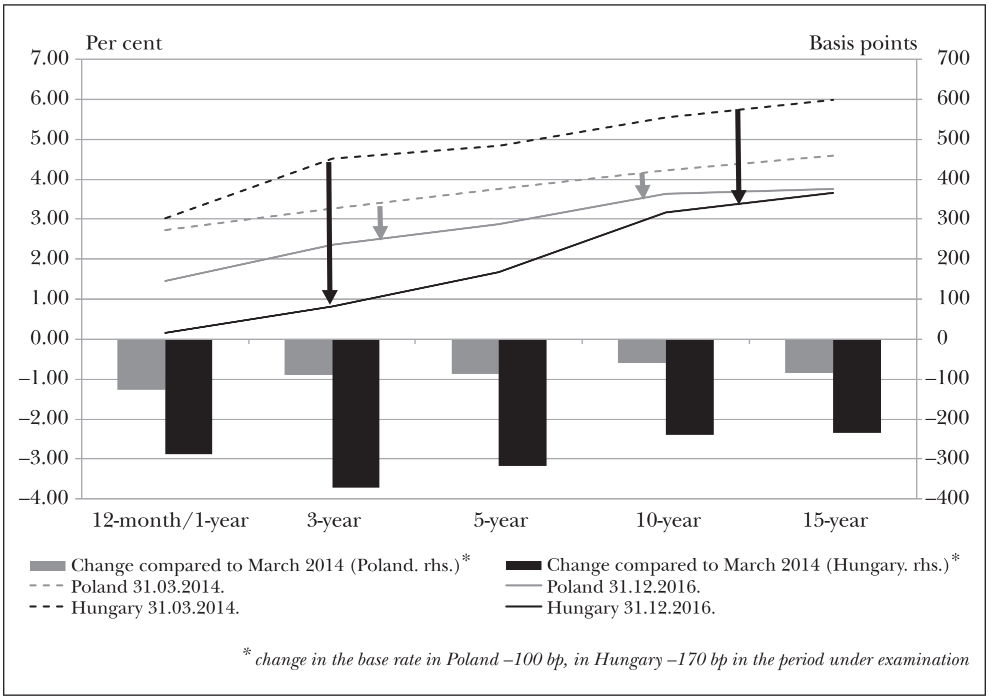
Source: ÁKK

Hungarian benchmark yields have declined more sharply across all maturities since the announcement of the Self-Financing Programme than the Polish benchmark yield serving as a point of reference. If we consider the movements of Polish

PSZ 2017. angol.szam_beliv_v16.indd 112 2017. 04. 06. 7:29:00

yields as the consequence of the modification of the international environment in Central and Eastern Europe, we can conclude that the country-specific decrease of Hungrian yields was around 120-150 basis points between spring 2014 and summer 2016. It has to be taken also into consideration that the main policy rate in Poland was lowered by 100 basis points between March 2014 and June 2016 while the Hungarian interest rate cut amounted to 170 basis points during the same period of time. If we substract that difference we have a decrease of 50-80 basis points in the long end of the yield curve which can be essentially related to the Hungary-specific Self-financing programme.

Figure 10: Polish and Hungarian government bond market benchmark yields



Source: Thomson Reuters Datastream, ÁKK

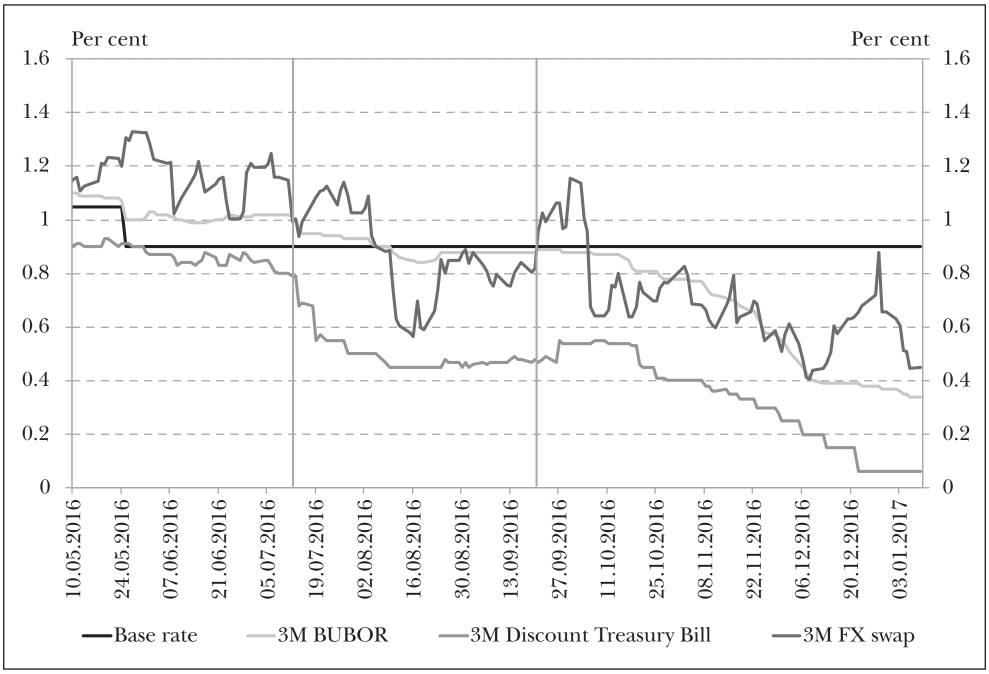
From an oither point of view we can accept that the Self-Financing Programme contributed to the decline in bond yields directly through the transformation of the operational framework of monetary policy and indirectly by moderating risks. According to the regression of Csávás–Kollarik (2016), the total effect of the Self-Financing Programme on yields between the announcement of the Programme and Summer 2016 could have been as high as 75–90 basis points. Meanwhile, the base rate cuts amounted to 170 basis points (from 2.6 per cent to 0.9 per cent); in other words, the Self-Financing Programme supplemented the yield-effect of central bank interest rate cuts with a magnitude of one half of their effect.

PSZ 2017. angol.szam_beliv_v16.indd 113 2017. 04. 06. 7:29:00

If we consider the cap system introduced in July 2016 as an operational framework partly supporting the Self-Financing Programme[23], it is worth to assess the impact of these measures on the monetary conditions.

As a result of the changing central bank instruments, the introduction of the cap system and the banking sector adjustment, relevant yields declined by 45–55 basis points in the main markets until the end of 2016.

Figure 11: Money market rates in the second half of 2016



Source: MNB, Bloomberg

Following the announcement on 12 July 2016 about the limitation of banks' access to the three-month deposit, the yield on three-month discount treasury bills declined by 30–35 basis, while the three-month BUBOR fell from 1 per cent to a level persistently below the base rate. Following the limited tenders in October, November and December 2016, a further decline of yields took place. As a result, in January 2017 the three-month BUBOR and FX swap yields fell well below the base rate, to around 0,3-0,4 per cent. Compared to July, the three-month discount Treasury bill decreased by some 50-70 basis points.

Conclusion

The global financial crisis brought into focus the external vulnerability of the Hungarian economy. For that reason Hungary identified the reduction of external exposure as a strategic objective. The self-financing concept – which is based on a mutual coop-

PSZ 2017. angol.szam_beliv_v16.indd 114 2017. 04. 06. 7:29:00

eration between the MNB, ÁKK and banks and does not include any mandatory regulation – decreases the external vulnerability by facilitating the reduction of foreign currency and external debt, through the refinancing of maturing foreign currency debt using local currency issuances.

The Self-Financing Programme affected all elements of the central bank toolkit while also supplementing the MNB's instruments by an unconventional element, the conditional central bank interest rate swap. The reform of the monetary policy instruments between 2014 and 2016 crowded bank liquidity out of the central bank and channelled it into the market of eligible collateral securities.

Banks have adjusted to the transformation of monetary policy instruments by downsizing their sterilisation portfolios and by increasing their holdings of securities eligible as collateral. This enabled the government to refinance its foreign currency debt with forint issues and to reduce gross external debt along with the foreign currency debt ratio. All these led to a significant reduction in the external vulnerability of the whole Hungarian economy between 2014 and 2016.

The Self-Financing Programme contributed effectively to the improvement in the external perception of the Hungarian economy. The Self-Financing Programme and the additional modifications to the central bank instruments were received positively by numerous international investors and international organisations. In their analyses, institutions primarily emphasised Hungary's reduced reliance on non-resident investors, improved resilience to external shocks, the favourable restructuring of Hungary's debt profile and the strengthening of internal financing. The improvement in external balance achieved as a result of the Self-Financing Programme played a key role in the upgrade of Hungary's debt rating into the investment grade category.

During the period 2014–2016 instead of non-residents, the domestic banking sector became the largest holding sector in the market of HUF denominated government securities. Through banks' increased demand for liquid securities, the foreign currency debt repaid by the Hungarian government from forint issues amounted to EUR 11 billion in 2014–2016, and accordingly, Hungary's external vulnerability declined. Compared to 42 per cent in March 2014, the foreign currency debt ratio dropped to around 25 per cent in 2016. Gross external government debt dropped from 50 per cent to nearly 40 per cent of GDP.

Concerning the effects of the Self-Financing Programme on monetary conditions in Hungary, the results are also impressive. The downward shift in long-term bond yields has been stronger for all maturities than that of Polish yields since the announcement of the Programme. The yield-impact of the Self-Financing Programme could be 75–90 basis points which makes that the Programme supplemented the yield-effect of central bank interest rate cuts with a magnitude of one half of their effect. Supplementing the easing cycles of the MNB, the Programme generated a decline in both short-term and long-term yields. Over the long term, the Programme supported, overall, the efficient implementation of the monetary policy stance.

The Self-Financing Programme achieved monetary easing while tightening the central bank's balance sheet. While numerous leading central banks managed to ease

PSZ 2017. angol.szam_beliv_v16.indd 115 2017. 04. 06. 7:29:00

monetary conditions only through unprecedented expansions of their balance sheets (i.e. quantitative easing programmes), thanks to the Self-Financing Programme, the MNB achieved this goal through a contraction of its balance sheet. The contraction of the MNB's balance sheet reduced the costs associated with holding reserves, and the MNB edged closer to the conditions of a potentially more efficient, liquidity-providing monetary policy.

Notes

1 This study is partly a refreshed résumé of the volume of studies "The first two years of the Self-Financing Programme" (2016) and also includes elements from other relevant publications of the Magyar Nemzeti Bank.

2 For a more detailed description see Matolcsy, 2015.

3 "The primary objective of the MNB shall be to achieve and maintain price stability. Without prejudice to its primary objective, the MNB shall support the maintenance of the stability of the financial intermediary system, the enhancement of its resilience and its sustainable contribution to economic growth; furthermore, the MNB shall support the economic policy of the government using the instruments at its disposal." Article 3 of Act CXXXIX of 2013 on the Magyar Nemzeti Bank.

4 It is not only a specificity of Hungarian securities markets, but also of other emerging economies in the European Union, where the majority of the eligible collaterals are government securities.

5 Consistent with international practice, the Guidotti indicator – a measure quantifying the country's short-term external debt – is considered by the MNB to be the most important reserve strategy indicator. In addition, it considers other indicators preferred by investors as appropriate in assessing the adequacy of the reserves and identifying the relevant risks (Csávás, 2015).

6 Regarding the communication related to the Self-Financing programme, government securities were often used by the MNB as synonyms of eligible assets; however, the aim of simplifying the communication for public was to facilitate the explanation and the transparency of central bank decisions.

7 Improving Hungary's debt profile. Background material. https://www.mnb.hu/letoltes/banks-can-contribute-to-hungary-s-self-financing-through-government-security-purchases-background-material.pdf.

8 It is important to highlight that in case of the IRS there is no distinction between the eligible assets, the same incentive is provided to any of these assets.

9 The year 2016 was an important milestone for the whole Self-Financing programme, justifying the investigation of the programme from a strategic point of view, particularly concerning the further necessity of the IRS facility. That assessment was made in July 2016 and as a result of that investigation the conditionnal IRS tenders of the MNB were terminated. The following results justified the terminaton of the IRS tenders:
– The external vulnerability of the country declined significantly. By the end of March 2016 the ratio of FX debt to gross government debt declined from 50 to around 30 per cent already.
– The MNB's balance sheet and sterilisation stock reduced. The MNB's balance sheet and sterilisation stock reduced significantly resulting a remarkable saving not only to the MNB but to the whole Hungarian economy.
– The demand for IRS facility decreased after two intensive years. The demand for the central bank interest rate swap (IRS) facility was intensive in 2014–2016, the IRS stock exceeds the HUF 1500 billion. Banks undertook to increase their stock of securities eligible as collaterals by that amount which stabilises efficiently the market for liquid securities. During the spring of 2016 the demand of banks at the IRS tenders reduced which means that the value added of the instrument decreased.
– The overhaul of the monetary policy toolkit related to the Self-Financing programme was largely completed by spring 2016. By the termination of the two-week deposit by the end of April 2016 the main reason of the introduction of the conditional IRS disappeared (the IRS was introduced to facilitate the shift of banks from the two-week instrument of the MNB to longer maturities).
The MNB held the last central bank IRS tender – an iconic element of the Self-Financing Programme

PSZ 2017. angol.szam_beliv_v16.indd 116 2017. 04. 06. 7:29:00

– on 7 July 2016. Termination of the instrument does not imply that the goals of the self-financing concept, i.e. the reduction of foreign currency debt and external vulnerability, are rejected. This is confirmed by the fact that the MNB reduced the frequency of the three-month deposit instrument from August 2016 and imposed a quantity restriction on the instrument from October 2016, thereby supporting the Self-Financing Programme while stimulating lending.

[10] Concerning the complementary instruments see Kolozsi–Hoffmann, 2016a.

[11] Kolozsi, 2014.

[12] Nagy–Palotai, 2015.

[13] Two-week loans were replaced by one-week loans and a three-month loan was introduced to replace the six-month loan.

[14] Varga, 2010.

[15] The reserve ratio was lowered from 2 to 1 per cent in December 2016, all other elements of the system remaining unchanged. The modification of the minimum reserve system supports the effectiveness of the new operational framework of the Hungarian monetary policy introduced in Summer and Autumn 2016 and especially the quantitative limitation of the three-month deposit facility. In its long-term strategy, the MNB committed itself to endeavour to harmonise its minimum reserve system with that of the ECB prescribing uniform reserve requirement for all credit institutions. Apart from some technical questions the Hungarian minimum reserve system is fully in line with the ECB's practice after the shift to the 1 per cent reserve ratio.

[16] Nagy, 2016.

[17] Improving the BUBOR market, which commenced at the MNB's initiative in the spring of 2016, was an inevitable prerequisite of the decline in interbank yields. Due to the introduction of the mandatory price quotation system, banks' limits against each other have significantly increased, market turnover has notably risen, and the information content of BUBOR has improved.

[18] From April 2016, the MNB raised the liquidity coverage ratio (LCR) requirement imposed on banks to 100 per cent. This step was implemented outside of the scope of the Self-Financing Programme.

[19] Even if between March 2014 and June 2016 (the termination of IRS tenders), the most dynamic increase in banks' eligible assets could be detected in corporate and other bonds whose stock increased more than sixfold, and the total stock of corporate, other bonds and mortgage bonds amounted to about 12 per cent of the eligible assets.

[20] SME loans started to increase dinamically in 2016. In September 2016, the annual growth rate of the total corporate lending of credit institutions was 1.8 per cent. After adjustment for the portfolio separation implemented within the framework of the resolution of MKB Bank, the growth rate amounted to 3.4 per cent. This expansion primarily reflected the increase in HUF-denominated loans. On a transaction basis, SME loans increased by 6 per cent in an annual comparison. The annual growth rate of the outstanding loans of the SME sector including the self-employed came to 7.3 per cent in the third quarter of 2016. The credit institution sector's household loan portfolio increased by HUF 37 billion as a result of loan transactions. Since the end of 2009, this was the first time that an increase was observed in the loan portfolio on a quarterly basis. The expansion of household loans outstanding is mainly affected by growth in loans granted to self-employers. The volume of new loan contracts increased by 43 per cent in an annual comparison and as part of this, housing loan output increased by 48 per cent over the past one year. Source: MNB, 2016).

[21] For more details see MNB, 2017.

[22] A ±1 percentage point tolerance band has been designated around the inflation target in 2015.

[23] If banks rechannel crowded-out liquidity to the government securities market, the external vulnerability of the country decreases in accordance with the spirit of the Self-Financing Programme, which also means a major improvement and progress for the whole economy. In addition, the ensuing decline in yields results in interest savings for the budget.

PSZ 2017. angol.szam_beliv_v16.indd 117 2017. 04. 06. 7:29:00

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PSZ 2017. angol.szam_beliv_v16.indd 118 2017. 04. 06. 7:29:00

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András Giday – Szilvia Szegő[1]

"Getting Over" National External Indebtedness – Or Is Baron Munchausen's Story Not a Mere Fairy Tale After All?[2]

Summary
The question of this article is how it was possible for the Hungarian economy to set on a growth trajectory after a W-shaped crisis despite a continuous and severe withdrawal of external resources. The country's net external debt relative to GDP dropped by nearly 30 percentage points within five years, representing a 5–6 percentage point reduction per year. Why has the economy not suffered an even greater setback as a result of such a rate of "loss" in financing resources? Is growth possible without resources? Obviously not.

This paradox was resolved when sources of financing were re-channelled into the internal supply of sources. The reason is that financing is similar to an electrical network: if connections are weak, power is lost. The country's excessive openness caused a significant loss of power (as tackled in this study), so the closing and reconnection of the money circuits to the internal resource supply (as amply illustrated in this study) increased the "power supply" to the economy.

Numerous actions taken by the national bank and the government took the country in this direction. From the area of financial regulation, the authors have selected the steps of allowing the moderate weakening of the Hungarian forint, the conversion of Swiss franc loans into forint loans, and the Funding for Growth Scheme (FGS). With regard to government measures, the focus is placed on cutting employment taxes, promoting community work, curbing monopoly profits, and channelling retail savings into financing sovereign debt. All this has set the economy on a trajectory

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PSZ 2017. angol.szam_beliv_v16.indd 119 2017. 04. 06. 7:29:00

where self-healing mechanisms have had an opportunity to start. Applicable financial funding of the national economy was an important key in answering the question raised in the article. Nevertheless, our other conclusion is that there is much to be done in the financing of corporations in a similar direction of funding.

Journal of Economic Literature (JEL) code: F34, H63, H31
Keywords: private-public external indebtedness, corporate sector lending, stabilizer sectors, Central Bank funding philosophy, public debt restructuring

Introduction – Was it a paradigm shift or only a practical approach?

What seemed impossible has become possible: economic growth simultaneously with a significant improvement in our external (non-resident) financial imbalance. Ten years ago, there was a huge debate in Hungary about the reason for the country's simultaneous external and internal indebtedness (the parallel deficit in the current account balance and the government budget balance, also called twin or double deficits).[3] The marked opinion was that the cause was government overspending and the effect was external indebtedness. In this approach, external debt is merely a passive outcome of irresponsible domestic extravagance (on the part of the government, and then after 2004, that of the households). This perspective – it was claimed – only allows a single way out: cutting internal expenditure and paying off the accumulated debt, in other words, by offering a high premium to external lenders, while maintaining a strong forint rate supported by high interest rates.

At this point, let us just note: The events after 2006 proved that high forint interest rates did not improve the country's balance (withholding internal spending); rather the reverse: the rapid introduction of forint convertibility indirectly deteriorated the balance. The reason is that the economic actors increasingly replaced their expensive forint loans with paradoxically "cheap" foreign currency loans. Thus, the country's population became foreign currency purchasers, and contributed significantly to financing the country's external indebtedness.[4] Even more importantly, under unclear conditions, they also assumed the rather high risk involved in foreign currency debt. (The fact that instead of the euro, the majority of the economic players became indebted in Swiss francs, the "golden currency" considered as a base currency, exacerbated the problem. This entailed a high risk ab ovo.)

The doyens of economics thought that the external balance could not improve without a massive cut in incomes. Any effort that emphasised internal resources without de-emphasising the need to reduce indebtedness was seen as a fairy tale. In several forums, such efforts were compared to Baron Munchausen's absurd story of pulling himself and his horse from the mire with his own hair. In this approach, only an external force, external resources, can sustain the country amid the trouble caused by debt. In this

PSZ 2017. angol.szam_beliv_v16.indd 120 2017. 04. 06. 7:29:00

article, we endeavour to draw a picture of the critical developments, several years after the debate, and seek an explanation for the "unexpected" development: the way an increase in the national income became possible despite a considerable drop in external resources. Does Baron Munchausen's tale have a hidden message? Does it have more to say beyond its description of the baron's talent for misrepresentation?

In order to understand the developments, we first analysed the resources of the major income holders and their use. In addition to government budget and foreign resources mentioned above, funds are held by households and by businesses (more specifically, the financial sector, to be discussed separately, which is only mentioned here in respect of the above). These sectors manage foreign financial resources, while – in this article the common approach is adopted – credit institutions "only" mediate financial resources. This shows that the net financial assets in this sector are minuscule compared to those in the other sectors; in other words, its creditors (payables) are nearly equal to its debtors (receivables). Returning to the other sectors if one sector's claims against another exceed its debts, then it finances the latter or some of the latter. (As a side note, let us add that the reverse of this correlation is also true: the debtor also finances the lender, as banks for the most part also sell the debtor's debt as a source of income. The debtor's debt represents profitable accounts receivable. This is why banks are not "grateful" for prepayment, as it reduces their assets.)

Thus, if we want to analyse external indebtedness, i.e., the change in external resources, we certainly gain important information from analysis of the financial standing of the major income holders (sectors) in the national economy as a whole (i.e., if they have a debit or a credit balance with regard to the other income holders). This is because raising external (foreign) funds is a method of financing, and presumably a method that is expensive and/or risky for the indebted country. (Anything that involves higher risk is more expensive, as business risk is paid for in the price.)

An investigation of the sources of growth must therefore cover financing methods. The reason is that business financing at present has to be considered as a separate industry. In business plans, financing is not merely a limit to be considered; it is frequently ranked as number one in business or at least it is assigned great priority. This is the case even if it is not obvious from the objects of a company. (This is also manifest in the fact that on corporate balance sheets the weight of financial profits increases in comparison with that of operating profits, i.e., to the income earned from the activities that constitute the objects of the company.) This also suggests that the resources required for financing growth cannot be set as a specific amount, as financing itself can also be the object of business. Based on this, we presumed that in addition to analysing changes in external resource volumes in light of growth, we must also look into its complex interrelationships with the various sectors of the national economy. The ultimate evaluation criterion is whether a specific method of financing has increased income generation or rather the reverse: it has reduced it. In the case of our subject, this question refers to income generation in the national economy and the possibility of its domestic use (e.g., interest payment may require 4 to 5 per cent of GDP, and thus

PSZ 2017. angol.szam_beliv_v16.indd 121 2017. 04. 06. 7:29:00

this ratio of the income cannot be used by the nation). This is exactly what financing is about: offsetting resources against generated income. Ultimately, the "benefit or loss" of external financing can be measured in the developments recorded for the income of the national economy (consumption and accumulation). The question "What quantity of resources is required to achieve a given percentage of growth?" follows the logic of passive financing. However, asking this question the other way round – namely, "How do you achieve a given income increase using the least possible resources?" – reflects an active financing logic. These two different considerations can also be followed at the level of the national economy. In this approach, at first sight "cheap" source may prove to be very expensive as we came to realise in the case of FCY loans.

All this also means that in addition to the domestic market, domestic financing resources may also represent significant resources for the domestic economy. In this respect the national economy is similar to a large corporation, for which financing is one of the important, or in the current financialized world, often the most important business lines. (The establishment of the Government Debt Management Agency was based on a similar recognition; however, it is engaged in "only" financing government debt and not the entire national economy as a whole.) Another important consideration is that the financing market is global, and so it develops according to global values. To find the most appropriate forms of financing in this is a real challenge not only from the perspective of public finances, but from that of the entire national economy. Not only individuals and not only individual business organisations require financing, but the entire national economy as a separate unit does as well. Domestic participants also participate in this, but the rest of the world plays a special role in this respect. In the case of long-term external debt, external resources are ultimately secured by the national economy as a whole. This includes a nation's assets, incomes, public funds, and public property (see, e.g., budgetary austerity programmes in permanently indebted countries, forced privatizations at undercut prices, wage outflow stops, pension cuts etc.).

Many people are unaware that within a country the "rest of the world" is a genuine economic sector. During the crisis in Hungary, it was not primarily the central government that was highly indebted to the rest of the world, but the corporate and the banking sectors as well (and through foreign currency loans, the households).[5] Consequently, the assumption that debt requires active financing applies not only to public finances, but to the national economy as a whole. So another question that arises is how to interlink external resources and internal income generation. If domestic ties are inefficient, then just as in a poorly built network, a significant part of the power, external resources, may be lost. If connections are good, power may increase. This is what, generally speaking, financing is about. Thus the fundamental question in the external financing of the national economy is the creation of appropriate domestic connections. In other words, financing should drive domestic income generation and should not trigger financing cycles (with the kind of financing practised in Hungary before the crisis, when "the coat was not cut according to the cloth"). The reason is that if this is not done, external financing, sooner or later, uses up domestic assets, whether physical or human. For instance, cheap wage labour attracting external funds (capital) also finances external debt service to the detriment of domestic human resources.

In light of this, the question arose whether financing the national economy has improved recently. If yes, this may provide a kind of explanation as to why domestic income generation and its use at home managed to increase despite a reduction in external resources.

Our analyses seem to confirm that economic policy has shifted from the earlier passive financing logic, accepted in certain respects for decades. The active financing approach has gained ground (for example, remember the retail resources included in financing the government budget or the activity of the National Bank of Hungary (MNB) in boosting financing). A change in the financing logic made the flow of funds more favourable in several areas. In other words, financing did its job.

In this study, we analysed the position of the major income holders in the national economy in respect of the flow of funds between them. We presumed that, to put it loosely, the smooth reduction of external funds was facilitated by the activity of domestic financing. This may explain why instead of crashing due to the significant gap in external resources, we saw a development in the opposite direction: despite some unfavourable foreign economic conditions, after a minor downturn, promising numbers have been achieved in recent years. In other words, Baron Munchausen's case is no mere fairy tale, but rather a parable with a lesson: the happy wording of a problem gives the clue to its solution. Consequently, the idea that external financing (indebtedness) is simply a reflection of some kind of extensive domestic consumption had to be left behind.

Thus, if someone is thinking along the previously accepted mathematics of growth and the economic structure characteristic of the period before the crisis, then the favourable process in recent years is difficult to comprehend from the developments in external indebtedness. In addition, an explanation is also required for significant economic growth without raising funds and with a poor external market performance. Moreover, external resources have also decreased. This is the question we tackle in more detail in the article.

In light of the developments seen in corporate financing, we think it is increasingly urgent to "re-discover" non-banking instruments (previously, the majority of lending was conducted on a corporate level). Note that bank lending remains lethargic in the world economy, especially in Hungary. Innovation is not only badly sought in the real economy, but also in financing. The weight of household savings (the net financial assets of the population are nearly equal to the annual GDP) shows that we have a basis to build on. The government budget is not the only area this money may be mobilized to finance. The SME sector may also be funded, and far better and more cheaply than currently. *Each tiny step made by the central bank in this direction, say, towards intercompany and household lending to business, would presumably boost domestic financing resources significantly, for example, by providing guarantees for lending between corporations.*

PSZ 2017. angol.szam_beliv_v16.indd 123 2017. 04. 06. 7:29:00

The rest of the world as an economic sector within the national economy

When it comes to the external indebtedness of a country, public thinking, and frequently even the thinking of professionals, considers it identical with sovereign indebtedness. Nevertheless, the period since 2000 has already been characterised by private indebtedness coming into the foreground. Similarly, debt service is thought to be the same as the repayment of a state debt, simply because it is done at the level of the state. This is another faulty approach: the state or government acts as the sovereign institution of the national economy to service the external debt in foreign currency if the national demand for FCY exceeds its supply. The reason also needs to be explained. On the basis of the "debtor has to pay" logic, we identify the debtor with the party that administers debt service. However, instead of the individual debtor, the mirror institution vis-à-vis the rest of the world is the domestic economy, or more accurately, the nation. Consequently, in addition to business partners, the debt owed by those who do business with the rest of the world is secured by a debtor community, that is, the domestic economy. And in a physical form this is represented, "embodied", by the state. *For this reason, the ultimate debtor (actually, the guarantor) to the rest of the world is the state, even if the debt is private.*

Thus, we will first examine external account holders (the rest of the world) that have registered headquarters in the country and then the other sectors of the national economy.

Financial practice has established a peculiar system of indicators for the analysis of developments in external funds: the balance of payments. It is compiled through an approach that differs from the financial accounts of the national economy, which compares the national economy's financial assets and the external accounts of foreigners with headquarters in Hungary. This is discussed in this article. A country's balance of payments, and more specifically, the current account, is far more widely used than its financial accounts. This current account balance focuses on developments in the country's solvency vis-à-vis the rest of the world. Among other dynamics, it reveals if exports provide coverage for imports at any given moment and for the outflow of income simultaneous with the inflow of foreign direct investment from abroad. It is also important to consider how surplus capital flowing in from abroad can cover a country's foreign currency needs. In a wider sense, a country's external debt is the indicator that shows to what extent the country is able to provide financing in foreign currency for its external debt. *This is what the external financing party is interested in and not so much the impact of resources obtained from abroad on the country's financial assets. The country's national bank is supposed to deal with the latter, and the country's government is authorized to do so.* If these institutions lack competence and other responsible circles do not assume this task, and then we see the events we experienced in financing in Hungary in the early 2000s. In short, this is characterised by the "too big coat" kind of external financing briefly described below.

External debt – Getting off the rails

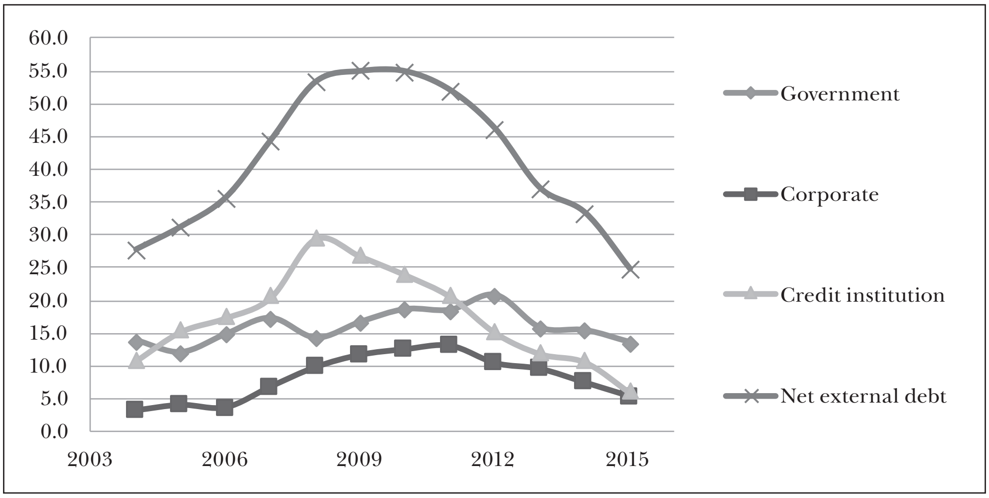
The country's external debt and the balance of payments used to measure it are critical indicators of economic standing. Unfortunately, disregarding the relevant analyses conducted by the National Bank of Hungary, this issue has still not been given sufficient attention in public thinking on economic issues. The debt owed by the national economy as a whole, i.e., the debt to the rest of the world, somehow escapes the field of view. This is no coincidence, as such questions are rarely asked.

In recent years, the country has broken new ground by being able to considerably reduce its external debt, to an extent previously considered inconceivable. Between 2010 and 2016, the (net) external debt fell from 55 to 23 per cent of GDP. This could be considered exemplary even in an international context.

A clear chart shows both the significant reduction in the country's previous outstandingly high debt in recent years and the contributions of the individual sectors to this reduction.

The net external debt and its components are depicted in the figure below.

Figure 1: Net external national debt relative to GDP and its components broken down by sector "Too big coat" external financing and its correction



Source: The authors' compilation

The figure shows a drastic fall in the net external debt and its sectoral components, considering all economic sectors (in this figure, reduction in household external debt is included in the fall in bank debt). The net external debt dropped to half of its 2009 value. In this regard, the financial sector is ranked first, as it reduced its external resources to the minimum from an extremely high level. Although this is a positive development in terms of reduction in external indebtedness, the positive nature alone fails to show the underlying processes. These include the fact that the massive

PSZ 2017. angol.szam_beliv_v16.indd 125 2017. 04. 06. 7:29:00

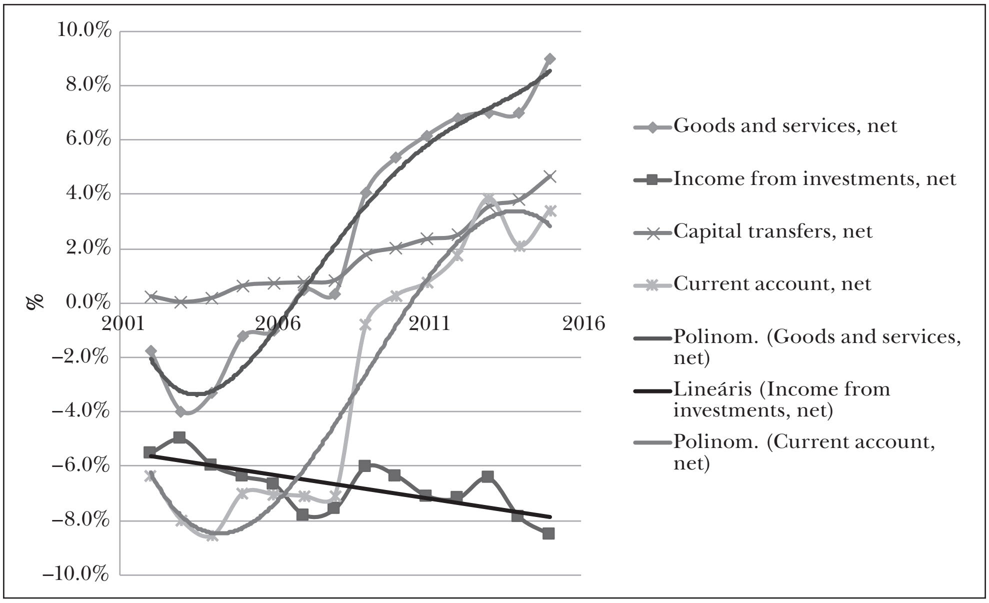
and cyclical external financing of the bank system, backed by foreign parent companies, is highly unfavourable for the economy. The upward and downward cycles were equally increased by that sector. Cycle fluctuations were very high. The sudden fall in external financing in the banking sector already shows that foreign-owned banks are capable of a rapid exodus, and this took place in Hungary. They left a gap in the country's financing (while this is the sector that collects the significant funds saved by the households). As shown below, a considerable part of external financing is done with the mediation of institutions other than the Hungarian bank system. (Note that this is an important task for Hungarian financial regulation and, more specifically, for financing regulation.) Another point that must be remembered is that the central bank and the government intervene in these processes. The series under analysis and the illustration of it also conceal the foreign currency lending crisis. The practical collapse of lending to households would have badly destabilized the financial system (primarily including lender banks) if the National Bank of Hungary and the government had not intervened to moderate this crisis. Among other actions, the MNB provided banks with significant amounts of foreign currency for the conversion of foreign currency loans to forint-based loans.

The figure clearly shows the 4–6 years when the external debt left the previous path. Credit institutions' external debt relative to GDP rose to 30 per cent, unprecedented in an international comparison, and jeopardised the financial system. The state's excessive external indebtedness is shown by the charts: it grew to 20 per cent of GDP and only returned to the 2004 level of about 13 per cent by 2015. In the few years to follow 2012, the salient imbalance in external debt was remedied. Note, however, that in the meantime, its structure was distorted: the ratio of external financing bypassing domestic banks grew. Most of the reduction in the external debt is attributable to households (and to a moderate extent, the corporate sector) cutting a significant ratio of their external debt. In contrast, it increased its savings noticeably. This improved the financial balance, but distorted the structure of financing. In order to correct frozen lending, the National Bank of Hungary launched its Funding for Growth Scheme (FGS) to maintain and promote the flow of funds.

From deficit to surplus – Trends and causes behind the balance of payments and the capital balance

The country's external indebtedness is analysed through the balance of payments between 2002 and 2015. Showing the trend over time, the chart focuses on the main items. This allows two important correlations to stand out: The balance of a country's current account payments (or the trend in its indebtedness) is predominantly determined by the balance of goods and services, as can be seen from the noticeable similarity in the two relevant curves. However, this previous correlation is corrected by another one. The high and increasing amount of income flowing out of the country has become the other cornerstone of the country's indebtedness. The reason is that ever since 2007, the surplus earned on goods and services represents a cut in consumable income. From another perspective, this means that, for instance, in 2015, disregarding other components, 8 per cent of the income generated in the national economy must be withdrawn from domestic use.

Figure 2: Key items in the balance of payments 2002–2015, % of GDP



Source: The authors' compilation

Details of changes suggest the following turning points. By 2007–2009, from the earlier level close to breakeven, the foreign trade balance had improved to a position of forming a real surplus of about 3 per cent of GDP. However, this was not reflected in the figures, as a (5 per cent) decline in the terms of trade between 2005 and 2008 deteriorated the foreign trade balance to GDP by 3.5 per cent. A significant improvement in the external account was seen from mid-2009, when the official data also showed a surplus of around 3 per cent.[6] The foreign trade surplus slightly increased after 2013. This was facilitated by a drop in oil prices to a level close to a decade earlier. Due to the high outflow of capital gains, the current account deficit was still high at that time. By 2011, the current account had reached parity, as, in addition to an improvement in the foreign trade balance, the outflow of incomes fell, the balance of transfers grew, and remittances sent home by people working abroad had increased.

In addition to debt, some improvement in Hungary's (external) financial balance is shown by the aggregate value of the current and the capital accounts. This figure has been showing a considerable surplus for the last three or four years. Since 2010, the aggregate balance of the two accounts mentioned has been positive, with a surplus amounting to a steady 5–8 per cent of GDP since 2013.

PSZ 2017. angol.szam_beliv_v16.indd 127 2017. 04. 06. 7:29:00

The reader might presume that external debt chopping in recent years was facilitated by the high value of EU funds. The majority of EU projects financed massive infrastructure, environmental protection etc. developments; moreover, to a significant extent, they created a market for western companies (e.g., STRABAG). This meant that only a small proportion of the EU funds could be used for debt reduction.

The effects of EU funds granted to facilitate the convergence of the Visegrád countries were analysed by Polish researchers on the basis of questionnaire surveys. According to their conclusions (regarding the whole chain of effects), the EU-15 countries' exports to the Visegrád countries is rising by a value that amounts to 61.5 per cent of the EU funds spent in the Visegrád countries.[7]

A detailed analysis of non-debt liabilities is beyond the scope of this article. It must be noted, however, that their net amounts have fallen moderately since 2009. There are two impacts underlying this decline. One is a slight increase in foreign direct investment. (Its effect relative to GDP is 4 per cent.) The other is the 15 per cent reduction in the value of FDI due to revaluation and other effects. Another important correlation seems to be important in explaining the shrinking credit financing, namely, that the corporate sector financed itself from internal funds at a ratio higher than previously. Their ratio has grown by 10 per cent in the balance sheet total, mainly from arise in the equity ratio.

In order to go further in evaluating the achievements in growing assets within the balance of payments and in cutting external debt, it is worth inquiring to what extent the changes in the individual economic players' behaviour can explain all this. In the rest of this article, the various sectors of the national economy (corporate, household, government, credit institutions and the central banking sector) will be analysed only broadly.

The corporate sector and its divergent financing

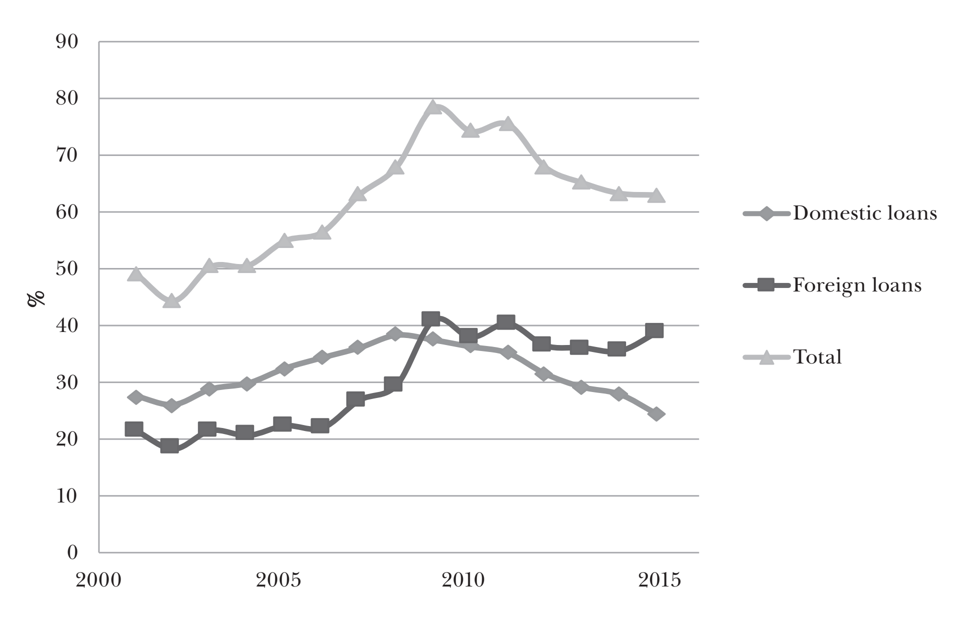
Changes in loans reduced the pace of GDP growth by 1 per cent between 2009 and 2013, and then this effect halved as a result of FGS loans.[8] According to the central bank's experts, in 2015 it was precisely corporate sector loans that remained 6–7 per cent below the trend value. The central bank's experts also claim that nearly half of the total economic growth achieved between 2013 and 2015 was generated by projects financed from FGS loans.

Due to the preceding lending boom, a sharp decline in lending aggravated corporate financing problems. The following figure shows lending cycles.

The figure clearly illustrates the sharp decline in corporate borrowing (Gém, 2011:348). The total quantity of loans dropped to levels before the crisis. Domestic borrowing fell even more sharply: in 2015, it was even below the 2001 level. The ratio of domestic loans to GDP fell from 39 to 25 per cent. The domestic corporate loan portfolio shrank by 25 per cent in nominal terms and 35 per cent at real value. Two-thirds of this loan reduction resulted from the drastic cutback in loans on offer. The net value of proprietary loans also fell.[9]

PSZ 2017. angol.szam_beliv_v16.indd 128 2017. 04. 06. 7:29:00

Figure 3: Up- and downturn in corporate loan portfolios (peak and low in corporate lending)



Source: The authors' compilation

The decrease in the loan portfolio was due to a considerable extent to the fact that the European parent banks withdrew significant amounts from the subsidiary banks operating in the new Member States in two waves (in 2009 and then in 2011), and as a consequence they cut their loans allocated among the new Member States. (This cut was so drastic that even the IMF proposed negotiations to remedy the situation – cf. First Vienna Initiative.)

The drop in lending affected particular economic sectors differently. Slightly more than half of the domestic loans are allocated to SME businesses. In Hungary, the place of borrowing depends primarily on company size. Some 60–80 per cent of large corporations' loans are obtained abroad (even if the owners are Hungarians). On the other hand, small companies take out 80 per cent of their loans from domestic banks (even in the case of non-resident ownership). It follows that the drop in domestic lending primarily affected the SME sector.

Tightening in lending resulted in a peculiar distortion in the corporate sector's structure. It limited both start-ups and the service sector. The reason is that, due to the crisis, banks prefer not to lend to companies with a short history or with insufficient collateral (and most services fit this description). Note that in terms of added value, the ratio of services, a less loan-intensive sector, has increased in comparison with 2009.

In the case of SMEs, the 14 per cent ratio of liquid assets in their balance sheet total exceeds the average (at 10 per cent). Although this helps them to borrow less, it is insufficient for implementing capital investment projects.

PSZ 2017. angol.szam_beliv_v16.indd 129 2017. 04. 06. 7:29:00

Central bank and government strategies to mitigate the downturn

The downturn was moderated by state (government + central bank) measures. *Overall, these are estimated to have improved the corporate sector's income position by about 3 per cent of GDP.* Approximately half of this, i.e., 1.5 per cent, was due to the effect of the currency devaluation in real terms. Export businesses benefited from this in particular as well some producers working for the domestic market. The other half was attributed to income-improving measures taken by the government. These included the following:

– excessive energy prices were cut,

– telecommunication fees were halved,

– the preferential 10 per cent corporate income tax rate is now applicable to a wider circle than previously,

– the sector's net interest expenditure is currently HUF 250 billion less than it was during the crisis,

– a significant cut in employment taxes has also improved profitability.

The position of the corporate sector was further stabilized by a reduction in wage costs, although a slight one, with a parallel increase in the gross operating profit ratio. The situation is similar in expenditures on capital formation. Despite a decline in this ratio relative to GDP in comparison with 2005, the current level is similar to the average of Hungary's neighbours. At 13 per cent of GDP, the corporate sector's investment ratio is around the average of the Visegrád countries (Giday, 2015:184).

EU funds

The use of EU funds increasingly introduces cycles in projects within the individual branches of the competitive sectors. In the years preceding a tender, companies gather strength and collect money (to provide as a contribution), and after tendering, they are engaged in the repayment of loans and in boosting capacity rather than taking out additional significant loans.[10] The past 2–3 years was a period of gathering strength: this is why corporate deposit portfolios have grown.

In 2009–2011, approximately HUF 600 billion in EU funds was available for the development of non-agricultural businesses. In comparison with the value of total investment projects implemented in seven years, this represented an additional source of about 6 per cent. Between 2014 and 2020, approximately HUF 2.5–3 trillion is available for projects to develop the core activities of non-agricultural companies.[11] This amount is already more significant, as the total projects would amount to some HUF 10 trillion implemented by these areas during the seven-year period. For this reason, EU funds may even replace borrowing, especially in respect of the developments foreseen in the next 2–3 years.[12] However, companies must prepare for this financially, as they are required to make significant contributions.

PSZ 2017. angol.szam_beliv_v16.indd 130 2017. 04. 06. 7:29:01

Rocketing household debt and later asset growth; the role of household assets in funding

The term "getting over" in the title is primarily intended to convey the fact that in the past 4–5 years the nation and its actors have made enormous efforts at significantly reducing external indebtedness. We thus wanted to call attention to the heavy price to be paid for external indebtedness not only by the contracting parties, but by the entire national economy, including all its sectors. The "debtor has to pay" approach is insufficient when it comes to indebtedness, as it disregards the fact that in addition to the debtor, his, her or its community (family, village, town or nation) is also involved in the debt community.

In some way or another, the debate that remains open to this day on the heavy price paid for household foreign currency lending concerns this very problem. In any case, it is certain that household foreign currency lending shook the very foundations of the national economy. This is manifest in the high prices the country had to pay to be able to gain access again to non-resident lenders, that is, to the money market. Unfortunately, all of the domestic economic actors should pay this price for a long time to come – although to different extents and through different intermediary systems. The first part of this article described this correlation in macro-economic terms, analysing the external indebtedness of the national economy and its sectors on the basis of their financial positions.

Our analysis of households proceeds from our previous assumption that the increase in household savings has contributed significantly to the reduction of the national economy's indebtedness. In the next section details are provided – primarily in relation to reduction in the external debt – of the specific developments in this sector (as the household also constitutes part of the economy).

Household lending

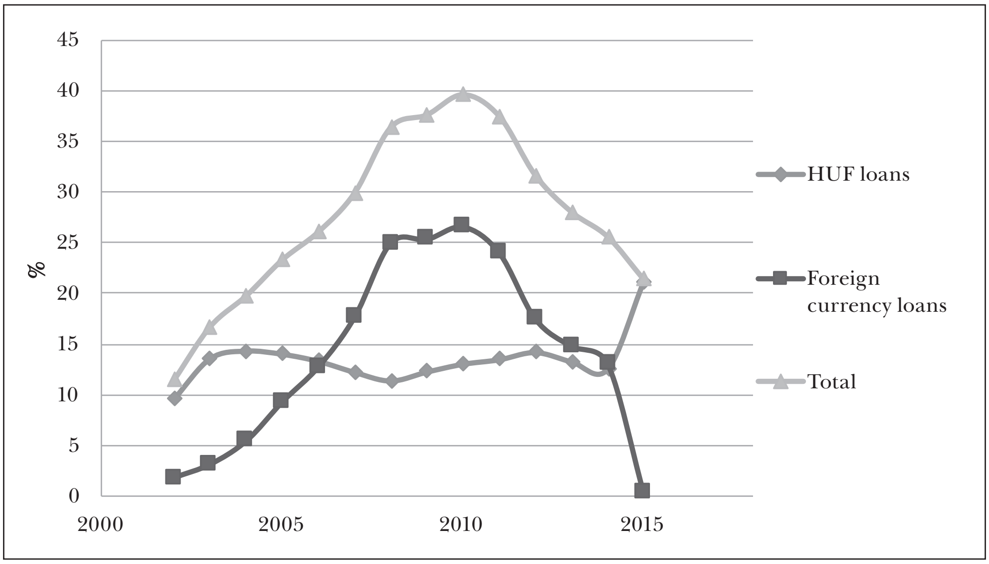
Household borrowing dropped drastically after the crisis. Up to the early 2000s, borrowing in forints was considerably limited by high interest rates and low household incomes. In other words, there were major checks on the financing of household investment projects. This is also manifest in the fact that household lending was extremely low even in an international comparison. Consequently, a kind of "thirst for loans" evolved. This was further aggravated by the increasing outflow of incomes in the early 2000s. On top of this, banks turned aggressively to retail lending. Competitiveness on this market led to a strong credit boom. Foreign-owned subsidiaries encouraged lending to households so impetuously that they even pushed into the background their banking risk and the foreign exchange risk undertaken by the population. Household credit demand was further augmented by the contradictory introduction of forint convertibility and the practically unlimited opening up of the foreign credit market without consideration for the indebtedness of the national economy. This situation was exacerbated by the fact that forint loans allocated at artificially raised interest

PSZ 2017. angol.szam_beliv_v16.indd 131 2017. 04. 06. 7:29:01

rates drove households to foreign currency credits. This kind of lending failed to properly price in external risks (e.g., the exchange rate risk, as a riskier product must be more expensive).

As a result, from the mid-2000s, household borrowing – with the ratio of foreign currency loans rising – started to rocket and then collapsed (Lentner, 2015b:308). The conversion of foreign currency loans to forint loans practically put an end to foreign currency lending. Consequently, these loans dropped to pre-crisis levels as a ratio of GDP. These developments are shown in the following "humpback", or rather "excrescent" diagram.

Figure 4: Household borrowing (HUF, foreign currency and total) as percentage of GDP



Source: The authors' compilation

Approximately 1 million households were granted mortgage loans, affecting 3 million people, nearly one-third of the population. Three-quarters of the affected families had children. Most of them were indebted in foreign currency, primarily in CHF. The average repayment instalments of CHF loans increased from HUF 40,000 in 2008 to HUF 86,000. The ratio of distressed loans had risen to 11 per cent by mid-2011. For this reason, in 2010–2011, banks sold 2 per cent of their foreign currency-denominated mortgage loans (to factoring or debt management companies).

After the crisis, household borrowing dropped drastically. Household loans to GDP still remain at the 2004 level. At least one tenth of debtors found themselves in a severe crisis. Their banks terminated their loan agreements and in many cases took their homes. A small proportion re-rent homes purchased by the appointed asset manager (this is a very low ratio, as this opportunity was only open to the long-term unemployed).

PSZ 2017. angol.szam_beliv_v16.indd 132 2017. 04. 06. 7:29:01

The crisis in the international financial system undermined the Hungarian financial system, which was inappropriately structured to withstand risk. In response, numerous actions were taken to withdraw the previous income growth, and even reverse it. Household incomes declined – due partly to a drop in real wages and partly to higher unemployment. 13th-month benefits granted by the government (to pensioners and public and civil servants) were terminated in 2009. Value added tax was raised by 5 per cent (2009). In 2011, private pension fund yields were paid off, and from 2012 VAT was further increased by 2 percentage points. Wages and salaries were heavily taxed. In 2008, 55 per cent was deducted from wages on average, and the tax margin was a conspicuously high 65–75 per cent.

In addition to approximately doubled debt service, incomes were burdened by utility fee hikes affecting all layers of society. This is shown by the fact that one million households were late in paying utility fees, several times the number of defaulting foreign currency loan debtors.

As a result, household consumer expenditure dropped significantly, as shown by the fact that it is only expected to return to the pre-crisis level (2007) in 2017. The value of household investments dropped to half. The situation is even less favourable in household home investments. Their current value (1.4 per cent of GDP) is merely a third or fourth of the value recorded before the crisis. As a consequence, a considerably higher ratio of incomes is spent on savings, in response to the lending shock experience and due to postponed investments. Some of these savings are actually made under the pressure of circumstances; indeed, households enjoy a smaller share of their income. An even more serious problem includes the long-term effects of a drop in investments. Housing difficulties have an adverse impact on the birth rate and the construction industry, which is driven by domestic demand, as well as causing shrinkage in the domestic market, which in turn limits SME sector growth.

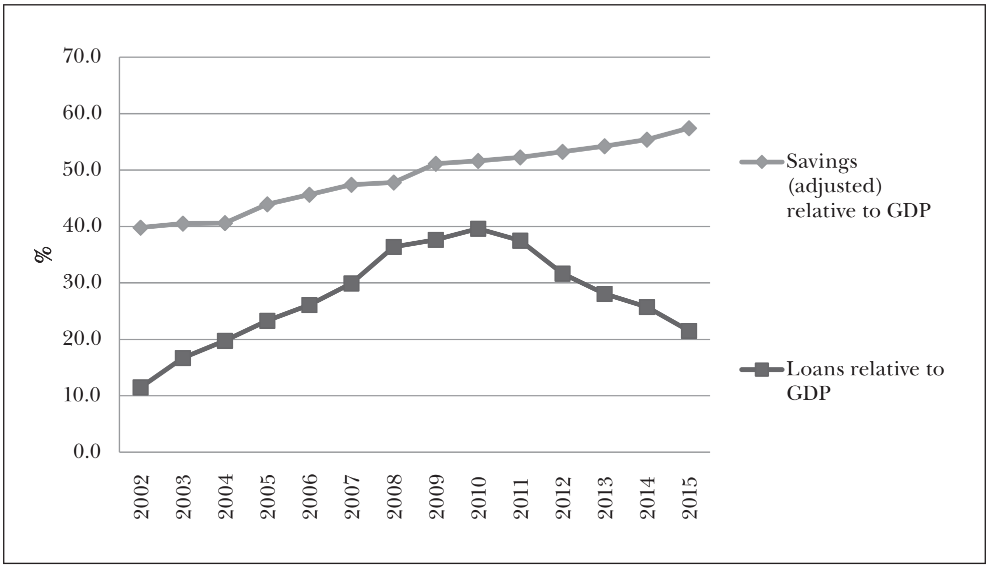
Household savings

As a result of the crisis, household savings rose considerably after 2009. The annual growth in household savings amounts to 4–5 per cent of GDP.[13] Initially, it was deposits that increased, and then it was the amounts placed in investment funds and government securities. In addition, assets held by the household sector in businesses also rose significantly. A propensity to save grew considerably: in seven years, the growth in net savings among the population came to 19 per cent of GDP.

The flat-rate personal income tax presumably contributed to the surge in savings. The tax regime put the social stratum that could be expected to save considerable amounts from its surplus income in a favourable position. Others also needed to start saving well in advance if they planned major spending (on a home or car). They did not seem to have access to loans with acceptable conditions within a few years.

The following figure compares borrowing to savings to show the weight of households in the stabilization of the national economy.

Figure 5: Household savings and loans as percentage of GDP. Adjusted for nationalized private pension funds (not included) after 2011



Source: The authors' compilation

In comparison with 2001, gross household savings increased by 20 percentage points (from 47 to 67 per cent of GDP). In comparison with the borrowing peak (2010), household borrowing relative to GDP fell by nearly 20 percentage points. (It would be worth analysing the current position of household lending separately with and without revaluations in comparison from a deep level of 2001 to 2015.) As a result of all this, as mentioned above, household investments, and especially housing investments, will have difficulty rising beyond their historical low.

The weight of loan-intensive car purchases within household spending has decreased considerably. The effect hit the home sector even harder. Home building fell one quarter of its previous value, and the number of home purchases dropped by 40 per cent. While two-thirds of the purchase price was previously covered by loans, by now this ratio is one-third at the most, and purely cash purchases are frequent. The fact that home renovation activity has declined even more represents a mass phenomenon. Overall, shrinking credit brought about a significant postponement in purchases of higher-value goods.

Thus, forcing down the indebtedness of the national economy entailed a kind of *"forced" household savings.* Note, however, that a development in household income closely correlates with external debt service. Such household savings are favourable for financing the national economy, as debt service has a price. And this price must be paid not only by the individual parties, but also by the whole national economy. Not to mention the negative effects on the future generation caused by lost investments. As shown in our previous analysis of the financial position of the various sectors of

PSZ 2017. angol.szam_beliv_v16.indd 134 2017. 04. 06. 7:29:01

the national economy, household savings finance the external debt of the national economy, which is in a grave situation.

After the crisis, the situation was further aggravated by the pre-2000 decline in household real incomes. In Hungary, real wages only reached the levels recorded before the regime change in 2004, and if the numerous fringe benefits paid in the 1980s are also taken into consideration (free kindergarten and crèche, employer's home purchase subsidy etc.), then the 1988 level was only reached in 2005 or 2006. The purchase value of wages paid in Hungary was only half of those recorded in more advanced countries in our region (and no more than a third or quarter at foreign exchange value) in the decade that started in 2000.However, the situation must also be considered from the perspective that the ratio of wages and similar incomes to GDP amounts to half of GDP, just as in other countries in the region (while this ratio is around 60 per cent in the old Member States of the EU). This is increased by the non-wage incomes of sole traders, classified as part of the household sector.

In any case, it is true that in the course of the crisis, the weight of the burdens put on households – to consolidate the national economy – is even greater if the developments of its incomes and savings are taken into consideration in comparison with the unfavourable processes of the years before the crisis.

Households as the stabilizers of the national economy

A decline in household income – aggravated by an increase in unemployment – was a kind of an emergency reaction to external indebtedness that jeopardised national sovereignty. Remember that the country's gross debt significantly exceeded even GDP. As a result, the country's national assets were at risk with the impending consequence of forced privatization, depreciation of household assets, insecure finance ability of the institutional network etc. In an international comparison, the structure of the banking system was severely vulnerable. Essentially, banks violated numerous lending rules (the ratio of deposits to loans, pricing risks in loans, the riskiness of financing their external debt etc.) (Lentner, 2015a:308). In addition, the central bank had an extremely low[14] level of reserves to secure lending against risks. This situation was further worsened by the fact that, as mentioned above, foreign parent banks withdrew huge amounts from their subsidiaries operating in new EU Member States, including Hungary, in order to stabilize their shortage of funds.

The drastic cut in household resources, which was a prompt reaction to consolidate the country's external debt crisis, must be considered in this context, even though it deserves criticism in several respects. In this study, we did not analyse how much a cut in household incomes may be harmful. An income decrease may contribute to additional income decreases, thus becoming a kind of vicious circle. This is because household consumption and investment (whether human or physical) are integral parts of the economy. Any "cut" in them may cause serious losses for the economy, which should rather increase its resources instead of reducing them on account of indebtedness. After 2010, Hungary was seeking a way out of this vi-

PSZ 2017. angol.szam_beliv_v16.indd 135 2017. 04. 06. 7:29:01

cious circle. Actions taken after 2010 to stabilize the position of households (and the financial system, which was in crisis) can only be comprehended in this grave historical situation. Any action to boost household income had to be taken with extreme caution. The heavy debt service caused by external indebtedness did not allow a significant adjustment in the use of the internal income. In addition, banks were not interested in retail lending either. Actions aiming to ease the situation of banks (funding them with "cheap" low-risk money) have still not prompted riskier investments in the real economy recently.

Actions to stabilize household income and assets

Without an analysis, a list of the actions taken is provided. Analyses would certainly add more detail to the point. However, even without an analysis, we think that the actions listed served to stabilize household burdens and improve the financial potential of households, as a business unit of the economy, for example, to moderately encourage investment, which had been frozen. What is even more important, a definite impetus can be seen in perhaps the most important area of household "investments": demographic investments (i.e., having children), especially in the interest of the generation that will become productive in the future and thus in order to stabilize the pension system. The most significant ones included the following.

In 2013, the institution termed the "exchange rate cap" was introduced as a first step towards the conversion of foreign currency loans to forint loans. In 2015, the complete portfolio of foreign currency loans (including car loans) was converted to forint loans. As a result of the 2015 conversion of foreign currency loans to forint loans, the principal loan debt decreased by 16 per cent. Together with the limitation on interest rates exceeding the benchmark, this resulted in a 20–25 per cent reduction in repayment burdens. Many debtors sold their home and bought another one (a smaller one or one located in worse surroundings) to repay their loans. Despite such a grave debt situation, the majority of borrowers kept paying their loans (by the dates due) at great cost.

Household indebtedness fell to nearly half of the value recorded in 2008 primarily as a result of repaying mortgage loans. As a ratio of GDP, the reduction was 16 percentage points.

From 2013, community work was considerably expanded.

The flat-rate income tax from 2012 provided households with a significant amount of income. This had two impacts worth mentioning. First, families without children in the top fifth of the population received a surplus of about HUF 300 billion. Second, families with children retained about HUF 150 billion per annum.[15]

The tax regime was specifically rounded out with job protection action plan benefits (Giday, 2013:407) and wage rises to offset tax hikes.[16]

Mention must also be made of the chain of effects brought on by oil prices, followed by a drop in prices, which resulted in falling fuel prices and actions taken to push down overhead costs.

PSZ 2017. angol.szam_beliv_v16.indd 136 2017. 04. 06. 7:29:01

Loan repayments required 4–6 per cent of household income per annum (representing 2–3 per cent of GDP, or 12–14 per cent in six years).

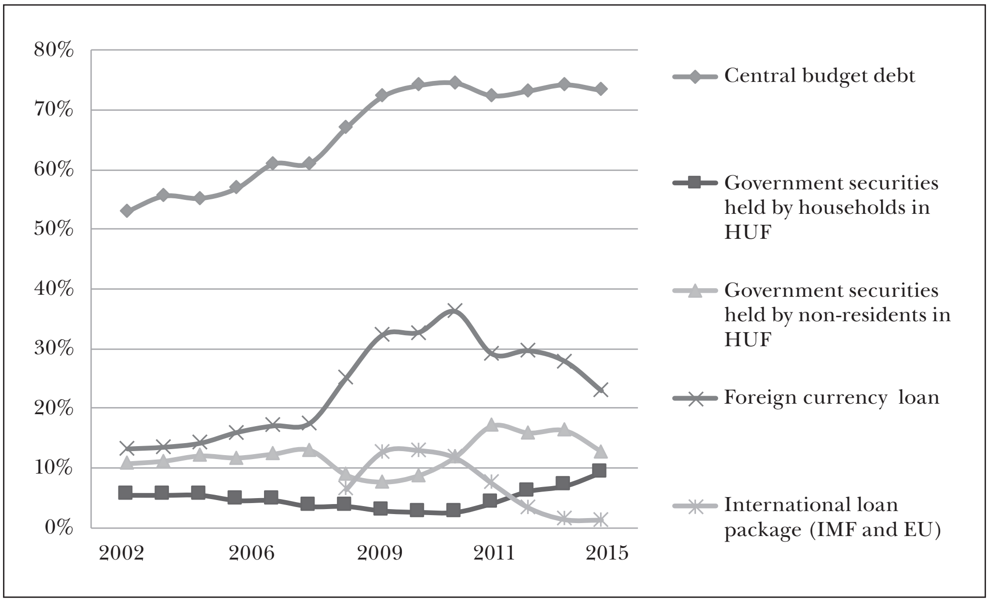
It was neither a government action nor a market development, but ensued from an EU regulation that the opportunity to find employment in any EU Member State has been available from 2011, resulting in several hundred thousand Hungarians finding jobs in more developed countries.

Finally, but among the first in significance, actions taken to mitigate the burdens of families who raise children must be noted. These were implemented partly by reducing related costs and partly through supporting housing investments (continued payment of the child home care allowance if the mother found employment, increased tax benefits for families with two children, housing investment subsidies paid for children, and the high benefit for establishing a family home, the so-called “CSOK”).

Public debt and its restructuring

The following figure plots the central budget debt and some of its components.

Figure 6: Central budget debt and its components as percentage of GDP, 2002–2015



Source: The authors’ compilation

The peak in the central budget deficit after 2007 is explained if general budget spending is analysed together with spending by the other sectors. Overspending by all the sectors in the national economy and the cumulative external indebtedness resulting from financing such overspending can be seen together in this general budget debt peak.

PSZ 2017. angol.szam_beliv_v16.indd 137 2017. 04. 06. 7:29:01

Firstly, let us analyse general government spending alone. From mid-2002, following up on their 2002 election promises, the government went into chronic overspending, causing a high deficit.[17] The 13th-month pension payment and the 50 per cent rise in wages for civil and public servants drove government debt relative to GDP from 52 to 69 per cent in five years (Giday, 2013:288).

The government paid high interest (4–4.5 per cent of GDP). Although the year 2006 saw a tightening, 90 per cent of this tightening was based on tax hikes instead of remedying the root cause and cutting spending (Kovács, 2014:350). In addition, the surge in the oil price, which offset a significant portion of the positive effect of the foreign trade balance, was not anticipated. As the remaining strategic state-owned properties (MOL, the natural gas industry and Postabank) were sold, there was insufficient Hungarian power to counterbalance foreign interests. In this respect, the following items may be highlighted in government spending:

– The value of government investment projects was also high (in excess of 4 per cent of GDP per annum).

– Local governments borrowed huge amounts in foreign currency (by 2009, this portfolio had exceeded 4 per cent of GDP) (Lentner, 2014:339).

– A significant ratio of constructions was implemented in a PPP scheme (Báger, 2015:159), disregarding the fact that this was far more expensive than any other source of funding.

An analysis of government indebtedness does not in and of itself explain the debt peak after 2007. *The reason is that the government, under attack by speculative forces, was the sovereign institution that took out the rescue loan from the IMF–EU in 2008 for the purpose of stabilizing not only the position of public finances, but also the external financial position of the national economy.* (See our previous analyses of the external debt of the whole national economy (private included), which must ultimately be secured by the sovereign state.)As a consequence, a *financial emergency evolved in Hungary in 2008* because central bank reserves were insufficient to securely cover the unrestricted gross external debt (which increased to 110 per cent of GDP). Speculators exploited the situation, and Hungary was not provided any loans to honour its maturing payment liabilities. Everyone remains silent about the fact that in 2008–2009, it was not only households and corporations that were heavily burdened by the foreign currency debt crisis, but also the Hungarian national economy. For this reason, the government as a national income holder had to intervene and apply for an international loan to prevent the country's insolvency.

The figure below illustrates the trends in the government debt. The wave in the curve of government debt was due, for the most part, to the foreign currency debt owed to international institutions (from loans taken out by the government from international institutions to top up foreign currency reserves).

The figure also shows a subsequent development. In 2010, the new government assumed the responsibility of repaying the IMF–EU foreign currency loan which had been taken out because of the crisis. Funds were raised on the domestic market for this purpose. As the outcome shows, despite sharp criticism in the Hungarian busi-

PSZ 2017. angol.szam_beliv_v16.indd 138 2017. 04. 06. 7:29:01

ness media, the government was capable of achieving this goal. The fact that the foreign currency lending crisis compelled households to save significant amounts was of great assistance. In targeted steps, the government increasingly used these savings to finance its debt. The chart illustrates that parallel with a decrease in government debt denominated in foreign currency and non-residents' forint debt in government securities (for the most part, due to repayment of the IMF–EU loan), households increased their purchase of government securities. A reduction in forint-denominated government securities held by non-residents relieves the country of the double risk of this type of lending. The chart clearly shows the gradual restructuring of financing in government debt and the return to money market financing (Bánfi–Bánfi–Bánfi, 2013:220). As a result of these changes, a significant reduction was seen in the government debt denominated in foreign currency (to 24 per cent by 2015), and the ratio of forint-denominated government debt owed to non-residents also dropped considerably (Barcza, 2015:452). At the moment, the latter only slightly exceeds government securities held by Hungarian households.

All this shows that government debt restructuring according to the active financing logic noted above was successful. It is also worth mentioning that the interest incomes paid to households are not taken out of the country and so they raise domestic consumption. Thus, it was possible to transform the interest income flowing out of the national economy before (negative liability) into two types of positive financing (domestic income and domestic consumption).

Since the restart of economic growth, the gross government debt has been falling by an annual average of 1 per cent of GDP (Domokos–Pulay–Pető–Pongrácz, 2015:441). The drop in the government debt and its financing has considerably reduced the interest paid to the rest of the world. As a result, the interest relative to GDP fell by 1.4 percentage points between 2014 and 2017.

After six years of chronic deficit-making, the Hungarian government has been strictly adhering to the 3 per cent deficit limit since 2011. Its income has been fundamentally restructured for two reasons. One of them is the profound change in the tax regime: consumer taxes have been increased considerably, while employment taxes have been cut. The other reason is that with an upturn in the EU's convergence programmes, EU transfers also grew and represent a significant ratio in incomes. On the expenditure side, a major change included the use of EU funds, representing cyclically fluctuating amounts. As the majority of funds transferred for convergence were spent on fulfilling government duties in the 2007–2013 period, government projects had (temporarily) nearly doubled by the period between 2012 and 2015.[18]

Due to the fact that the deficit remained below the 3 per cent limit, the primary balance had a surplus of about 1 per cent per annum in the past few years. In other words, the government's overall spending was less than its incomes, and this itself had a restrictive effect on the economy. The situation is somewhat eased by now because interest expenditures are falling. Thus, an annual 0–0.5 per cent primary balance will be sufficient to achieve a 2–2.5 per cent deficit, and this effect will boost growth slightly.

PSZ 2017. angol.szam_beliv_v16.indd 139 2017. 04. 06. 7:29:01

The central bank and its funding philosophy

After the autumn of 2001, when the central bank extended the exchange rate band, assertive speculative flows of funds permanently appreciated the forint, significantly increasing the trade deficit. Thus, the chronic current account deficit grew further. The current account deficit, an indicator of a country's external indebtedness, fluctuated around 7–8 per cent of GDP for several years. The central bank's forint appreciation policy indirectly contributed to raising external indebtedness. Simultaneously, the central bank also enlarged Hungary's foreign currency exposure with its failure to prevent the spread of foreign currency lending. As a result, by the autumn of 2008, it had turned out that the central bank was unable to attend to its duty to protect the legal tender. In the course of a speculative attack, the central bank had to increase the foreign currency reserve to a considerably higher level. To provide initial assistance, the government allocated the loan borrowed from the IMF–EU to the central bank in the autumn of 2008. However, repayment of this loan required repeated amounts of foreign currency, and the central bank obtained them from commercial banks (through bond issues, paying additional interest).

The central bank's criticism of the government's overspending fell on deaf ears. In this situation, the central bank employed interest rate hikes again and again, increasing the interest burden as well as inflationary expectations, but it failed to address the root causes (i.e., government overspending and external indebtedness).

From 2012 on, the central bank gradually lowered the base rate in small steps from 7 to 0.9 per cent by 2016 (Dedák, 2013:87). In addition, with scheduled government security purchases and the low interest rates on FGS loans, it managed to reduce interest rates (gradually but definitively)in the domestic markets: in government securities, in corporate loans, and – following the conversion of foreign currency loans to forint loans – in household mortgage loans as well.

The period between 2009 and 2012 can be viewed as a time of "internal depreciation". Due to foreign currency loan debtors' shaken position, the government refused to undertake major forint depreciation.

Following the conversion of foreign currency loans to forint loans, foreign currency reserves were decreased in 2015–2016, and thus funds were released to stabilize the financial system and boost financing.

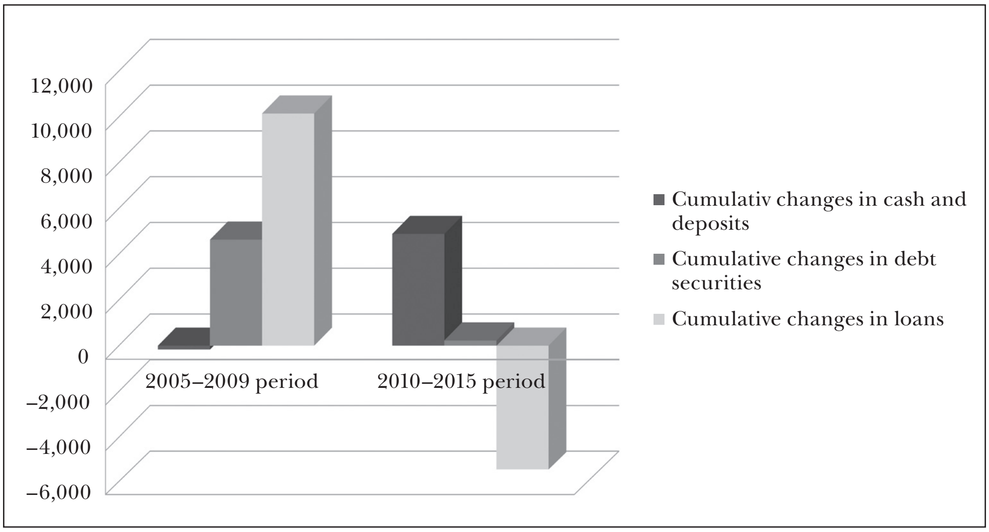
Currently, the central bank is taking the initiative to create a "bad bank" to help commercial banks get rid of their distressed corporate loan portfolios.

In 2013, the central bank announced the Funding for Growth Scheme to halt the shrinkage of lending to the SME sector.

The following figure contains a striking illustration of how badly this was needed. This is manifest in the fact that between 2010 and 2015, credit institutions increased their deposit portfolios instead of attending to their duty, i.e., supplying the economy with financial instruments (the rise in household deposits provided them with resources to this end).

PSZ 2017. angol.szam_beliv_v16.indd 140 2017. 04. 06. 7:29:01

Figure 7: Comparison of cumulative changes in finantial institutions lending activity in two successive periods (2005–2009 and 2010–2015) (HUF billions)



Source: The authors' compilation

Restructuring Swiss franc loans

Banks reacted to the fall of Swiss franc interest rates in a way diametrically opposed to the norm: instead of decreasing their interest rates, they increased them, and the Annual Percentage Rate in Swiss francs grew to 7–8 per cent. The other shock was caused by the 25 per cent appreciation of the Swiss franc in 2011. The extra profit realised on these loans is characterised by the central bank's analysis, which shows that the banks' estimated cost of funds for Swiss franc mortgage loans was 2 per cent, but they transferred these loans to households at 8–9 per cent APR between 2010 and 2014.[19] This means that the banks imposed an extra margin on debtors, who were also required to pay the exchange rate risk. In reaction to this, at the end of 2011, the government left a short period open for prepayment at an exchange rate that was more favourable than the market rate. This was a solution for one-fourth of the debtors in the crisis situation. Prepayment reduced the household mortgage loan portfolio by a quarter. Although this caused losses for certain banks, financial stability improved through the reduction of credit institutions' external indebtedness. Naturally, the fact that the sector was deprived of its better performing debtors is another issue.

In 2013, the "exchange rate cap" was introduced in coordination with the banks and the central bank. This was the first step towards the conversion of foreign currency loans to forint loans, and, naturally, two-thirds of the performing debtors registered for it. As a first step in the conversion of loans denominated in foreign currencies, the exchange rate of the Swiss franc used for conversion was fixed in 2014. In retrospect, this proved to be the right decision, as debtors were thus protected against another

PSZ 2017. angol.szam_beliv_v16.indd 141 2017. 04. 06. 7:29:02

strengthening of the Swiss franc (which actually struck like lightning by 20 per cent in early 2015). In 2015, the complete portfolio of foreign currency loans (including car loans) was converted to forint loans.[20]

The central bank assisted first in the elaboration of the exchange rate cap and then in the conversion of foreign currency-based household loans to forint loans. Following the conversion of foreign currency loans to forint loans, the central bank reduced the foreign currency reserve in 2015–2016, thus creating the opportunity to grant long-term loans to commercial banks to enable them to steadily finance foreign currency loans converted to forint loans.[21] The funds thus becoming available at banks were tapped to finance government securities.

As households' foreign currency risk fell with prepayment and the exchange rate cap, financial and monetary policy was no longer a captive of the exchange rate after 2013. This facilitated the central bank's enforcement of an increasingly active financing approach in its monetary policy.

How did we manage to pull ourselves out of indebtedness "by our own bootstraps"?

It is a fact that growth resumed despite heavy debt reduction. This can only be understood in light of the changes implemented by economic policy makers after 2010. A detailed analysis of the programmes listed is beyond the scope of this article. As emphasised above in a different context, we consider it important to note that the factors listed contributed to the significant improvement in the trade balance of the national economy. The factors determining financing in the national economy underwent changes. This played a role in the increase in the national economy's financial assets (Lentner, 2015a:463), which helped to reduce the national economy's debt towards the rest of the world. As discussed in the first part of this article, the gross external indebtedness of the national economy fell from 110 to 68 per cent of GDP, in other words, by 40 percentage points in five years, or 8 percentage points per annum.

The most important actions taken to improve economy financing:

1. Coordination between the central bank and the government
2. Radical change in the tax regime
3. Dismantling the private pension fund scheme
4. Levying taxes on and curbing monopoly profits
5. Restructuring Swiss franc loans

In our opinion, the key element in the simultaneous restart of growth and debt reduction was that the synergic impacts between the steps above created qualitatively new forms of conduct and financing relationships.

– The government and the central bank acted in concert to involve increasing household savings in domestic financing, where appropriate, in financing the government debt. With a larger share of the general government debt financed from household funds, more national assets remain in Hungary. This approach was applied in financing the government budget, and more specifically, the government debt.

PSZ 2017. angol.szam_beliv_v16.indd 142 2017. 04. 06. 7:29:02

– Thus, in 2013, a more intensive rising of funds from households in forints was announced. In three years, the government securities held by households rose from HUF 900 billion to HUF 4.3trillion. In 2012–2013, the central budget assumed the local governments' foreign currency debt in the amount of HUF 1.3 trillion, thus reducing external vulnerability (Lentner, 2015a:308).

– The central bank's Self-Financing Programme was a radical change (Kolozsi–Hoffmann, 2016:15). The central bank used this programme to redirect a high ratio of the funds placed by commercial banks with the central bank to finance the forint ratio in the government debt. As a result of these changes, a significant reduction was seen in the government debt denominated in foreign currency (to 24 per cent by 2015), and the ratio of government debt owed to non-residents as part of the forint-denominated debt also dropped considerably.

– The aim of the central bank's self-financing programme launched in 2014 was to reduce Hungary's external vulnerability. With the transformation of the central bank's monetary policy instruments, the central bank stimulated banks to go through an adjustment. The banks realigned significant sources from the central bank's instruments into government securities. In the last two years, the stock of banks' government securities increased by more than HUF 2.2 trillion, and according to the international investment community, the Hungarian economy has become more resistant to external shocks.

– In 2013, the central bank announced the Funding for Growth Scheme to halt the shrinkage in lending to the SME sector. The amount allocated was HUF 2.5 trillion, representing 8 per cent of GDP.

As the inflation rate fell, the amount of cash retained by households increased, currently amounting to 12 per cent of GDP (Novák–Vámos, 2014:540).

– This is 1.5 times the usual 8 per cent. This means additional resources placed at the central bank, which is channelled back into the domestic economy (see FGS) like oil for this driving engine.

– The aim of implementing a drastic change in the tax regime was to boost economic growth and to provide tax benefits to depressed sectors that are lagging behind in GDP generation. The majority of industry-specific taxes were converted to consumer taxes.

– Levying taxes on and cutting monopoly profits. (For example, industrial electricity and natural gas prices exceeded those used in the Visegrád states by 20 per cent before 2009.)

– Financing the external debt from withdrawn pension fund assets, and the purchase of state assets in strategic sectors (in banks and energy).

– Managing the foreign currency debt crisis with central banking instruments (halving household debt).

– In the past few years, the grey (semi-legal) economy has started to whiten. This is suggested by a State Audit Office report, which establishes that a rise in VAT payments has exceeded the turnover increase in the past 2–3 years, and thus the annual tax surplus amounts to 0.95 per cent of GDP. According to a study conducted for the

PSZ 2017. angol.szam_beliv_v16.indd 143 2017. 04. 06. 7:29:02

central bank's Fiscal Council, the ratio of the hidden economy fell by 2 percentage points between 2010 and 2014.[22]

Changes in labour taxes and household transfers between 2011 and 2012 might add 2 and 1.5–2 per cent to GDP growth, respectively, because of a change in working behaviour. This is shown by a micro-simulation model (Baksay–Csomós, 2014).

Conclusion – Funding as a key for the past and the future

Both economics training and public thinking fail to recognise that in a globalized world the rest of the world is an important sector in the Hungarian national economy. In the case of indebtedness, the rest of the world has a claim and the nation as a whole owes a debt. The "debtor has to pay" logic fails to reveal macro-economic correlations. This is because on a macro-economic level, the national economy as a whole and its institutions constitute a debt community vis-à-vis the rest of the world. Thus, the excessive external indebtedness of the government and the corporate sector as part of the national economy is covered by those with accumulated domestic assets. For this reason, they are in a position to pay the price of reducing debt first through the reduction of their income and/or by saving an increasing ratio of their income. In case the regulatory environment channels savings to domestic financing, the internal resources can generate more income. And this promotes its growth. The latter represents the logic of active financing over that of passive financing. The 30-percentage-point drop in the external debt to GDP in four years was allowed by a shift to active financing. This represents the recognition that domestic financing should also be managed like the domestic market. The external debt could only be reduced through a significant increase in household savings and the use of financial instruments inactivating domestic resources. Reduction was achieved with interest rate cuts and the central bank's Self-Financing Programme known as Funding for Growth Scheme and by a targeted multi-faceted government programme to stabilize household incomes. (This included programmes aimed at stabilizing the position of debtors in Swiss francs, the moderation of the income-draining effect of monopoly profits, tax and employment policy programmes, aimed at aiding families and increasing the birth rate etc.).

Such an operation was required after the 2008 crises, which consisted not only of cutting expenditures, but also measures to help the system to recover. What does this mean? Prior to the 2008 financial crisis, a cyclical peak developed on the country's debt curve. Foreign-owned Hungarian subsidiary banks made a considerable contribution to this cycle: in the upward period of the cycle with a massive encouragement of borrowing (from external resources), and then in the downward period with the withdrawal of external funds and a lending freeze. Private indebtedness to the rest of the world in the upward phase of the cycle even exceeded government debt. Although the central bank made efforts to check such pro-cyclical budget financing around the mid-2000s, at the same time it also contributed to external indebtedness. It failed to

PSZ 2017. angol.szam_beliv_v16.indd 144 2017. 04. 06. 7:29:02

provide sufficient coverage for the alarming size of indebtedness, either by topping up central bank reserves or by regulating collateral for banks' foreign debt. *As a consequence, an emergency situation developed in Hungary's external financing.*

Developments in external indebtedness clearly show that external financing must be managed on the level of the national economy as a whole. This is because the way external resources are linked to internal income generation is also important. If domestic connections are inefficient, then just as in a poorly built electrical network, a significant part of the power (in our case, external resources) may be lost. If connections are good, power may increase. This is what, in general, financing is about. Thus, the fundamental question in the external financing of the national economy is the creation of appropriate domestic connections. In other words, financing should drive domestic income generation and should not trigger financing of economic cycles. If this is not done, external financing results, sooner or later, in using up domestic assets, whether physical or human. For instance, cheap wage labour attracting foreign money (capital) also finances external debt service to the detriment of domestic human resources.

This study calls attention to the previous gross errors made in the external financing of the Hungarian national economy as a whole, without questioning the responsibility of the individual participants in external indebtedness. Our main purpose was to demonstrate as well that Hungary does have significant domestic resources that can be used in financing. The active financing approach, which gained ground after 2010, placed the emphasis on raising domestic resources for funding as opposed to external indebtedness. The Government Debt Management Agency and the National Bank of Hungary have provided numerous examples of the successful tapping of domestic resources. Partly as a forced outcome of the foreign currency crisis, household savings have made it possible to reduce the external debt. These savings are major resources, which have also appeared in corporate financing, but only the initial steps have been taken in this area.

In light of this, the question arose whether the financing of the national economy has improved recently. The answer is yes. This explains why domestic income generation and its proper use have managed to boost growth despite a severe reduction in external resources.

Coverage for the excessive external indebtedness of the government and the corporate sector is provided by households in the last resort with its significant financial and real assets. It follows from this that the population may be the main sector in financing to reduce the external debt. This can be done passively, by merely "cutting" incomes, as well as actively. The latter constitutes an operation which repairs the financial system while operating. In this context, the article differentiates passive financing (requisition of funds to fill the holes) and active financing (redirecting domestic funds towards domestic financing). An analysis of the developments from this perspective revealed that the change of economic policy approach after 2010 brought about major changes in the financing of the national economy. A demonstrative step in this process was the prepayment of the IMF–EU credit package and the simultane-

PSZ 2017. angol.szam_beliv_v16.indd 145 2017. 04. 06. 7:29:02

ous adoption of an economic policy relying on domestic resources. This change of attitude is a logical continuation of the shift in approach that put the development of domestic markets into the foreground of economic policy. In our analyses, we revealed that the focus has shifted to domestic funding.

Note that the primary and urgent task after the crises was to heal bad wounds caused by the debt crash. The financial position of the Hungarian national economy shows many positive processes. Nevertheless, its position remains partly vulnerable. This suggests that there is a great deal still to be done to turn the flow of domestic financial funds into a growth stimulus instead of a mere recovery. The upturn in household consumption is a good sign; however, this is "only" indicative of the fact that it will soon (in 2017) reach the pre-crisis level. Corporate lending, in other words, raising corporate funds via financing instruments, is still anaemic. The weight of household savings shows that we have a foundation on which to build. The government budget is not the only area in which this domestic resource may be mobilized to do effective finance; the SME sector may also be funded, and far better, more securely and cheaply than currently. Each tiny step taken by the central bank in this direction, i.e., towards a kind of non-bank lending, would presumably boost domestic financing resources significantly, for example, by providing guarantees for lending between corporations. In light of the above, one might ask: "Does the Munchausen effect work after all?" In response to the shock caused by the indebtedness crisis, self-healing mechanisms kicked into action with help from the central bank and the government. But in the area of autonomous financing of domestic corporations, there is much to be done.

Notes

1 This study has been conducted within the framework of the Wekerle Sándor Scientific Workshop of Public Finances – National University of Public Service, Institute for Public Finances.

2 This research will continue within the framework of the project above, under the following title: Who Finances Whom, or Who Pays in the End? – What do the Financial Accounts of the National Economy Suggest? (forthcoming in the next issue of *Polgári Szemle*) by András Giday and Szilvia Szegő.

3 A fair glimpse of this economic policy debate is offered in the "Exchange of Views" column in *Pénzügyi Szemle*, vol. 1, 2007 (essays by Péter Mihályi, István Csillag and György Szakolczai). The dramatic acceleration of external indebtedness is, however, not hinted at in the debate.

4 In a debate aired on Radio Kossuth, economist György Surányi called attention to the fact that through foreign currency lending operations, authorities were compelled to involve the population in the financing of the country's disastrous external debt ("Ütköző" with Péter Róna and György Surányi, Radio Kossuth, 12 June 2014).

5 When we speak of a country's indebtedness, practically everybody thinks of the government budget. The external indebtedness of a national economy is not even a part of everyday conversation. And even more importantly, the concepts and the statistical system of external indebtedness are neither sufficiently comprehensible nor unequivocal.

6 This was mildly facilitated by falling oil prices. If completely adjusted for a decline in the terms of trade, the 2009 foreign trade surplus would have been around 5 per cent.

7 *Evaluation of benefits to the EU-15 countries resulting from the implementation of the Cohesion Policy.* No. 28, IBS, Warsaw, 2011, 172, http://ibs.org.pl/app/uploads/2016/07/IBS_Report_01_2011.pdf.

PSZ 2017. angol.szam_beliv_v16.indd 146 2017. 04. 06. 7:29:02

[8] Prior to 2008, it had the opposite effect: GDP growth increased by 1–1.5 per cent per annum driven by a rapid growth in domestic lending.

[9] The gross value of the latter fell from 16 to 10 per cent, and their net portfolio (from 8 per cent) to 4 per cent of GDP.

[10] In general, they apply for tenders with basic improvements not requiring rapid decisions and implementation (site expansion, replacement of 1–2 pieces of basic machinery etc.). If in contrast, market expansion requires the rapid installation of a new machine, they usually do not rely on slow grants, for fear of losing a market opportunity.

[11] Tender invitations are expected for 30 per cent of HUF 9000 EU funds (GOP, ROP etc. tenders) in manufacturing, tourism and logistics.

[12] This is because the government intends to commit most of the funds and distribute the majority of them in the period between 2016 and 2018.

[13] This represents 8 per cent of household income (such high values were unprecedented in any single year in the period between 2002 and 2008).

[14] Zsuzsa Mosolygó, lead economist at the Government Debt Management Agency, named the insufficiency of the MNB's foreign currency reserves (in comparison with the sovereign risk) as one of the root causes of the crisis in the discussion entitled "Original Signs – Hungary and the Financial Crisis". Ultimately, this was the factor that led to the EUR 20 billion loan being taken out from the IMF, the European Commission and the World Bank (Portfolio.hu internet portal, 18 November 2008).

[15] After minor modifications, this amount currently comes to HUF 230 billion per annum.

[16] The latter is called an "expected" wage rise for those who earn less than HUF 230,000 per month (see Svraka–Szabó–Hudecz, 2013:401).

[17] The deficit relative to GDP was 8 per cent of GDP on average between 2002 and 2006.

[18] A kind of division of labour can also be seen here, just as in the case of companies. The EU finances large and very costly development projects, like railway modernization, underground construction etc., while renovations and minor investments are financed by local governments or the central budget.

[19] MNB Report on Financial Stability, November 2013, 47.

[20] As a result of the 2015 conversion of foreign currency loans to forint loans, the principal loan debt decreased by 16 percent on average. Together with the limitation on interest rates exceeding the benchmark, this resulted in a 20–25 percent reduction in repayment burdens.

[21] In their summary and analytical essays, Csaba Lentner et al. provide a detailed analysis of the central bank's role in the management of the foreign currency lending crisis and ultimately in securing the financial conditions for the conversion of loans from a foreign currency basis into loans denominated in forints (see Lentner, 2015c).

[22] ECO-VISTA, p. 58, www.parlament.hu/documents/126660/769617/N%C3%B6veked%C3%A9si+k%C3%A9pess%C3%A9g%C3%BCnk+%C3%A9s+a+rejtett+gazdas%C3%A1g+%282016%29.pdf/963758a6-0509-4c7e-bb90-7fa6a670e9c7 (accessed 2 November 2016).

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Data sources:
Portfolio data, balance of payments, etc. published on the Central Bank of Hungary website.
Central Bank publications: Balance of Payments Report, Report on Inflation, Report on Growth, Financial Stability Report.

Appendix

IMPACTS OF ACTIONS
CORPORATIONS

	Effects				
Actions	**Inflation reduction**	**Income growth**	**Liquidity improvement**	**Strengthening confidence etc.**	**Comparison with other Visegrád countries**
Liabilities					
EU funds		+	+		also in Hungary
FGS	+	+	+	+	only in Hungary
Funds withdrawn by Western banks			-	-	stronger in Hungary
Costs					
Interest rate cut	+	+		+	stronger in Hungary
Energy price cut	+	+		+	stronger in Hungary
Expected wage rise		-			only in Hungary
Cutting telecom fees	+	+		+	stronger in Hungary
Adoption of an electronic road toll	-	-			also in Hungary
Crisis taxes	+	+		-	1–2 elements also in Hungary
Other					
Online cash register	-	-		becoming legal	only in Hungary
Slightly weakening forint	-	+		+	stronger in Hungary
Tax change (EVA rise, KATA, KIVA)		-		-	
EKR				Becoming legal, administrative burden	only in Hungary

PSZ 2017. angol.szam_beliv_v16.indd 149 2017. 04. 06. 7:29:02

IMPACTS OF ACTIONS
HOUSEHOLDS

	Inflation reduction	**Income growth**	**Liquidity improvement**	**Strengthening confidence**	**Comparison with other Visegrád countries**
Lending and saving					
CHF mortgage interest rate hike	-	-	+	-	not in Hungary
Prepayment		+		+	not in Hungary
Availability of government bonds		+			stronger in Hungary
Conversion of FCY loans to HUF loans	+	+		+	stronger in Hungary
Costs					
Central bank interest rate cut	+	+			for households, only for new forint loans, but there are hardly any
Reduction in overhead costs	+	+		+	stronger in Hungary
Expected wage rise		-		+	only in Hungary
Job protection action plan	+	+		+	
VAT hike (to 27 per cent)	-				also in Hungary
Flat-rate personal income tax	+	+		-	only in Hungary
Other					
Extension of community work		+		+	stronger in Hungary
Reversal of the private pension fund scheme	+	+ (yield payment)	+ (liquidation by the state)	-	
Reduction in the period of unemployment benefits		-		-	

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Bianka Parragh

Competitiveness and Economic Stimulus[1]

New Dimensions and Instruments of Monetary Policy

Summary
The revolution in economic and fiscal policy that has been brought about since 2010 and the revolution in monetary policy implemented since 2013 have provided reasonable grounds for strengthening the regional competitive position of Hungary. The business climate in Hungary has changed for the better, a tendency which was indisputably triggered by the innovative and effective role undertaken by the state. The efficient role of the state was embodied in its concept innovation, meaning a changed viewpoint at the root and branch level of economic policy. From a monetary aspect, the state's contribution to economic productivity and a monetary policy that builds on unconventional instruments to provide a long-term stimulus to the economy have proven its commitment to economic development using innovative methods in line with an economic policy that establishes a goal structure with new criteria and a new composition. This study focuses on monetary policy and analyses the effects of the successful measures and innovative methods which have enhanced competitiveness and stimulated the economy.

Journal of Economic Literature (JEL) code: E52, E58, E62, O40
Keywords: monetary policy, economic policy, competitiveness, economic incentive, economic growth

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PSZ 2017. angol.szam_beliv_v16.indd 151 2017. 04. 06. 7:29:02

Introduction

With the successful consolidation of public funds and economic stabilization after 2010, the Hungarian economy moved ever closer to maintaining equilibrium and simultaneously creating the conditions for growth and for the sustainment of growth. The appropriate priorities set by economic policy from 2010 and then following this, the re-interpretation of the mission of the National Bank of Hungary from 2013 and a monetary policy that broke with the caution that had earlier been characteristic played an important role in the stabilization of the economy. Thus from 2013 a new monetary era brought about a revolution in monetary policy. By applying unorthodox instruments and a monetary policy supporting national economic policy, the Magyar Nemzeti Bank (National Bank of Hungary – MNB) achieved significant results in the field of sustainable economic growth.

Effects on competitiveness of the responses to the outbreak of the 2008/2009 financial and economic crisis

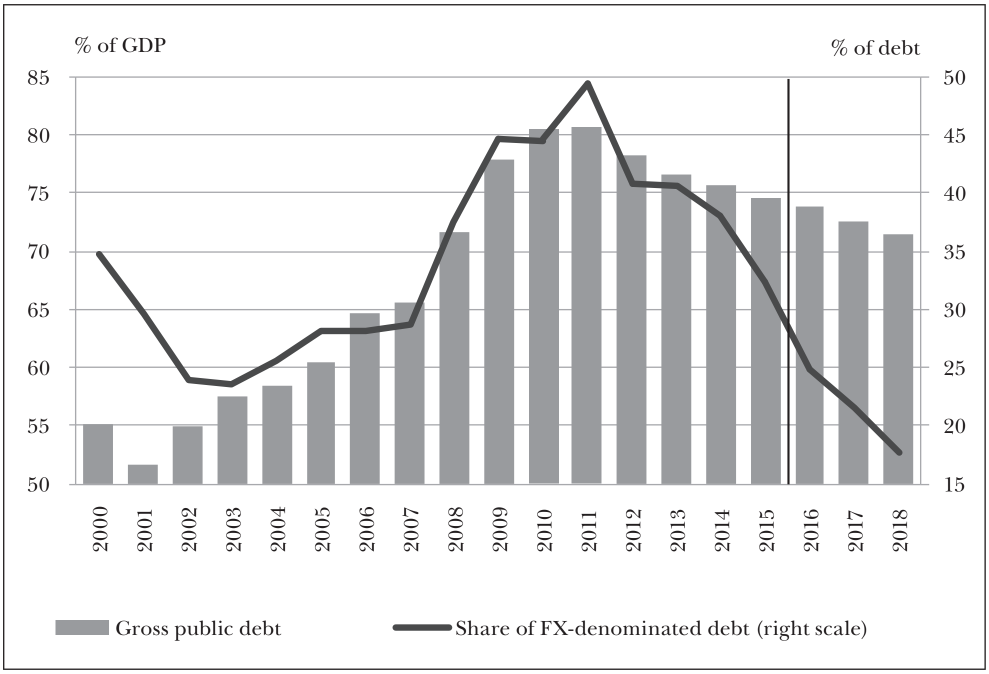
The financial and economic crisis that spilled over from the American mortgage market, and hit the otherwise weak Hungarian economy in 2008, presented challenges both to the current national economic policy and to monetary policy. The appropriate direction of monetary policy and the monetary political instruments applied have significantly influenced the balanced growth of the economy. Competitiveness and productivity show a strong correlation, and it can be clearly seen which were the special factors typical of Hungary that, as a consequence of the 2008 financial and economic crisis, exponentially weakened competitiveness and led to the especially weakened state of the Hungarian economy.

The phenomenon of a persistent twin deficit is a simultaneous substantial budget deficit and current account deficit. A considerable phase of the market transition was characterized by a twin deficit, which meant that during the transitory period of shock therapy the balance figures deteriorated in a similar way to the 1970s. The Bokros package and the related series of careless privatization decisions made in haste in 1995 to 1996 temporarily brought some improvement until 1997. However, in 1998 the budgetary position reached a deficit of 8 per cent of GDP. Between 1998 and 2002, budgetary conditions nevertheless improved despite the persistence of the current account deficit. Nevertheless, between 2002 and 2006 a twin deficit again characterized the balance of the Hungarian economy.[2] As a consequence of Hungary's accession to the European Union, Hungary set the objective of reaching a budgetary deficit lower than 3 per cent. This undertaking was not fulfilled in any year from EU accession until 2010. This EU undertaking was satisfied for the first time in 2011 thanks to the new economic policy objectives and consequent measures implemented from 2010 onwards. The budgetary position reached equilibrium and the objective to have a deficit to GDP ratio lower than 3 per cent became sustainable. As a result the current account balance was continuously positive, thus ensuring the conditions for sustain-

PSZ 2017. angol.szam_beliv_v16.indd 152 2017. 04. 06. 7:29:02

ability. In Hungary, the excessively high deficit, coupled with an unfavourable financing structure,[3] high external indebtedness, consumption instead of investment, and excessive lending in foreign exchange together contributed to the excessively high level of vulnerability of the country.

Figure 1: Gross public debt forecast – calculated with unchanged (end-of-2015) exchange rate



Source: Magyar Nemzeti Bank

Figure 1 shows the changes in the state debt, including the proportion of foreign currency indebtedness, from 2000 onwards. Hungarian retail foreign currency loans grew considerably due to the high budget deficit and mostly as a consequence of the high domestic interest rates which resulted in a large interest spread. A positive income outlook and increasing retail consumption were accompanied by a continually reduced level of savings and an abundance of liquidity at a global level.

A Hungarian economy that became progressively riskier to finance ended up in a financial condition that was dependant and exposed, because it was driven more and more by outside factors and was operated with loans, not to mention the pro-cyclical nature of budgetary policy.[4] Most developed countries reacted to the economic and financial crisis with loosening, applying an anti-cyclic fiscal policy. However, Hungary responded with more austerity and tightening, which it was forced to apply as a consequence of the previous unjustifiably loose fiscal policy and high debt, and thus it applied a pro-cyclical fiscal policy, leading to a worse contraction in GDP.

PSZ 2017. angol.szam_beliv_v16.indd 153 2017. 04. 06. 7:29:02

Further risks arose as excessive lending was going global and resources were primarily being used for the purposes of consumption and operation. A budget with a bad fiscal taxation structure together with the chronically unsustainable level of state debt and debt servicing deepened the crisis even more.

Low activity and employment in the labour market and the increase in foreign currency loans restricted monetary policy and increasing state debt led to a higher exchange risk. After the 2008 financial and economic crisis, Hungary had no choice but to change a growth model that had become unsustainable as it was being financed from indebtedness.

Among the actors in the market, the financial culture of enterprises, households and families has been substantially transformed to reach a higher level of quality, a trend which should continue into the future under any circumstances. Behind this process there were a whole series of pressures which could be best perceived in the expansion of foreign currency lending and overlending. A high price was paid for the transformation of the culture and this process had its victims from both a human and a financial respect, the reasons for which can be found in the previous ill-considered neoliberal economic policy that ignored national interests. What triggered lending in foreign currency was the high interest rates and the artificially strong exchange rate, as it led to a stable exchange rate with the euro by regional standards. In the sense of the real economy, the strong forint exchange rate coupled with high base rates resulted in an exposed situation, because domestic small and medium-sized enterprises became less interested in exporting and their focus changed towards importing, while the opposite trend would have been desirable for the national economy to boost competitiveness.

Increasing deficit in competitiveness in the years of the outbreak of the crisis

The process by which the local government sector became indebted to the private sector and the massive liabilities owed by the municipalities to companies significantly strengthened the trend of circular debt as a consequence of the 2008–2009 economic crisis, which continued to destroy the chances of domestic micro, small and medium-sized enterprises finding a way out.[5] It caused serious challenges in terms of competitiveness and survival to a wide circle of contractors and subcontractors who were faced with a mass of obligations from contracts that remained unpaid after the deadline even though they had been fulfilled. Further serious problems were caused by the state carrying out a substantial decentralization of tasksto local governments, but not following it with a process of decentralization of funds. As a result a serious operating deficit developed in the years preceding EU accession and local governments used investment loans for their operating expenses, a practice that they camouflaged. Upon EU accession new development assistance became available, though the necessary co-funding was not made available to local governments from the central budget. In order to solve this problem, local government issued foreign currency bonds despite

PSZ 2017. angol.szam_beliv_v16.indd 154 2017. 04. 06. 7:29:02

not receiving continual income in foreign currency and the loans taken out were not used for productive investments. This appeared as a factual element (Lentner, 2015:42): the neoliberal economic philosophy that led to the indebtedness had failed on the secondary level of the state budget by 2008-2010.

The intensification of the interest of Hungarian-owned small and medium enterprises in importing, as described earlier, caused significant disadvantage and damage to competitiveness. Unused market advantages brought by EU accession, the attraction of substantial foreign working capital by domestic business investments, the persistently low ratio of Hungarian businesses in exports, the increase of the exchange rate exposure to a dramatic level due to the failure to replace the national legal tender with the euro,[6] the low level of financial information and knowledge, the failure of banks to provide information and warnings[7] and the ill-advised taking out of foreign currency loans by retail customers led to a crisis in the fabric of the economy.

Monetary policy for sustainable growth and a competitive national economy

"The primary objective of the Magyar Nemzeti Bank (National Bank of Hungary) is to achieve and maintain price stability. Without prejudicing its primary objective, the National Bank of Hungary supports the preservation of stability of the financial intermediary system, the enhancement of its resilience, and its sustainable contribution to economic growth; furthermore, the National Bank of Hungary supports the economic policy of the government using the instruments at its disposal."[8]

The goal of the economic policy is to increase social welfare by influencing and coordinating economic trends, with each branch of economic policy,[9] including monetary policy, contributing by realizing its own respective goals.

Taking the examples of East Asian countries, which Dani Rodrik also studied, countries that apply independent economic political solutions adjusted to their national characteristics are able to grow. Measures branded as unorthodox by international financial institutions may lead to success if the government leading the country is committed to economic growth and can intervene in the economy appropriately with innovative methods.[10] The effective and innovative role undertaken by the state can be regarded as a basis and, simultaneously, a recipe for economic growth based on development.

A new, unconventional approach – goals and instruments

The crisis confirmed that in addition to the primary goals of the central bank, as defined in the Central Bank Act it is necessary to simultaneously analyse in depth the market trends of various instruments in addition to monitoring low inflation. Excessive trends in the credit market may set back economic growth in the long term, making it impossible to reach the inflation goal at the same time. Central banks were successful in achieving price stability before the crisis, but in the meantime there was

PSZ 2017. angol.szam_beliv_v16.indd 155 2017. 04. 06. 7:29:02

an intensification of risks that seriously jeopardized financial stability, with the result that it became impossible to ensure sustainable economic growth. The financial and economic crisis in 2008–2009 warned us that the shocks impacting the economy could be greater than ever before, therefore central banks with an inflation goal necessarily moved in the direction of greater flexibility.[11] In Hungary the current inflation goal is 3 per cent and the desirable inflation level is 3 per cent +/- 1 per cent, which constitutes the range within the tolerance band.

In addition to the central bank's primary goal of price stability, a new goal structure has been set up for which the central bank has dedicated new instruments.[12] Growth criteria have a higher priority than before as macro-prudential regulation enters as a new element in the central bank's decision-making processes.[13] The instruments for changing the base rate supplement the macro instruments which support financial stability, economic growth and monetary transmission[14] that directly influence the activity of the financial system and its risk tolerance. It is one of the central bank's goals to set up an interest environment which provides a stimulus to the real economy and which, by maintaining a 0.9 per cent key policy rate, improves the supply of loans to small and medium-sized enterprises and has an investment-inducing effect. The incentive effects of a low interest environment can be felt by a wide range of economic actors and help to achieve price stability. The system of central bank goals has become more flexible and the key policy rate that is the primarily instrument for achieving the first and foremost goal has been expanded with further central banking instruments and the MNB has started to apply its new set of tools. The Funding for Growth Scheme and the Second Funding for Growth Scheme have been introduced in order to strengthen the extended set of central banking tools and support small and medium-sized enterprises, while the Growth Support Scheme and the Market Lending Scheme have been introduced in order to reinstate a healthy market lending structure. The Self-Financing Programme as a further tool intended to reduce external vulnerability, the resolution and settlement of the issue of foreign currency loans, and the de-recognition of foreign currency loans and the aforementioned undertaking of micro- and macro-prudential liability embody the renewal of the monetary policy of the National Bank of Hungary. Using its monetary market instruments, the National Bank of Hungary helps to finance the gross debt of the national economy from internal sources by supporting self-financing. When it formulates its set of instruments, the central bank endeavours to ensure the efficiency of financial intermediation and the promotion of competition in the monetary market, thus achieving the central bank's goals i.e. ultimately helping to achieve and maintain price stability.

Harmony of monetary and fiscal policy as a criterion for economic stimulus

The existence and supportive nature of the harmony between monetary and fiscal policy is an important constituent of the competitiveness of the national economy.

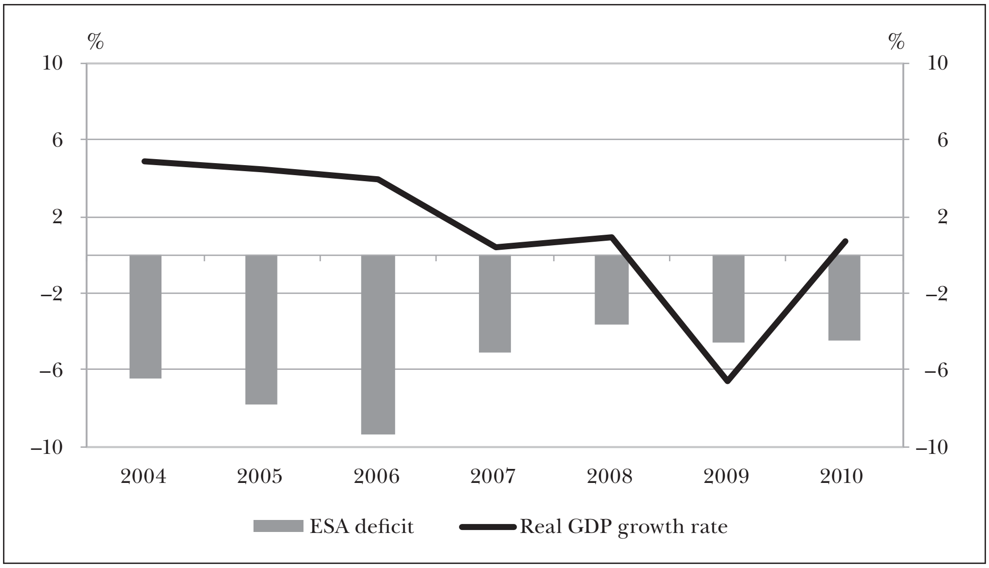
PSZ 2017. angol.szam_beliv_v16.indd 156 2017. 04. 06. 7:29:02

More and more central banks[15] are highlighting the traditionally important role of a supportive fiscal policy environment in the implementation of persistent and sustainable economic stability.

Monetary policy itself is not capable of managing a crisis because new channels are needed for financing in the traditional room for manoeuvre of the central bank in a tightening environment that yields low returns. Supportive harmony between monetary, fiscal and economic policy can provide good grounds for achieving an impact that stimulates the economy and intensifies competitiveness. If these complex conditions are met, it becomes possible to apply an anti-cyclic policy that stimulates productive investments and enhances competitiveness.

Referring back to the aforementioned effect of the pro-cyclic fiscal policy that magnifies negative economic cycles, and the necessity of relaxation as a reaction to the crisis that most developed countries applied, the Hungarian economy was forced along its path due to the mass of accumulated indebtedness and the previous inadvisably loose fiscal policy at the onset of the crisis, which caused a substantial drop in GDP (Figure 2). The budgetary position improved at the expense of growth and was coupled with a shrinking economy.

Figure 2: Evolution of ESA deficit and real GDP growth rate between 2004 and 2010



Source: Eurostat

In 2009, as an effect of the international crisis the Hungarian economy shrank by 6.3 per cent, more than the other three Visegrád countries and the EU-27 average. This considerable decline was partly a consequence of the stagnation that had previously been typical and partly a requirement of strict fiscal policy at the time of the crisis.[16] There was a shortage of liquidity and a lack of trust in society and among busi-

PSZ 2017. angol.szam_beliv_v16.indd 157 2017. 04. 06. 7:29:02

nesses. In the years preceding the crisis the degree of mistrust towards the previous government and the loss of credibility multiplied year by year.

The risk to exposed countries drastically worsened and international institutions proved inadequate and weak. As the risk to exposed countries rose, more countries were downgraded into a category where they would not otherwise belong. Hungary was categorised as one of the 10 riskiest countries, which led to a drastic fall in competitiveness and a negative perception in the international arena.

A break with all earlier, failed crisis management techniques could not be postponed any long and the state had to intervene without delay. An economic policy that was built on order and traditional national values was implemented from 2010 onwards and closed the era of neoliberal economic policy instruments that had led to and maintained earlier excessive foreign dependency (IMF, EU) and Hungary started to build its economic policy on other cornerstones, with more emphasis in this school of through on the role of the state. The national economic policy was not intended to reduce state debt by introducing newer austerity packages, as in the Hungarian economic model the priorities are fair distribution and sharing of tax burdens, economic structures that strengthen the competitiveness of the national economy and systems that reduce state debt to a permanently low level. A key issue is the support of the material growth of the national economy, of enterprises and of the population, which at the same time is the long-term goal of the government's fiscal policy. With the use of the prime instrument of fiscal policy – taxation – the focus was on the introduction of new taxes and the fair imposition of tax burdens on international multinational companies and the commercial banks subject to their economic power, which had so far been exempted from taxes. Measures by the state, the reduction of household bills, family tax allowances, and the reduction of corporate and personal income tax rates stabilised and invigorated economic life and, most of all, improved the income position of the population.

The solution of system-level problems established system-level structural transformations. The low state debt and inflation environment have improved the perception of the country abroad, and at a time of economic recession, the maintenance of balance and harmony between monetary and fiscal policy is indispensable.

Programmes to support lending to small and medium-sized enterprises in order to boost competitiveness

After the outbreak of the 2008–2009 financial and economic crisis there was a considerable drop in corporate loan portfolios in Hungary; there was a narrowing of the possibilities of getting loans as a consequence of the otherwise unjustified decrease in banks' willingness to lend, and they mostly favoured large corporations. After 2008, a period which can be considered that of the credit crunch, there was a substantial decline, even by international standards, in loans to small and medium-sized enterprises (Matolcsy, 2015). This period was rather protracted, and its end was made possible by the monetary policy tool the Funding for Growth Scheme, which was announced in

PSZ 2017. angol.szam_beliv_v16.indd 158 2017. 04. 06. 7:29:02

2103 as an incentive to help lending, and which can be characterised as an innovative scheme in monetary history. Loans at the maximum interest margin of 2.5 per cent became available through the programme's provision of refinancing loans at a preferential 0 per cent interest rate for credit institutions that had experienced the persistent market disruption in lending to small and medium-sized enterprises. The strengthening of monetary transmission[17] and financial stability is among the tools of monetary policy. A few months after its introduction, the Funding for Growth Scheme yielded good results, halting the negative spiral of the loan market. Soon it reversed the trend in lending to small and medium-sized enterprises, and then in 2014 it led to an expansion in corporate lending. In the first phase, it was fundamentally refinancing that played a dominant role, while in the second phase investment loans were the focus. In 2016 the exit phase of the Funding for Growth Scheme began with the aim of reinstating healthy market lending. By November 2016 nearly 36,000 companies had been given preferential financing with a value of 2160 billion forints. The annual growth impact of the Funding for Growth Scheme is also significant; in 2013–2015 it improved the output level of the economy by 1.7 percentage points, while also providing a solid basis for an improving economic trend. Trade, the processing industry and agriculture dominated, but the Funding for Growth Scheme had a dynamic and powerful impact by international standards.

In developed market economies the small and medium-sized enterprise sector is given more attention because it has been recognised that it plays a significant role in domestic production and in the mitigation of the unemployment problem due to its ability to soak up the workforce, and so due to its economic power it can potentially play a stabilising role in the economy. The goal, in the interests of Hungary's economic growth, is to strengthen self-supporting and growing small enterprises so that there will be an ever broader and growing layer of medium-sized enterprises operating in the economy. It is of vital importance to take into account the size-specific characteristics of micro-, small and medium-sized enterprises.

The economic stimulus effect of the Market Lending Scheme

The second phase of the Funding for Growth Scheme and the Second Funding for Growth Scheme was concluded at the end of 2015. The conclusion process required a gradual exit, because risk mitigation is a primary criterion during the exit period, so that companies are not otherwise confronted with a sudden lack of funds. In January 2016 the National Bank of Hungary launched the Growth Support Scheme for the continuity of implementation of investments and their stimulus. In addition to the exit phase of the Funding for Growth Scheme, the Growth Support Scheme comprises central banking instruments that support lending with a positive stimulus, including the Market Lending Scheme (MNB, 2016). By adding the Market Lending Scheme, the National Bank of Hungary extended its set of unconventional instruments, whose main method is the interest swap deal subject to the condition of lend-

PSZ 2017. angol.szam_beliv_v16.indd 159 2017. 04. 06. 7:29:03

ing and whose supplementary instrument is a preferential deposit facility. In addition to this, the main instrument of the exit phase of the Funding for Growth Scheme is, in the first pillar, limited forint loans offering targeted forint-based financing and, in the second pillar, forint loans combined with a swap, in which banks change the forint loans to foreign currency, helping them to lend funds to small and medium-sized enterprises with natural hedging in foreign currency. The National Bank of Hungary has formulated the goal of this pillar as being the mitigation of market distortion that has developed due to long-term financing in foreign currency.

The boosting of the lending activity of banks was, on the one hand, targeted with the interest swap transaction linked to lending activity launched as a part of the Market Lending Scheme in order to manage the interest risks of lending to small and medium-sized enterprises in the long term. On the other hand, the lending activity of banks was intended to be increased by the stimuli that appeared in the capital requirements of banks, which can be regarded as means to invigorate the economy for better capital adequacy.

The establishment of a new corporate credit information system[18] enables the central bank to contribute to and assist well-informed lending decisions with relevant information channelled towards the banking system.

New instruments to reduce Hungary's vulnerability

De-recognition of foreign currency loans

The process of indebtedness of the Hungarian population began to unfold from the beginning of the 2000s and was more and more prevalent in the years before the financial and economic crisis that erupted in 2007. The tendency to lend in foreign currency had a strongly negative effect on all market players, and was manifested in drastically high repayment instalments as the forint exchange rate weakened. The banks added to the soaring repayment instalments that were linked to the exchange rate rise by raising interest rates unilaterally in order to counterbalance their losses and widen the exchange spread.[19]

A strong degree of cooperation between economic and monetary policy was necessary in order to successfully sort out the issues with foreign currency loans, and this was embodied in legal and economic dimensions. Firstly, the statutory legal background was framed, this being the backbone of the regulation of the settlement procedure.[20] From an economic point of view, the motivation for forint conversion had to be led by fact-based economic rationality. At the end of 2014 conditions were right for it to become possible to bring an end to the life of this decade-old financial product.[21] The two essential conditions for this were the approach of forint and foreign currency interest rates to each other, which had never occurred before, and an appropriate level of foreign currency reserves of the central bank, which was a crucial issue for banks.

In concluding the era of foreign currency loans, the National Bank of Hungary played a complex and, at the same time, indispensable role. It acted and functioned as a

PSZ 2017. angol.szam_beliv_v16.indd 160 2017. 04. 06. 7:29:03

regulatory and supervisory authority responsible for financial stability. Thus the possibility opened up to eliminate the most perilous financial risk of the Hungarian economic history of our times and to liquidate the open foreign currency position of households.[22]

Two groups of foreign currency tenders can be distinguished in connection with the de-recognition of retail foreign currency loans,: foreign currency tenders linked to final repayment (2011–2012) and tenders for selling euros and Swiss francs in relation to settlements and forint conversion of retail foreign currency loans. The main goal of the tenders for the first group was exchange rate protection, while the primary goal of the tenders in the second group was the management and reduction of the exchange rate risk for banks.

It is an important result that foreign currency tenders help to reduce private sector foreign currency exposure and the short-term external debt of domestic banks, including the reduction of Hungary's external volatility. The balance sheet total of the MNB is lower and so the success of the central may improve.

It should be highlighted that the forint conversion did not result in any change in the forint exchange rate and borrowers of mortgage-backed loans did not have to suffer when the Swiss exchange rate cap was lifted. In consequence the volatility of the country improved considerably, the ration of gross indebtedness to foreign currency fell and monetary transmission became stronger.

Significance of the Self-Financing Programme

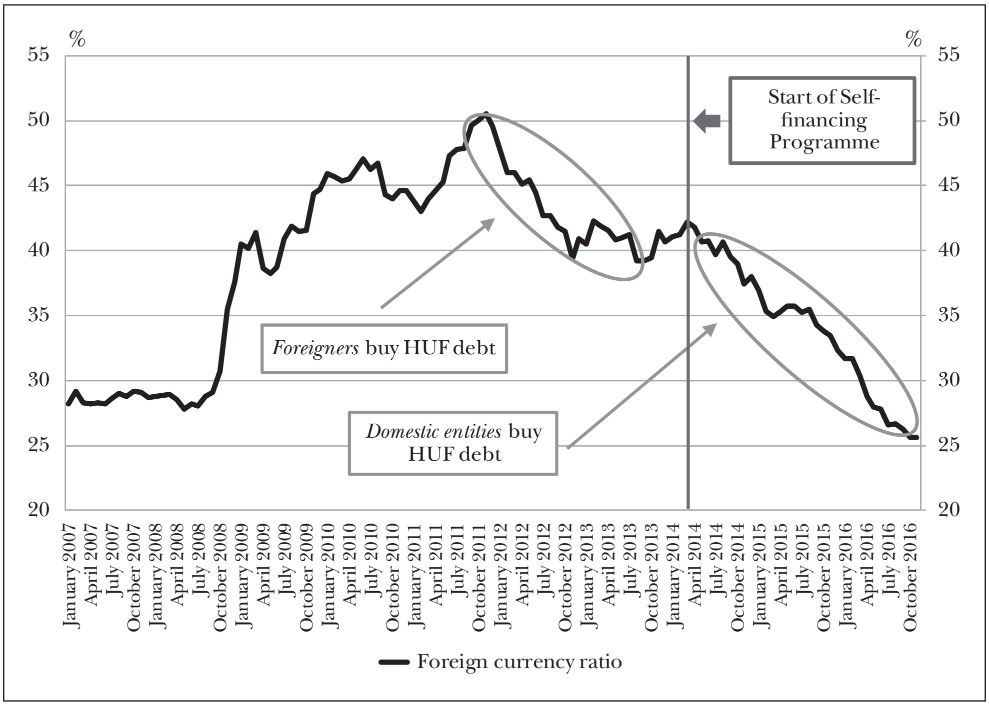
The impact of the financial and economic crisis that was damaging the fabric of Hungarian economy from 2008 was most prevalent in the dimension of volatility, and so it became one of the prime objectives to make efforts to reduce the external volatility of the country and its dependence on external and foreign currency sources. The central bank announced its Self-Financing Programme to strengthen the financing of the state debt internally and reduce dependency on external sources. It can be classified as a positive outcome of the programme that the central bank's balance sheet became simpler, in other words narrowed down, which was coupled with improving monetary transmission.

External volatility reduces if the Government Debt Management Agency can renew any maturing foreign currency debt in forints, while striving to involve domestic players in this process. It is of fundamental importance that there should be sufficient demand for the increasing supply of forint government securities. The National Bank of Hungary can influence these trends in several ways. One possibility is to induce banks to re-channel their liquidity held at the central bank to the state securities market (government bonds instead of central bank funds), and so a drive towards the state securities market can be a solution. It is advisable for the central bank to makes its own instruments less attractive by making them less liquid. In this way the form of the central bank's key policy instrument was changed at the level of operative implementation. In the summer of 2014 the key policy instrument was switched from bonds to a deposit facility, and in the autumn of 2015 from a 2-week deposit facility to a 3-month deposit facility. With the longer term of the key policy instrument commercial banks

PSZ 2017. angol.szam_beliv_v16.indd 161 2017. 04. 06. 7:29:03

are able to manage interest risk arising from purchases of long-term state securities, while resorting to interest rate swaps, and so instead of the 2 weeks central bank facility, state bonds maturing in several years' time show up on their balance sheet, a tendency that is reinforced by the impact of the programme to redirect towards the state securities market. In return for the interest rate swap facility banks agree to keep state securities in the long term (conditional instrument), therefore the price of the instrument is more favourable than market rates. While in the second phase the 2-weeks deposit facility was limited, in the third phase of the programme the 2-week deposit facility was withdrawn. Figure 3 illustrates the most welcome substantial change in the proportion of foreign currency debt, including the positive stimulus effect of the Self-Financing Programme, which increases the demand for state securities.

Figure 3: Foreign currency ratio of central government debt



Source: ÁKK [State Debt Management Agency], 2016

The effect of innovative monetary policy initiatives and instruments on competitiveness

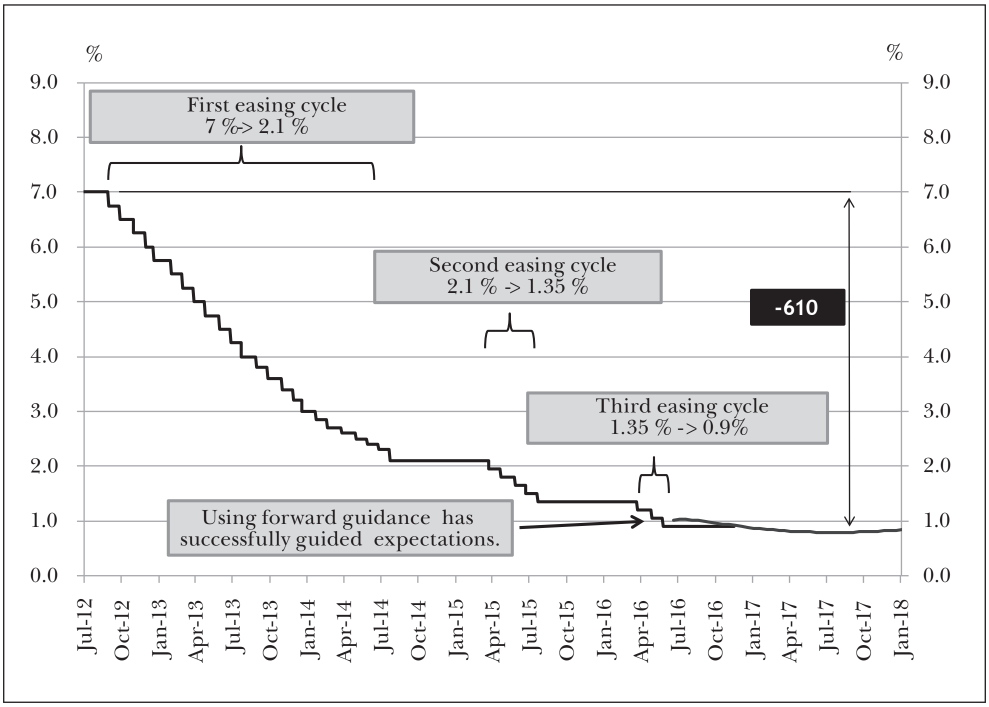
From the spring of 2013 the National Bank of Hungary put together a new set of objectives and a new set of instruments to reach these objectives by taking on a new role and by changing its attitude. The monetary policy can be characterised as a brave step and as requiring a new way of thinking, and is in harmony with the orientation

PSZ 2017. angol.szam_beliv_v16.indd 162 2017. 04. 06. 7:29:03

towards economic policy in its application of innovative solutions through unconventional, unorthodox measures and instruments that were not typical in the two decades that followed the political and economic transition.[23] In order to ensure financial stability the central bank followed an innovative way of thinking targeted at triggering economic growth and reinforcing monetary transmission.

The interest rate lowering cycle of the monetary policy generated positive trends in the dimensions of the economy. The forward-looking quality of the monetary policy is also crucial, as this is how a response can be given with current decisions to inflation trends that are anticipated in the future. The favourable development of macro-economic trends, the series of coordinated measures and steps and the complex system of cooperation extended to monetary and fiscal policy improve market prospects and predictability for the market players of the competitive and private sectors, providing a positive stimulus to their future expectations.

Figure 4: Development of the base rate and market expectations



Source: Magyar Nemzeti Bank [National Bank of Hungary], 2016

The goal of the key policy instrument is to model the interest rate in the money market in the way deemed most optimal by the central bank. It should be noted that the key policy instrument can directly influence short-term interest rates, which appears as an operative objective. Based on the transmission mechanism, any change in the central bank rate is a sign that influences the expectations of market players.

PSZ 2017. angol.szam_beliv_v16.indd 163 2017. 04. 06. 7:29:03

Over the past few years the gross external debt of Hungary has shrunk considerably, especially the short external debt, while the central bank's international reserves have grown. The reserve adequacy is at a level that guarantees the MNB sufficient room for utilising reserves and, at the same time, the country's external debt can fall further with the positive balance of payments trends, while thanks to the inflow of funds from abroad (especially EU transfers) the central bank may retain or, in the future, expand its room for manoeuvre.

The improvement of competitiveness and the success of economic catch up have special significance from the point of view of the Hungarian national economy. The concept of improvement of competitiveness is only possible in a structure of targets that is well constructed when it comes to practical implementation, that is defined by priorities and that does not ignore timing. The countries that manage to give an impetus to their industrial production can substantially improve their competitiveness and make better use of the trends of globalisation while curbing the level of their dependency. This can be aided by an active state role model and a proactive, forward-looking approach and way of thinking. Catch up models do not provide a straightforward recipe, as every country has to find their own path, adapting the established measures to local conditions. "Practically every entrepreneurial centre in today's world is based on pro-active governmental intervention."[24] The proactive and innovative role also includes the current analysis of past events, as this is the way to reach those conclusions and set up such an algorithm that help us to avoid mistaken decisions and steps that lead to adverse situations. The change of the monetary policy regime that was carried out between 2013 and 2016 was realised by the government following a single goal.[25]

The instruments and priorities of the competitiveness policy can be summarised as follows:[26]

– ensuring stability: stability in the real economy, fiscal and financial stability; good institutions; adequate business environment;

– influencing the volume of resources: increasing activity; investment; expansion of lending activity;

– improving the quality of resources: increasing productivity; education; health care; R+D;

– operation of the state: efficiency of institutions; cutting back red tape; simplification of the tax system; whitening of the economy.

Conclusions

In a broad sense economic policy can help to improve competitiveness in many ways, and so complex cooperation is needed in the coordinated management of the branches of economic policy and in the support system to stimulate the economy.

The unconventional economic value system that was established in successive steps from 2010 relied on numerous measures that triggered an improvement in competitiveness and an active role that influenced the economy, and it yielded indisputable results in the reduction of the volatility of the Hungarian national economy.

PSZ 2017. angol.szam_beliv_v16.indd 164 2017. 04. 06. 7:29:03

The results that followed from the revolution in economic, fiscal and monetary policy provide good grounds for the growth-stimulating, complex and innovative economic policy to continue to develop with a commitment towards economic convergence and with the goal of achieving sustainable convergence and economic growth, reinforcing the role of the National Bank of Hungary on the path of monetary policy.

The successes of the unorthodox Hungarian crisis management and the internationally-recognised results it has achieved in terms of convergence, are substantiated by positive employment and labour market data, the persistent downward path of the deficit, the termination of the excessive deficit procedure, the permanently low base rate, the social responsibility of the National Bank of Hungary with its Growth Support Schemes and the Self-Financing Programme, the upgrading of Hungary and, most of all, the recognition of the Hungarian Model in the field of sustainable economic growth and improvement of competitiveness.

Notes

1 Research was conducted in the framework of the at National University of Public Service, Wekerle Sandor Public Finance Scientific Lab, Budapest.

2 Up until 2006 the fiscal balance showed a deficit of 6-10 per cent of GDP and the current account deficit moved between 6 and 8 per cent of GDP.

3 Unfavourable structure: low FDI and high indebtedness.

4 The pro-cyclical fiscal policy strengthens economic cycles and is characterized by austerity at the time of economic decline and fiscal expansion at the time of economic growth. This policy invigorates and tightens when the contrary would be needed.

5 Csaba Lentner writes about the process and results of indebtedness of the municipalities (Lentner, 2015, Chapter 1 & Epilogue).

6 A transition to the euro partly took place in economic and business life without the national legal tender being replaced with the euro. The basis of settlement between market players and companies was the euro and was denominated in euro and in the course of certain business settlements, euro-linked payment had to be made, e.g. rents for property, and cooperation with foreign business partners in Hungary. As a result, it became possible for a group of foreign business partners, foreign enterprises and domestic entrepreneurs to gain extra profit.

7 For more details see: Lentner, 2015, Chapter 1, an example taken from the news archive of the Hungarian News Agency (MTI) as of 31 January 2006. Title: No worries about foreign currency based arrangements – "anyone intending to take out a long-term loan may choose foreign currency-based arrangements without worry, because during the term of the loan in all likelihood there will be no movement in the exchange rate that would cause a substantial increase in repayments in the long term" – says the Hungarian Banking Association (Lentner, 2015:48–49).

8 Act No. CXXXIX of 2013 on National Bank of Hungary.

9 Branches of economic policy: for example fiscal policy, tax policy, employment policy, besides monetary policy.

10 Dani Rodrik, a professor of the Institute for Advanced Study of Princetown.

11 Avoiding the excessive volatility of real variables: ex ante inflation target band (from March 2015).

12 The standard forint market instruments are the key policy instrument, the mandatory reserve system and measures promoting the seamless operation of the interest corridor, which is supplemented by the application of high priority unconventional instruments.

13 Act CXXXIX of 2013.

PSZ 2017. angol.szam_beliv_v16.indd 165 2017. 04. 06. 7:29:03

[14] In the course of the monetary transmission mechanism the steps of the central bank on monetary policy have an impact on output and the development of inflation through the impact on the decisions of market players, which is possible via 5 channels: interest rate channel, exchange rate channel, asset price channel, credit channel and waiting channel.

[15] ECB, Fed.

[16] For more details see Parragh, 2014.

[17] An essential component is the efficiency of the interest rate channel.

[18] By adopting the bill proposed by the MNB, the MNB analyses credit information and company financial data from the aspects of credit risks, company characteristics and macro-economic trends.

[19] Different kinds of exchange rates at which a higher amount was made available than the amount calculated at the forint/foreign currency exchange rate, but upon repayment a greater forint amount was necessary to pay the same amount of foreign currency.

[20] Act No. XXXVIII of 2015 and Act XL of 015 on the regulation of the repayment of increased interest rates and fees to consumers.

[21] For more details see Kolozsi–Banai–Vonnák, 2015.

[22] The settlement process involved 3.6 million consumer loan agreements. The settlement and forint conversion of retail foreign currency mortgage-backed loans amounted to 3,000 billion forints, while the settlement and forint conversion of the Swiss franc-based vehicle and personal loans amounted to 300 billion forints according to the data of the MNB.

[23] Based on Palotai, 2016.

[24] Joseph Lerner, Harvard Business School, innovation expert.

[25] In more detail, see Lentner, 2016.

[26] Based on György Matolcsy, National Bank of Hungary (2016).

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PSZ 2017. angol.szam_beliv_v16.indd 166 2017. 04. 06. 7:29:03

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Péter Novoszáth

The Main Challenges and Risks for Social Security Systems in the European Union

The Essence of Reforms in Hungary After 2010

Summary
In all Member States social security systems are used to help secure social goals such as protection against poverty. In the majority of European Union (EU) countries public schemes also play a core role in securing levels of pension benefits and health services that to a reasonable degree allow people to maintain the living standards from their active years into retirement. After 2010 the objective of comprehensive pension reform in Hungary was to return to the two-pillar pension system, based on social solidarity on the one hand and voluntary contributions on the other, which is in place in eighteen EU Member States, from the former Hungarian three-pillar system which is hopelessly threatening the budget balance, and is financially unviable in the short, medium and long run. Having accomplished this transformation, the government is committed to maintaining and supporting voluntary private pension funds parallel to the state-run social security pension pillar. In the second half of 2010, as a result of the world economic crisis and the restriction measures linked to it, a major crisis evolved which required a series of immediate measures from the new Hungarian government formed in that year. How did the new government manage to consolidate the Hungarian pension system? You can find more details in this article.

Journal of Economic Literature (JEL) code: H55, H62, H63, H75
Keywords: budgetary deficit, demographic crisis, EU's Stability and Growth Pact, Hungarian pension reform, public debt

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PSZ 2017. angol.szam_beliv_v16.indd 167 2017. 04. 06. 7:29:03

The main challenges and risks for social security systems

The sustainability and adequacy of social security systems depends primarily on the development of employment and employment income and savings set aside for pension purposes. Financing arrangements, the conditions of eligibility and labour market conditions must be calibrated for there to be a balanced relationship between contributions and entitlements as well as among the actively employed contributors and the number of retired beneficiaries (European Commission, 2012).

The current key challenges facing pension systems are:

1. Ensuring the fiscal sustainability of social security systems
2. Increasing the labour market participation of women, younger and older workers, inactive people of working age, those living in deep poverty, and Roma people
3. Ensuring the financial sustainability of health systems
4. Ensuring the financial sustainability of pension systems
5. Maintaining the value of the level of pension benefits
6. Implementation of Pension Reforms in the European Union

The ability to ensure fiscal sustainability means that a government is able to finance current and future obligations and liabilities into the long term. According to the baseline scenario of the latest forecasts for the period 2013 to 2060, total age-related expenditure is expected to increase to 1.3 per cent of GDP for the EU 28 and to 1.4 per cent of GDP for the Member States of the euro area (see Table 1). However, a number of significant differences are found between Member States. According to the forecast, in the baseline scenario ten EU Member States (Finland, Austria, Czech Republic, Netherlands, Slovakia, Germany, Belgium, Luxembourg, Malta and Slovenia) will see a growth from 2013 to 2060 of 2.5–6.8 per cent in the proportion of GDP allocated in the budget for age-related expenditure. EU experts forecast lower, but still significant, growth in expenditure 0–2.5 per cent of GDP in another group of Member States (Bulgaria, Portugal, Estonia, Sweden, Hungary, Poland, Ireland, Romania, Latvia and the United Kingdom). By contrast, according to the EU forecast, in the case of a third group of countries, age-related spending is expected to decrease by 0.8–2.8 per cent of GDP in Croatia, Greece, Latvia, France, Denmark, Cyprus, Italy and Spain (European Commission, 2016).

As reported by EU experts, overall no significant risks of fiscal stress appear on the the horizon for Hungary, though some variables (share of debt denominated in foreign currency, share of debt owned by foreign investors, and share of non-performing loans in the banking sectors) point to possible short-term challenges. Medium risks appear, on the contrary, in the medium term from a debt sustainability analysis perspective due to the still moderately-high stock of debt at the end of the projection (2026). A medium degree of risk also emerges due to a gap with respect to the 60 per cent of GDP Treaty reference value and the unfavourable projected cost of ageing, thus leading to an overall medium risk for the country in the medium term. No sustainability risks appear over the long run (European Commission, 2016).

PSZ 2017. angol.szam_beliv_v16.indd 168 2017. 04. 06. 7:29:03

Table 1: Projected change in age-related expenditure components, baseline and risk scenarios, 2013–2060

	Pension expenditure		**Healthcare expenditure**		**Long-term care**		**Education expenditure**		**Unemploy-ment benefits**		**Total expenditure**	
	2013	**2013–2060**	**2013**	**2013–2060**	**2013**	**2013–2060**	**2013**	**2013–2060**	**2013**	**2013–2060**	**2013**	**2013–2060**
Austria	13.9	0.5	6.9	1.3	1.4	1.3	4.9	0.0	0.8	–0.2	27.9	2.9
Belgium	11.8	1.3	6.0	0.1	2.1	1.5	5.8	0.1	1.8	–0.2	27.5	2.8
Bulgaria	9.9	–0.4	4.0	0.4	0.4	0.2	3.0	0.4	0.5	–0.2	17.8	0.3
Croatia	10.8	–3.9	5.7	1.7	0.4	0.1	3.7	–0.4	0.5	–0.3	21.2	–2.8
Cyprus	9.5	–0.1	3.0	0.3	0.3	0.2	7.3	–1.2	0.8	–0.6	20.9	–1.4
Czech Republic	9.0	0.7	5.7	1.0	0.7	0.7	3.4	0.7	0.2	0.0	19.1	3.0
Denmark	10.3	–3.1	8.1	0.9	2.4	2.0	7.6	–0.7	1.4	–0.5	29.8	–1.4
Estonia	7.6	–1.3	4.4	0.6	0.6	0.7	4.4	0.8	0.2	0	17.1	0.6
Finland	12.9	0.1	7.8	0.7	2.4	2.1	6.1	0.3	1.9	–0.4	31.2	2.7
France	14.9	–2.8	7.7	0.9	2.0	0.8	5.0	–0.2	1.5	–0.4	31.1	–1.7
Germany	10.0	2.7	7.6	0.6	1.4	1.5	4.1	0.3	0.8	0	23.9	5.0
Greece	16.2	–1.9	6.6	1.3	0.5	0.4	4.1	–1.1	1.2	0.9	28.5	–2.3
Hungary	11.5	–0.1	4.7	0.8	0.8	0.4	3.6	–0.2	0.3	–0.1	20.8	0.8
Ireland	7.4	1.1	6.0	1.2	0.7	0.7	6.0	0	2.1	–1.1	22.1	1.9
Italy	15.7	–1.9	6.1	0.7	1.8	0.9	3.7	–0.2	0.9	–0.3	28.2	–0.9
Latvia	7.7	–3.1	3.8	0.6	0.6	0.1	3.8	0.8	0.3	–0.2	16.2	–1.7
Lithuania	7.2	0.3	4.2	0.1	1.4	0.9	3.9	0.9	0.2	–0.1	16.9	2.1
Luxemburg	9.4	4.1	4.6	0.5	1.5	1.7	3.3	0.2	0.7	–0.2	19.5	6.2
Malta	9.6	3.2	5.7	2.1	1.1	1.2	5.9	0.1	0.3	0	22.6	6.6
Poland	11.3	–0.7	4.2	1.2	0.8	0.9	4.4	–0.1	0.2	–0.1	20.9	1.3
Portugal	13.8	–0.7	6.0	2.5	0.5	0.4	5.2	–1.0	1.5	–0.9	27.0	0.3
Romania	8.2	–0.1	3.8	1.0	0.7	0.9	2.6	0.4	0.1	0	15.5	2.1
Sweden	8.9	–1.4	6.9	0.4	3.6	1.5	5.7	0.2	0.4	–0.1	25.5	0.6
Slovakia	8.1	2.1	5.7	2.0	0.2	0.4	3.4	–0.4	0.2	–0.1	17.7	4.0
Slovenia	11.8	3.5	5.7	1.2	1.4	1.5	5.3	0.8	0.6	–0.2	24.7	6.8
Spain	11.8	–0.8	5.9	1.1	1.0	1.4	4.6	–0.8	2.2	–1.7	25.4	–0.8
The Nether-lands	6.9	0.9	7.2	1.0	4.1	3.0	5.2	–0.5	2.0	–0.8	25.4	3.6
United Kingdom	7.7	0.7	7.8	1.3	1.2	0.4	5.1	0	0.3	–0.1	22.1	2.3
EU–28	11.3	–0.3	6.9	0.9	1.6	1.1	4.7	0	1.1	–0.4	25.6	1.3
Euro area	12.3	–0.1	7.0	0.8	1.7	1.3	4.5	–0.1	1.3	–0.4	26.8	14

Source: European Commission, 2016

PSZ 2017. angol.szam_beliv_v16.indd 169 2017. 04. 06. 7:29:03

The challenges caused by an aging society will be increased by the doubling of the old–age dependency ratio (the ratio of people over 65 compared to those of 15–64 years) from 2010 (26 per cent) to 2050 (50 per cent). In fact, the real challenge is the economic dependency ratio, which is the number of working-age inactive, unemployed and retired compared to the number of active employees. The Vienna-based Austrian Chamber of Labour and Commerce calculates that if the European Union fulfils the goal of achieving the Europe 2020 strategy, with a target of a 75 per cent employment rate in the 20–64 age group, and further progress is made in the period between 2020 and 2050 then the economic dependency ratio will rise to a lesser degree, from the current from 65 to 79 per cent (European Commission, 2012). Therefore the future adequacy and sustainability of pension systems in several EU countries, including Hungary, can be improved by increasing the employment rates. And it is not only necessary to do this for older age groups but for all those groups where employment rates are currently low, such as women with small children, the young, the less educated, the elderly, those living in extreme poverty, Roma and other disadvantaged people. Achievement of the EU employment goals and convergence to the best performing countries in terms of employment can mainly neutralize the negative impact of aging on public finances in most countries. It is therefore particularly important to strive to achieve full employment and timely implementation of social inclusion programmes.

All of this requires a concerted and co-administration of several measures including, but not limited to, new jobs, stimulating the dissemination methods of work organization, improving the conditions for lifelong learning, introducing measures enabling compatibility with private and family life, measures for the improvement of the health status of the elderly, and effective and efficient action against any form of discrimination (based on age, race, gender, sexual orientation, financial situation etc.) in the labour market.

The European Union health systems are the focus of a high level of social protection and they form the cornerstone of the European social market economy. The health sector comprises about 8 per cent of the EU's total workforce of 8 per cent and creates value added (GDP) of 10 per cent. Today there are significant differences between Member States. While in the case of Austria, Denmark, France, the Netherlands and Germany the contribution of health to the country's GDP exceeds 11 per cent, in the case of Estonia, Latvia and Romania it is below 7 per cent (European Commission, 2013). The health expenditure per capita in terms of ranking is led by the United States among OECD countries, spending 17.6 per cent of its GDP on health spending, followed by the Netherlands (12 per cent), France (11.6 per cent) and Germany (11.6 per cent). The share of GDP allocated to health spending (excluding capital expenditure) in Hungary was 7.4 per cent in 2013, compared with an OECD average of 8.9 per cent. This is slightly down from 2012 but at the same level as in 2009. Hungary spent the equivalent of USD 1719 per person on health in 2013, compared with an OECD average of USD 3453. Public sources accounted for 65 per cent of overall health spending, which is below the OECD average (OECD, 2015). Some countries have introduced measures to complement their public pay-as-you-go pension scheme

PSZ 2017. angol.szam_beliv_v16.indd 170 2017. 04. 06. 7:29:03

with private insurance systems, but the main shortcoming of this approach is that it does not reduce the formation of future poverty risks at all, even for the lower income groups; only those with higher incomes have improved future prospects for the real value of pensions. Therefore, many Member States, including Hungary, must find additional pension savings opportunities that can also help to reduce the future risk of poverty for those with lower incomes. The main obstacle to this is that lower income households are much less able to put aside further savings from income than higher earners. The financial and economic crisis has clearly shown how to substantially improve the impact on the functioning funded pension schemes to mitigate risks and the ability of the financial market to absorb shocks.

The European Commission shed lights on the details in the Annual Growth Survey (European Commission, 2015). The implementation of these objectives can ensure a far better balance between work and years spent in retirement and help encourage additional pension saving efforts. According to the White Paper on goals for setting up a sustainable pension system, the European Commission proposed the implementation of the following items (European Commission, 2012):

– link the retirement age with increases in life expectancy;

– restrict access to early retirement schemes and other early exit pathways;

– support longer working lives by providing better access to life-long learning, adapting work places to a more diverse workforce, developing employment opportunities for older workers and supporting active and healthy ageing;

– equalise the pensionable age between men and women; and

– support the development of complementary retirement savings to enhance retirement incomes.

The implementation of the pension reforms along these lines will put pension systems on a more sustainable path, thus helping Member States to ensure an adequate income in old age for their citizen despite the less favourable demographic situation.

The initiative of the European Union

In 1998, the Hungarian government carried out a transition to the so-called Three-Pillar Pension System. The Mandatory Private Pension Scheme (MPPS), which puts the operation of public pensions in the hands of the private sector, and its organizational entity, the Private Pension Funds (PPFs), was the core of this pension reform in Hungary. In Hungarian, it is referred to as *Kötelező magánnyugdíjrendszer*. The reason that it is described as "mandatory" is simply that, as opposed to the third pillar (the voluntary pension scheme), it entails statutory membership (Iwasaki–Sato, 2005). In the structure established on 1 January 1998, the pension contributions paid by those entering the mixed system were divided. One part of the contribution was not paid into the social security pension system which operates on the basis of the 'pay as you go' principle, but it was credited to an individual fund account as a private pension fund membership fee. According to the structure, around one quarter of contributions were paid into private pension funds. Therefore, private pension fund benefits

PSZ 2017. angol.szam_beliv_v16.indd 171 2017. 04. 06. 7:29:03

should have covered the social security benefits which are around 25 per cent lower. According to the 1998 plans, the second pillar would have gradually covered an increasing proportion of members until all of them were covered. Only career starters would have been obliged to enter the system. However, the actual legal regulations made it possible for everyone to freely decide to enter the mixed system until the middle of 1999. Nevertheless, those stepping into the mixed system had to face the fact that their future pension would decrease by 25 per cent even if they had paid the whole pension contribution into the social security pension fund system before they voluntary entered the mixed system (Magyarország Kormánya, 2012).

However, the number of people stepping into the mixed system in 1998–1999 did not live up to expectations. There were many cases of people who decided to enter the mandatory private pension fund system even though it was not a favourable choice for them. The fundamental reason for doing so was the rather single-sided information campaign related to introducing the pension reform, which emphasised only the advantages of individual accounts and inheritance and neglected the risks of entering the mandatory pension fund system. The declared purpose of establishing the funded pension pillar was to contribute to the financeability of the pension system. However, when setting the long-term objective, it should have been taken into consideration that there would be several decades of deficit in the state pension pillar following the introduction of this system. Although part of the contribution of members entering the mixed system had already been transferred to their private pension fund accounts, the expense obligations of the state pillar remained unchanged. Extra expenses would have been eliminated only gradually and over a very long time, around 5–6 decades. Following this point of time, the costs saved as a result of lower benefits would have compensated for the deficit. In Hungary, due to the high number of people entering the mixed system, the amount of the deficit – the extra burden of the social security pension system – significantly increased during a short period of time. The member list reached 50 per cent of all insured members even by 2000, the second year after the introduction of the system, and it gradually reached more than 60 per cent by 2010. The deficit of the ‘pay as you go’ pension pillar gradually increased as a result of the loss of return and it reached 1 per cent of GDP by 2004, while it was close to 1.3 per cent of GDP by 2009. As a result of the increasing loss of return, similarly to other countries introducing a pension reform, the accountability of the returns of the mandatory funded pension pillar as a state budgetary return also became a key question in Hungary.

Calculations published in a 2008 study revealed that introducing a more-than-two-pillar private pension fund system resulted in significant differences between each country in terms of the magnitude of state financing and its temporal distribution, considering the annual state-financing need due to the loss realised in the state pillar (see Table 2). This emerging cost exceeds 3 per cent of annual GDP in Bulgaria, Poland and Slovakia. The relevant values are 2.4 per cent in Hungary, 2 per cent in Estonia and 0.3 per cent in Lithuania. In Latvia and Sweden, this system was introduced in such a way that it did not require any extra financial support from the state budget. The introduction of the system had to be financed from the state budget for only two years in Slovakia and for three years in Latvia. Poland, Hungary and Bulgaria faced the worst situation, as the state budget had to contribute to the operation of the mandatory private pension fund system even in the 6th and 7th years following the establishment of this pillar (Center for Policy Studies PRAXIS, 2008):

Table 2: Total financing needs of the pension reform during the seven years following the reform (% of GDP)

Country (year of introducing the reform)	Year of reform	+1 year	+2 years	+3 years	+4 years	+5 years	+6 years	+7 years
Bulgaria (2000)	2.0	2.0	3.1	2.6	2.4	2.4	3.6	
Estonia (2002)	0	0	0.4	0.3	1.9			
Latvia (2001)	0	0	0	0	0	0		
Lithuania (2004)	0.1	0.2	0.3					
Poland (1999)	0.9	1.6	2.2	2.9	2.9	3.3	3.0	3.4
Hungary (1998)	0.5	0.7	0.7	1.0	1.8	1.4	1.6	1.9
Slovakia (2005)	2.5	3.2						
Sweden (1999)	0	0	0	0	0	0	0	0

Source: Centre for Policy Studies PRAXIS, 2008, 16–17

The loss generated by the pension reform is not the result of state "overspending", but of the structural reforms introduced in order to provide financeability in the future. For this reason, it was not obvious in the beginning whether the impact of the pension reform had to be taken into consideration when determining the government budget deficit or not. Eurostat, the competent EU authority, published a declaration in 2004 with regard to the presentation of public accounts (Beetsma–Oksanen, 2007). This declaration stipulated the methodology to follow in the practice of all involved countries during the presentation of public accounts. The declaration made it obvious both in the case of Hungary and other EU Member States that the return of the funded pension pillar cannot be considered public finance income according to the public finance accounting rules of the European Union. Starting from 2007, all countries were obliged to follow the points laid down in the declaration. In the spring of 2005, the Council of the European Union (ECOFIN) decided about the extent to which the return of the obligatory funded pension pillar can be accounted for from the aspect of excessive deficit procedure. According to this decision, the return of the funded pension pillar can be accounted for as public finance return to a constantly decreasing extent – 100, 80, 60, 40 and 20 per cent. With this decision, the European Union basically gave a 5-years extension to countries introducing the mandatory funded pension pillar for considering the impact of the funded pension pillar when establishing the structure of public finance. However, this decision did not make the situation of the affected countries notably simpler. Countries that in-

PSZ 2017. angol.szam_beliv_v16.indd 173 2017. 04. 06. 7:29:04

troduced a pension reform were given a smaller scope for budgetary action for the subsequent period in order to implement their economy policies in comparison with countries which did not undertake the structural rebuilding of the pension system.

As a result of the capital market processes in 2008 and 2009, the value of the mandatory private pension fund savings quickly decreased. When pension fund members faced the account balance of 2008, they saw that the value of their preceding year's savings had decreased by around 20 per cent on average, instead of the expected increase. Although the processes of the subsequent period partially compensated for the losses, the 2008 processes shocked pension fund members. This practical experience was the opposite of what they had previously heard about the advantages and safety of the mandatory private pension fund system. The members were not given any unambiguous promise for the period up to the determination of the amount of the pension. As regards future processes, they only had a limited guarantee concerning the future increase of savings. This process greatly held back society's trust in the mandatory private funded pension pillar in Hungary. A significant doubt emerged in a large proportion of pension fund members about whether the savings collected within the mandatory private pension fund system would really help them in establishing the financial background for a decent old age. The decrease of the accumulated savings and the loss of society's trust also occurred in other countries operating the mandatory funded pension pillar.

There are many people in Hungary who remember that one of the main objectives in establishing the mandatory private pension fund system was to improve the lack of capital of Hungarian enterprises with their investments and to improve their competitiveness as a result. However, not one implemented investment has been reported during the last 16 years. To avoid any confusion, the current owner of Budapest Airport is not Hungarian either, but a Canadian state pension fund called PSP Investments. The question arises as to why a foreign state pension fund sees economic advantages in what a Hungarian mandatory private pension fund or the state do not. Hungarian private pension funds initially invested their capital in Hungarian funds and then in foreign stock exchanges in the hope of higher profits, which was either a successful or an unsuccessful action. However, they definitely did not contribute to the economic development of Hungary and the improvement of its competitiveness, but instead they held it back.

In Hungary, these unfavourable processes revealed several internal contradictions of the second pillar. It thus became obvious that membership was not favourable for a significant proportion of mandatory private pension fund members. Their private pension fund benefits determined at the time of retirement would not be able to compensate for the reduction of their social security benefits even in the case of a high future return. Even though social unrest resulted in the granting of the opportunity to leave the system in 2009, it was possible only for the oldest age groups (above 52 years of age), which represented only 4 per cent of pension fund members. It also became obvious that the significant risks of the private pension fund system could not be made consistent with the mandatory entrance into the system.

PSZ 2017. angol.szam_beliv_v16.indd 174 2017. 04. 06. 7:29:04

The economic crisis also revealed that the risks of the operation of the private pension fund system were borne almost solely by pension fund members and the state (through compensating for the budget deficit). The financial sector, which was authorised to operate the mandatory private pension fund system, was able realise a stable return independently of its successfulness as a result of the operation of funds and the performed property management activity. By erasing all limitations on purchasing shares before the economic crisis, mandatory pension fund members were encouraged to buy shares in the most unfavourable time from an economic point of view. At the same time, being able to determine the maximum property management fee without any impact assessment made it possible for trust companies to realise a return above the average property management fee (Magyarország Kormánya, 2012).

During the introduction of a 2009 study, the OECD described the high cost level of the Hungarian mandatory private pension fund system as a negative example. Of all mandatory pension fund systems, members had to pay the highest administrative and management costs in Hungary, amounting to around 2 per cent of the wealth managed by the system, while these fees were the lowest in Sweden (less than 0.5 per cent of the managed wealth). As regards non-OECD countries, the highest fees were observed in Costa Rica (2 per cent) and the lowest in Bolivia (0.5 per cent) (Tapia–Yermo, 2008).

These differences in fees are so high that they could result in up to a 30 per cent difference in return realised by members between countries operating with the highest and the lowest administrative cost. This criticism also showed that the losers of the high cost level are fund members, as this difference resulted in significantly lower sums credited to their individual accounts. This difference became a significant problem especially in view of the great losses resulting from the economic crisis which finally led to decreasing costs. However, the financial sector in Hungary still continued to generate unduly high costs in the case of mandatory private pension funds (Magyarország Kormánya, 2012). The amount of operational expenses was 137 billion HUF in the Hungarian mandatory private pension fund system in the period between 2000 and 2010. Operational expenses were limited by legal regulations from the beginning. However, their amount (6 per cent, 5.5 per cent, and 4.5 per cent) still remained high at the international level, which was shown by the related OECD analysis. This high cost level made it possible mainly for large pension funds to waste money during their operation. Larger mandatory private pension funds usually outsourced the tasks which were within their scope of activities to organisations – mostly fund services – dealing with the given duties in a professional manner. Fund services usually performed administrational and registry activities, as well as recruitment of members for private pension funds. Due to the practice of these fund services of invoicing complex administrational costs, the operational expenses of the sector appeared in a non-transparent way in the financial reports of private pension funds (Magyarország Kormánya, 2012).

Mostly as a consequence of the actions described above, the return of Hungarian mandatory private pension funds was especially low in the 13-year-long period

PSZ 2017. angol.szam_beliv_v16.indd 175 2017. 04. 06. 7:29:04

between 1997 and 2010 and was not even on a par with inflation; they had a negative return. None of the mandatory private pension funds operating in Hungary reached the level of the index of short-term government bonds (RMAX), but they were significantly lower. Consequently, Hungarian mandatory private pension fund members would have been better off if these funds had invested the savings of their members into Hungarian government bonds (Magyarország Kormánya, 2012; KEHI, 2011).

The affected countries (including Hungary) had to face a dual problem. In addition to the narrowing scope of budgetary action as a result of the funded pension pillar, they also had to deal with its loss of popularity. All these factors made it obvious that the continuation of the pension reform would only be justified if it were carried out more carefully. The restructuring of the pension system in order to provide financeability in the long run can only be undertaken if it does not result in a more unfavourable situation.

By prescribing a maximum level of only the explicit state debt instead of the whole state debt (implicit & explicit), the EU's Stability and Growth Pact did not support reforms aiming at the recapitalisation of pension systems since the point of recapitalisation is making part of the implicit state debt explicit.

However, the framework conditions should have been reshaped, since the restructuring process endangered the benefits of a certain proportion of pension fund members in the given situation and it significantly held back the scope of budgetary action of all the affected countries. The conditions should have been changed in a way to provide tangible advantages and acceptable risk to all parties affected by the funded scheme – both society and the public finances in addition to the financial sector operating the system.

The Ministers of Economy and Finance of the nine affected Member States of the European Union sensed these dilemmas and sent a joint letter to the heads of the European Union in August 2010. In this letter, they pinpointed that the approach laid down in the Stability and Growth Pact establishes an unfavourable situation for the countries which carry out pension reform in order to provide for the long-term sustainability of the state budget. The ministers requested a modification of the points set out in the Pact in order to abolish this discrimination.

The European Union's Commissioner for Economic and Monetary Affairs responded with an understanding of the initiative. At the same time, the Commissioner declared that the EU's rules currently in force do not make it possible for the revenue of private pension fund systems to be accounted for as public finance revenue. According to the standpoint of the European Commission, the extra expenditures arising from the introduction of the private pension fund system can only be taken into account if the launching of the excessive deficit procedure is at stake.

The need for restructuring of the Hungarian Three-Pillar Pension System

Between 2008 and 2010, the Pension Insurance Fund requested a public finance contribution of around 600–700 billion HUF each year and the deficit would have grown to around 800 billion HUF by 2011 without the subsequent measures taken by the

PSZ 2017. angol.szam_beliv_v16.indd 176 2017. 04. 06. 7:29:04

Orbán government. Since the Hungarian pension expenses are high by international standards, the constantly deteriorating demographic circumstances would have resulted in a further increase in the deficit. The government realised that the solution for two of the most fundamental problems of the Hungarian economy – the low level of economic activity and population decline – cannot be provided by the constant modification of the pension fund system with a "patch and mend" approach. The ageing of the population should not have been used as a pretext for discrediting and, consequently, eliminating the existing social protective systems in order to substitute them with systems which serve a different purpose, i.e. the extension of the liquidity of capital markets. For this reason, in 2010, the new Hungarian government made it clear that they wanted to solve this problem by focusing Hungarian economic policy on two areas: increasing employment and preventing population decline (NGM, 2011).

The assumption that the conversion to a capitalised private pension fund system would automatically reduce the evasion of the payment of contributions proved to be wrong. Also, after the drastic reduction of benefits, the issue of maintaining the standard of future benefits gave grounds for serious concern and the measures by previous governments resulting in the reduction of pensions and their value in real terms further increased these concerns.

During the introduction of the Hungarian pension reform in 1997, the risk of macro-economic considerations overriding social political objectives should have been taken into account; therefore it should have been clarified which values were at stake. The primary purpose of the pension reform should have been the improvement of old age income security, independently of the suggested model. No series of political steps can be called pension reform if they do not improve pension benefits, but make them uncertain, even if they have a positive effect on certain areas. In fact, it became obvious by 2010 that the pension reform of 1997 did not live up to the expectations at all and was a complete failure. Even though this reform undoubtedly contributed to the extension of international capital market liquidity, it had a very slight contribution to the improvement and growth of the Hungarian economy, the development of Hungarian investments, the growth of savings and the accumulation of Hungarian capital. Neither did the introduction of the mandatory private pension fund system make the finance of the pension fund system easier and more secure. The experts and politicians with an interest in the development of private pension funds, together with the international financial institutions, banks, investors and the media interested in maintaining and extending the system, created the false illusion that the new private pension fund system introduced in 1997 in Hungary would be capable of this task. On the contrary, this system significantly contributed to an increase in the budgetary deficit and state debt. As time went by, further limitations, weaknesses and imperfections of the private pension fund system were revealed and it eventually failed internationally in 2007 as a result of the global financial and economic crisis before it could become an orthodox system and take root in the more developed countries of the world as expected by its followers. Today, both internationally renowned financial

PSZ 2017. angol.szam_beliv_v16.indd 177 2017. 04. 06. 7:29:04

experts and journalists ask what the point of the whole system is if no positive benefit can be expected from retirement savings (Flood, 2013). "Not only did the mandatory private pension fund system not solve the problems of the already defective Hungarian pension fund system, but it became another severe social and economic problem itself… The amount of operational costs and unrealised profits is around 850 billion HUF" (Magyarország Kormánya, 2012).

The assumption of the World Bank that capitalised private pension fund systems are of higher standard than 'pay as you go' state systems was proved to be wrong. There are many 'pay as you go' systems successfully operating in the world today without being on the brink of bankruptcy. Undoubtedly, strengthening the close correlation between paid contributions and paid pensions could improve the transparency and acceptance of non-capitalised systems, but all these can also be performed without privatising old age security. It also became clear that the solution to problems with demography and low economic activity cannot be postponed or swept under the rug on the pretext of reforming the pension system. These problems must be solved as soon as possible independently of the difficulties of operating the pension fund system.

There is a growing imbalance emerging between numbers of entrants to the labour market and those leaving (see Table 3). Fewer and fewer people entered the labour market in recent years. There are two main reasons: firstly, there were fewer and fewer people of working age and, secondly, those aged 15–24 became a smaller and smaller part of the population.

Table 3: Hungarian total population, by age groups (thousands)

Age group	**1990**	**1994**	**1998**	**2002**	**2006**	**2008**
Total population	8244.3	8370.5	7755.8	7762.2	7721.8	7710.2
15–19	766.9	869.1	720.6	634.1	609.2	600.5
20–24	678.7	745.2	872.4	739.4	644.7	627.7
50–54	597.7	633.2	648.4	728.3	820.3	802.4
55–59	607.5	558.9	569.2	605.7	668.6	694.7

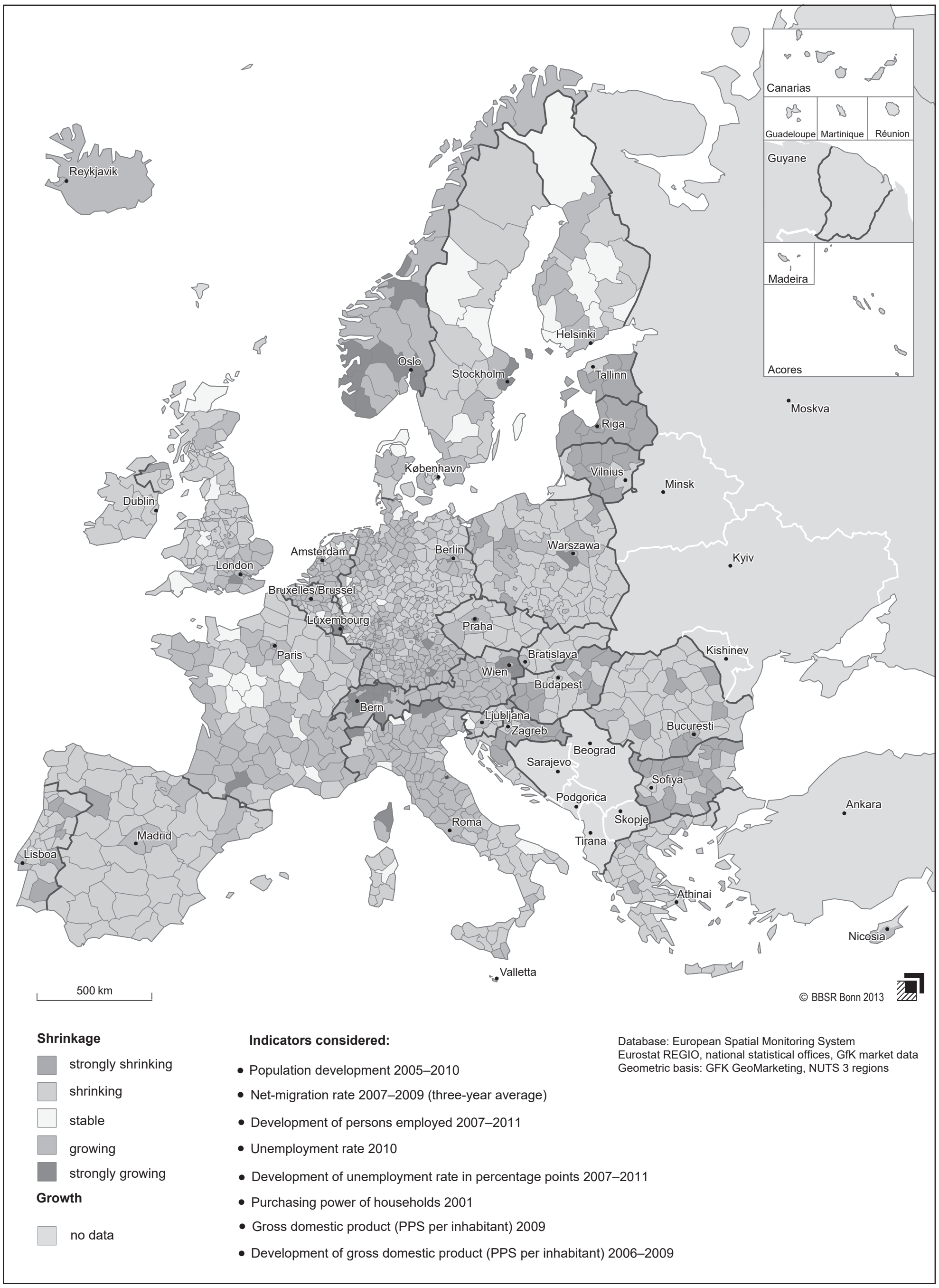
Source: ILO, http://laborsta.ilo.org/STP/guest

Similarly to other Member States of the European Union, Hungary faces a severe demographic crisis; life expectancy has increased by around 5 years during the last 50 years and it is predicted to increase by a further 7 years by 2060. The low number of birthsand a dramatic change of the age composition of the population has resulted in an ageing society. One of the consequences of these phenomena is that the old age dependency ratio will be doubled: currently, the EU average of the amount of people of active age per person above 65 years of age is four (the situation in Hungary is worse), while it is expected to be only two by 2060 (Prugberger–Barta, 2015).

A new analysis of the Federal Institute for Research on Building, Urban Affairs and Spatial Development (BBSR) reveals large disparities in the population development within Europe. The BBSR collected data between 2001 and 2011. While that might

PSZ 2017. angol.szam_beliv_v16.indd 178 2017. 04. 06. 7:29:04

Figure 1: Growing and shrinking regions in Europe (2005–2010)



Source: The Federal Institute for Research on Building, Urban Affairs and Spatial Development (BBSR), 2015

PSZ 2017. angol.szam_beliv_v16.indd 179 2017. 04. 06. 7:29:04

sound slightly outdated, these are actually the most up-to-date figures Europe has to offer, as 2011 is the most recent year for which comprehensive population data is available for the whole of Europe. Shrinking and growing regions are often side by side. The results of the censuses carried out in Europe in 2011 provide the basis for a EU-wide comparison of the population development in 2011 based on the latest census of each country, which was generally carried out in 2001. The regional picture of growing and shrinking regions in Europe shows their parallel development in nearly all countries. Only a few countries reveal homogeneous national development trends e.g. Switzerland and Norway ("growth") or Bulgaria and Hungary ("shrinking") (see Figure 1).

In addition, the level of employment in the European Union was the lowest in Hungary. According to 2010 data, the Hungarian employment level was 8.7 per cent lower than the EU average. Of the new Member States of the EU, the level of employment increased by nearly 10 per cent in Bulgaria and by nearly 8 per cent in Poland between 2002 and 2010, while that of Hungary decreased (by 0.5 per cent) in the same period (Novoszáth, 2014).

Hungary steps towards correction of the pension reform

In this new situation, Hungary was forced to take action. The central budget had to compensate for the contribution deficit resulting from the introduction of the mandatory private pension fund system by paying the amount of deficit to the Pension Insurance Fund. On this account, the state provided a total of 2043.2 billion HUF budget support to the Pension Insurance Fund between 1998 and 2009 and 372.4 billion HUF was planned to be provided in 2010 (Magyarország Kormánya, 2012). These amounts transferred from the central budget to the Pension Insurance Fund increased the budget deficit from year to year. The Hungarian state covered the deficit by issuing government bonds and taking loans which eventually increased the deficit with their interest. At the same time, Hungary declared several times and in an unambiguous way that it aspired to make its budgetary balance indexes in conformity with its obligations arising from EU membership. However, after examining the budget processes of 2010 and planning the scope of budgetary action of 2011, it became obvious that the narrow scope of budgetary action restricted the state's ability to comply. Even the measures which were indispensable for putting Hungary on a path to growth were at risk. Expectations concerning future measures also caused uncertainty in the private pension fund system.

In October 2010, in order to continue the pension reform more carefully, the Government of the Republic of Hungary initiated several steps which were adopted by the Parliament. The most important measures were the rules of free choice of pension funds as set out in Act C of 2010 which came into force on 3 November 2010. The most important rules were as follows:

– The mandatory private pension fund membership of career-starters was phased out. However, insured employees under 30 years of age and those above 30 years of age entering into an insurance scheme for the first time in Hungary can also establish membership of a pension fund.

– The opportunity of returning to the social security pension system was provided to all private pension fund members. This step gave a chance to those who voluntarily became pension fund members to rethink their previous decision, this time possessing all-inclusive information under the new circumstances. They were given fair information about the possibility of returning, with both the benefits and risks of this decision being pointed out, and they had the opportunity to weigh their experience of the operation of the private pension fund system. According to the previous rules, those who were obliged to establish a membership with a private pension fund by law also had the opportunity of returning to the social security pension system.

– The membership fee to be paid by each private pension fund member (8 per cent of their income) were accounted for as pension contribution between 1 November 2010 and 31 December 2011. Therefore, this amount was added to the revenues of the social security pension system. This step is basically the same as the crisis management measure used by Estonia between 1 June 2009 and 31 December 2010. This change did not affect private pension fund members adversely. Those who decided to return will be handled as if they had not ever established a pension fund membership when determining the social security pension benefits. In the case of those deciding to maintain their private pension fund membership, this period will be accounted for during the determination of their future pension benefits. Their benefits will be calculated by taking into consideration that not only the three quarters, but the whole amount of their pension contributions were transferred into the social security pension system for 14 months. Therefore, no pension member will lose money.

Both the returning of private pension fund members into the state pillar and the transfer of private pension fund membership fees for 14 months resulted in extra income for the social security pension system, which was partially a short-term and also long–term extra resource. On one hand, this amount reduced the increasing deficit of the social security pension system, while, on the other hand, it was spent on reducing the state debt. The extended scope of budgetary action made it possible to take the measures needed for launching economic growth and for providing stability for the Hungarian economy.

There was a significant change in the social security pension system on 1 January 2012. In accordance with the Hungarian Constitution, pensioners are defined as those who have reached retirement age and women who have obtained the right to retire after a 40-year-long eligibility period. In the future, pension benefits before retirement age and disability pensions will not be financed from the Pension Security Fund and not as pensions, but as other benefits.

In recent decades, it was possible for pensioners to obtain pension benefits and discounts based on various different allowances before actually reaching retirement age. For this reason, the actual age of becoming a pensioner was only very slowly moving closer to retirement age. In the future, anticipatory old-age pension benefits, reduced anticipatory old-age pension benefits, early retirement pensions benefits, pensions

PSZ 2017. angol.szam_beliv_v16.indd 181 2017. 04. 06. 7:29:05

benefits of miners and artists, service pensions, the pension benefits of parliamentarians and mayors and early old-age pension benefits will not classified as pensions. At the same time, the benefits listed above will increase to the same extent as pensions and the rules of taking a job while obtaining these benefits will be the same as in the case of pension benefits obtained prior to retirement age. In the case of two special allowances, those working in underground mining can obtain entitlement to miner benefits and the artists of four special ballet companies can obtain entitlement to ballet artist annuities. However, these two benefits are not classified as pensions either and they are governed by the rules of benefits before retirement age (NGM, 2012a).

According to the Hungarian Constitution which entered into force on 1 January 2012 and the Stability Act, private pension funds are no longer part of the mandatory pension system. In accordance with Point (4) of Article XIX of the Hungarian Constitution, "Hungary shall contribute to ensuring the livelihood of the elderly by maintaining a general state pension system based on social solidarity and by allowing for the operation of voluntarily-established social institutions. The conditions of entitlement to state pension may be laid down in an Act with regard to the requirement for stronger protection for women."

After 97 per cent of previous members returned to the state pillar in early 2011, around 100,000 members remained in private pension funds, representing around 250 billion HUF. Paragraph 42 of the Act no. CXCIV of 2011 on the Economic Stability of Hungary which entered into force on 1 January 2012 stipulated that solely the Pension Insurance Fund is entitled to pension contributions (10 per cent) paid by natural persons based on statutory obligations. This provision established a new situation in the pension system.

The rule about "contracting out" was abolished; therefore, it follows from the general rules that private pension fund members can obtain entitlement the same way (100 per cent) as those entitled to pension benefits in the social security pension system from 1 January 2012 (however, specific calculation rules still have to be refined). Remaining members obtained 75 per cent pension entitlement referring to the period before 31 December 2011, which increases to 76 per cent due to the compensation provided as a result of forwarding the membership fee for 14 months.

As a result of the legislative amendment in late 2011, the possibility of returning to the state pillar was provided to private pension fund members again until 31 March 2012. The detailed rules referring to returning were mostly the same as those of the returning opportunity in 2011 (public duty exemption was also provided). Around 25.03 per cent of private pension fund members returned to the social security pension system in the second period. Therefore, the number of private pension fund members decreased below 75,000 people.

Every member had the option of remaining a member of private pension funds if they wanted to. Even today, there are numerous private pension funds operating in the country with a member list of around 75 thousand people. However, career-starters are not obliged to become a member of private pension funds and the option of previous private pension fund members to return to the state pillar is now available.

PSZ 2017. angol.szam_beliv_v16.indd 182 2017. 04. 06. 7:29:05

A Hungarian citizen filed a complaint on this matter which the Strasbourg European Human Rights Court dismissed on 13th January 2013 on the grounds that no rights to private property were violated. The court rejected the petition.

Conclusion

A few years ago, it was heresy in Hungary to curb the mandatory private pension system. Today, even the IMF's former chief economist Mark Allen (Bielecki–Allen, 2014) argues for similar steps and the Czech Republic, Poland, and Slovakia have also followed the Hungarian example. It has become apparent that the low yield and high cost did not serve the interests of pensioners.

The Hungarian social security system will work in a stable and sustainable way in the long run only if the currently prevailing unfavourable proportion of active and inactive people can be altered drastically and if the number of entrants to the labour market permanently surpasses the number of those leaving the labour market. The currently declining demographic trend also needs to be reversed. None of the Hungarian governments in office before 2010 realised that extension of employment, the reduction of economic inactivity among the active population and increasing the number of births are the key factors for the growth of the Hungarian economy and the financial stabilisation of the Hungarian social security system. A radical change can only be expected from 1 million new taxpayers and 1 million more newborns in the upcoming ten years.

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PSZ 2017. angol.szam_beliv_v16.indd 184 2017. 04. 06. 7:29:05

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Ákos Szalai – Pál Péter Kolozsi

What Shall We Do for a More Competitive Hungarian Economy?

Thoughts About the Monograph Competitiveness and Growth *of the Magyar Nemzeti Bank*[1]

Summary
Since 2010 Hungary has implemented a major turn in its fiscal policy which was followed by a fundamental change in its monetary policy resulting in a new era concerning the growth of the Hungarian economy. These changes form the basis of an economy being simultaneously characterised by balance and growth. Over the last six years the position of the Hungarian economy has been improving significantly especially concerning the quantitative aspects of competitiveness, the results of which have been recognized by financial and capital markets in addition to international organizations and the major credit-rating agencies. However, a faster and more sustainable convergence requires an improvement concerning the qualitative characteristics of the economic resources as well. For an outbreak from the moderately developed economic status it is essential to speed up the catch-up process with additional reforms focused on competitiveness. Along with the relevant international best practice and the theoretical background, the new volume of the book series of the Magyar Nemzeti Bank entitled "Competitiveness and Growth" presents also the necessary measures for that "competitiveness revolution".

Journal of Economic Literature (JEL) code: E58, E62, H20, J20, O40
Keywords: monetary policy, human capital, financial stability

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PSZ 2017. angol.szam_beliv_v16.indd 185 2017. 04. 06. 7:29:05

Introduction

What is the key factor to economic growth and performance? What differentiates successful economies from the ones that lag behind? What should be done to achieve economic and social development? – Considered as an independent science, economics has handled this dilemma since it was formed. It is quite telling that Adam Smith's, the father of economics, main work published in 1776 focused on what is behind the nations' economies, what explains if a nation has an abundance or shortage of necessities and convenience goods (Smith, 1776). For more than the last 200 years the question of competitiveness on a micro- and macro-economic level has remained in the centre of attention of both the mainstream and the alternative schools of economic thought.

However, in the last decades the approach has become dominant but not predominant in the practice of economic policy that competition and the market themselves create development, and there is no need for state intervention to build up competitiveness consciously. The global financial and economic crisis that broke out in 2008 brought about changes in this respect as well, because it drew attention to the importance and responsibility of the state and to the fact that growth in itself is not sufficient: processes that do not converge with the equilibrium, and are not structurally founded, i.e. unsustainable, and leed to collapse sooner or later. Therefore a real solution may only be constituted by an economic policy offering firm grounds for the whole economy, and ensuring a place in the global competition: in other words it creates competitiveness. This experience was especially true and relevant in countries that were struck hard by the crisis – in Hungary as well among others, where several turnarounds in economic policy had to be implemented to restore stabilisation, economic balance, and to initiate the process of sustainable growth and an effective convergence that yields results.

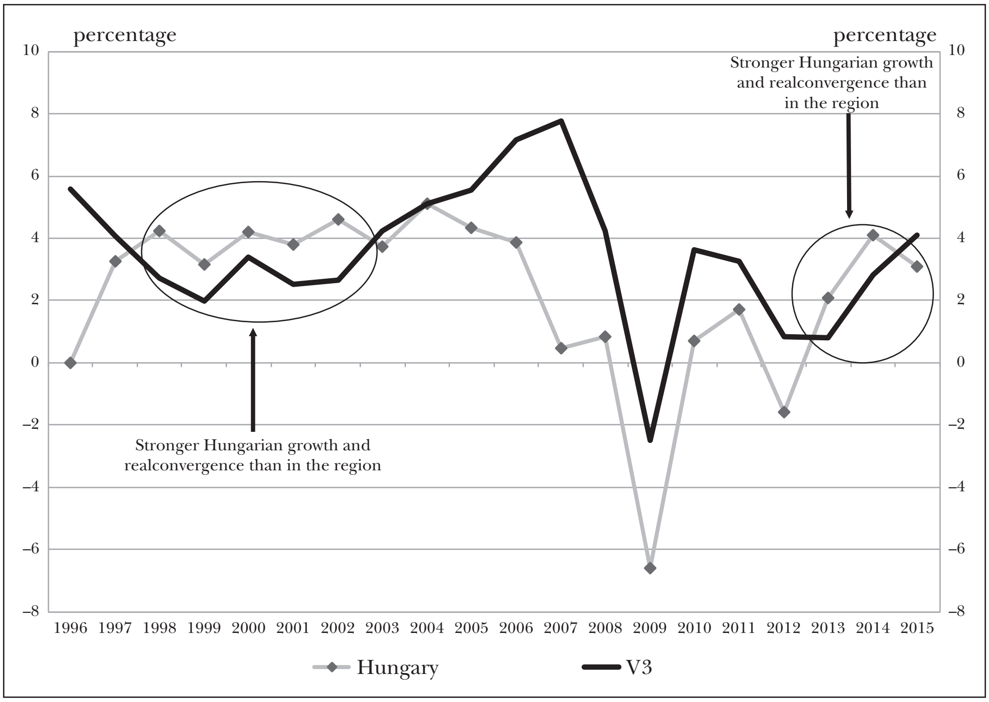
To cope with the challenges facing Hungary it is essential to improve economic thinking in Hungary, to integrate modern economic approaches that implement and exploit experiences stemming from the crisis and adjusts them to the domestic situation. Having established this as its objective the Magyar Nemzeti Bank (MNB) launched a series of books in 2015 by the publication of Economic Balance and Growth (Matolcsy, 2015), and it went on to publish the monograph Competitiveness and Growth in 2016 as the second piece of this series. The volume that aims to contribute to the public thinking on the subject of sustainable economic growth and competitiveness to promote the government's economic policy (Matolcsy, 2016) – fills a gap, primarily because it does not only facilitate the comprehension of the present challenges by examining theoretical studies and listing global experiences but it also sets 50 actual proposals for measures, which marks a break from the ivory tower attitude so typical of academics. The relevance of the proposals, the justification and timeliness of the volume is highlighted by the fact that the government and the central bank have implemented more than 40 per cent of the proposals.

PSZ 2017. angol.szam_beliv_v16.indd 186 2017. 04. 06. 7:29:05

The further improvement of competitiveness as the effective continuation of the reforms in Hungary after 2010

To fully understand the analyses and the proposals in particular set forth in the volume it is worth looking back to the recent events in the Hungarian economy and economic policy. At the beginning of the 2000s the competitive advantage of Hungary, a country considered number one in the region, had diminished to zero by the end of the 2000s as a result of the irresponsible economic policy and the wrongly structured economic model. Consequently a fundamentally weakened economy had to face the global financial and economic crisis; which economy had already been lagging behind the region by that time. Following the transformation crisis after the political transition Hungary had exhibited a relatively dynamic convergence until the beginning of the 2000s, and as a result the country held a strong position in the region (Figure 1). Subsequently, however, the Hungarian national economy – in spite of the favourable global real economic activity – fell behind the competitors in the region gradually, which is attributable to the applied unsustainable economic model that was fundamentally wrong in its structure and was based on external indebtedness.

Figure 1: Changes in the annual real economic growth in Hungary and the Visegrád region (V3) (GDP, year/year)



Source: Eurostat

The direct impact of the unsustainable model was that the growth in real economy supported artificially from external sources came to a halt in 2007, the employment rate was stuck at a low level, the current account and the budget balance showed high deficit permanently and the public debt rose significantly, which was coupled with the indebtedness of the private sector in foreign currency carrying an outstanding systemic risk (Matolcsy–Palotai, 2016). The serious macrostructural problems stemming from irresponsible and incoherent economic policy became even worse due to the global financial and capital market crisis in the autumn of 2008, and a national economy had to face this crisis which had already been weakened in its economic fundamentals and become unfit for competition.

The turnaround in fiscal and monetary policy after 2010 and 2013 respectively, provided a foundation for the economic growth coupled with balance by creating a healthy economic structure, which is one of the fundamental pillars of lasting convergence. After 2010 there was a sharp paradigm shift in the economy. It marked the start of a new economic policy in its approach and foundations that created an economic model – by gradually strengthening the domestic factors of production through structural reforms – which supports growth and also ensures external and internal macro-financial stability of the national economy. Following the realisation of the fiscal consolidation there was a major turnaround in the monetary policy from 2013. Consistent with its primary mandate, the central bank launched several innovative programmes to stimulate growth and to achieve a well-structured funding supported by the domestic investor base, beside its permanent base rate cut cycle.

As a result of the substantial structural changes the two main branches of the economic policy (fiscal and monetary policy) showed unprecedented coherence, which provided the basis for permanent economic convergence concurrently ensuring economic balance and growth. The results of this successful economic model have been visible for years. In the fourth year of real growth unemployment rate fell to historically low levels, the current account deficit has shown a surplus permanently, the government deficit-to-GDP ratio has remained well below 3 per cent and the public debt ratio has followed a downward path persistently, and foreign currency loans have been phased out of the households' balance sheet that constituted the basis for external vulnerability and hindered growth. Now the macroeconomic results achieved so far have not only been acknowledged by money and capital market participants but also by international organisations and credit rating agencies.

To rise from the moderately developed economic status it is essential to accelerate convergence; and to that end further reform measures need to be implemented that focus on the qualitative aspects of competitiveness. To maintain the results achieved since 2010 and to speed up permanent economic convergence it is imperative to improve our effectiveness and capacity of creating value. To that effect reform measures are required that further enhance competitiveness and favour qualitative over quantitative aspects in increasing resources. The acceleration of convergence in the global race of national econo-

PSZ 2017. angol.szam_beliv_v16.indd 188 2017. 04. 06. 7:29:05

mies is primarily warranted by the fact that Hungary regained its previous leading position within the region, as well as the need to escape from the middle income trap: something only few countries in the world have managed to do thus far.

The proposed measures aiming at the improvement of competitiveness, and their implementation up to now

The volume edited by Dániel Palotai and Barnabás Virág containing studies by numerous experts and analysts at the MNB specifies six areas of the multi-dimensional, tightly interrelated competitiveness criteria set while examining its domestic aspects: the competitiveness of employment, corporate sector, the state, human resources, the banking sector and the more effective utilisation of the EU funds. We present below the proposals for measures in the volume through the quantitative and qualitative dimensions of human and physical capital specifically mentioning the actual measures by the government and the central bank that have been implemented since the volume was published.

Increasing the volume of human capital

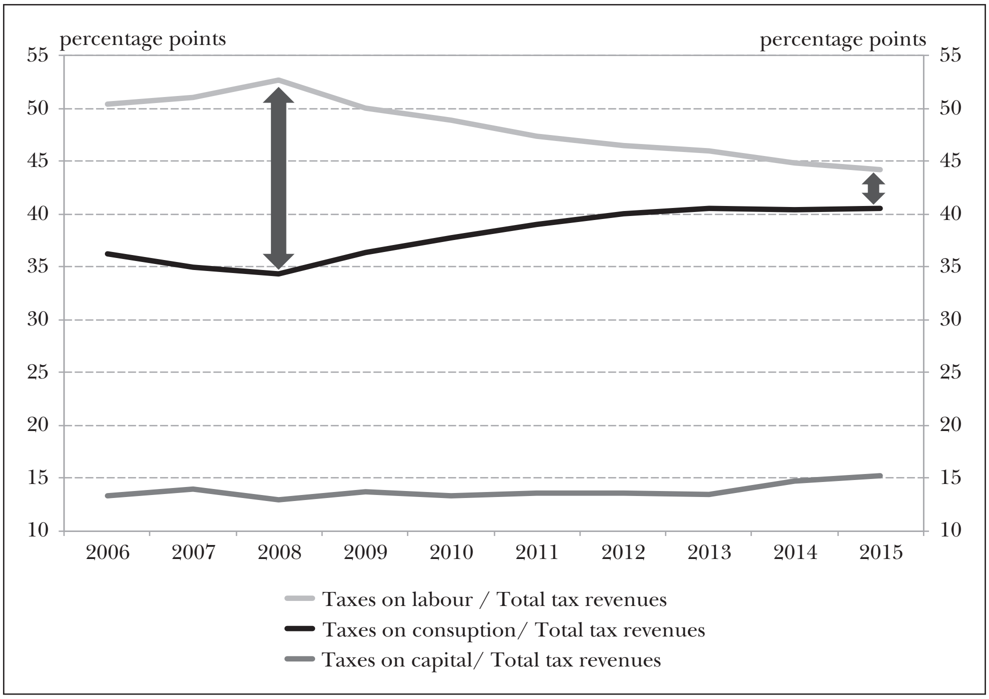
The volume pinpoints the unfavourable demographic processes as the potential obstacle of growth, and proposes measures aimed to mitigate and turn around these processes. One of the pillars of long-term growth potential is the continuous and active availability of the volume of human resources. The volume of human capital is determined by the demographic process typical of the national economy over the long-term. Similarly to the trends in Europe the gradual and permanent decline in the number of population and its aging have been observable in Hungary for decades, and this creates a production limit hindering economic growth seriously in the long term. To remedy this problem the volume proposes the implementation of numerous measures to increase birth rates, fertility rates. For example the expansion of the upper limit of the childcare benefit, the significant increase of the family tax base allowance for families who choose to have a second child, the increase of the one-off state (maternal) allowance after childbirth, quantitative improvement in nurseries and kindergartens, and the establishment of a family friendly workplace environment, promoting its publicity, and the improvement of day-childcare. The further, gradual increase of the family tax base allowance, the family housing allowance, as well as first marriage tax allowance and graduates' childcare benefit encourage young people to start a family and have children.

It is possible to achieve labour market activity and the increase of employment within the whole population through such tax incentives as the reduction of taxes on labour. Although as a result of the reform measures after 2010 Hungarian labour market data improved significantly, they are not outstanding in a regional comparison, therefore the volume suggests further measures should be taken in the area. A measure that would stimulate both the demand and the supply side of the labour market is the reduction of taxes on labour. According to the literature and the recommendations by international organisations (European Commission, IMF, OECD, World Bank) in addition to taxes on capital taxes on labour have a truly harmful and distortive effect on the economy. For this reason it is widely agreed that the transformation of the tax structure is more effective if the balance of tax centralisation is shifted from the taxes on labour to the taxes on consumption that have a less distortive effect. Such a change in the structure lessens the distortive effects taxation has on the economy, it promotes formalising the economy, increases employment, real growth and improves competitiveness over the long term (OECD, 2010). After 2010 the fiscal policy has been following down this path (Figure 2). For example the introduction and the reduction of the flat rate, proportional personal income tax (PIT), – through an increase in net wages – promoted the labour supply on both the extensive and the intensive margins, and it lessened the willingness to underreport income both on the employer's and the employee's part. The MNB's volume supports further cuts of the personal income tax. Moreover, burdens imposed on labour will be reduced by the targeted exemptions of employer's social security contributions implemented earlier within the framework of the Job Protection Action Plan (JPAP) that supports 850–900 thousand employees. The volume also makes a proposition to increase these and to extend the exemptions to more employees. The government decision made in November 2016 fits in this path of tax policy that stimulates competitiveness. According to this, in 2017 employer's social security contributions will decrease significantly from 27 per cent to 22 per cent. Moreover, they will fall further by 2 or 2.5 percentage points in 2018, which may continue in 2019–2022 depending on wage growth. In addition the minimum wage and the guaranteed minimum wage will increase from HUF 111,000 to HUF 127,650 and from HUF 129,000 to HUF 161,250 in 2017 respectively (in 2018 another 8 and 12 per cent increase may be expected). Mutually reinforcing one another, these measures stimulate willingness to take jobs significantly, and may contribute to reduce labour shortage in several settlements and sectors.

In addition to the reduction of taxes on labour other alternative measures may also support the working age population in their willingness to take jobs actively on the primary market. According to the volume these measures include the improvement of the training aspect in the public employment programme and linking the programme to the private sector (providing temporal financial aid to the latter), as well as strengthening certain elements of the pension system that encourage pensioners to stay on the labour market, or stimulating atypical employment (telecommuting and part-time jobs). The fact that the SMEs that undertake to offer part-time employment receive subsidies is closely related to this. Another incentive is that public employment is counted towards the job-seeking period from June 2016 onwards, therefore they become eligible for JPAP allowance. Additionally to increase support to provide incentive to young people who are the least employed (those under the age of 25) to work the government initiated the creation of a multi-step system called National Youth Guarantee.

PSZ 2017. angol.szam_beliv_v16.indd 190 2017. 04. 06. 7:29:05

Figure 2: Changes in the Hungarian tax structure



Note: Eurostat data are available until 2012, data of 2013–2015 are based on calculations made by the MNB
Source: Eurostat, MNB (Matolcsy–Palotai, 2016)

Improving the quality of human capital

Another significant factor of the successful economic convergence is the high quality of the human resources actively participating on the labour market, which can be ensured by the appropriate quality of education and health care. The improvement of labour quality is able to increase competitiveness and the growth potential of the real economy over the long term through the capacity of innovation and thus labour productivity. This can be achieved primarily by the quality development of education and healthcare services. According to the volume, as state spending on education as a percentage of GDP in Hungary remains below the average of the OECD countries, it would be appropriate to increase the public and private funds spent on education. For example this objective is supported by the introduction of the teacher career path model and the dynamic wage and knowledge development for several years as a part of the programme. Over the long term this supports the improvement of the quality of public education; however to achieve this the structural development of the education is also required. Although the introduction of the dual vocational training system may be considered as significant step forward Hungary is behind with regards to the achievement of basic skills (counting, writing, reading, reading comprehension). The aim of the strength-

PSZ 2017. angol.szam_beliv_v16.indd 191 2017. 04. 06. 7:29:05

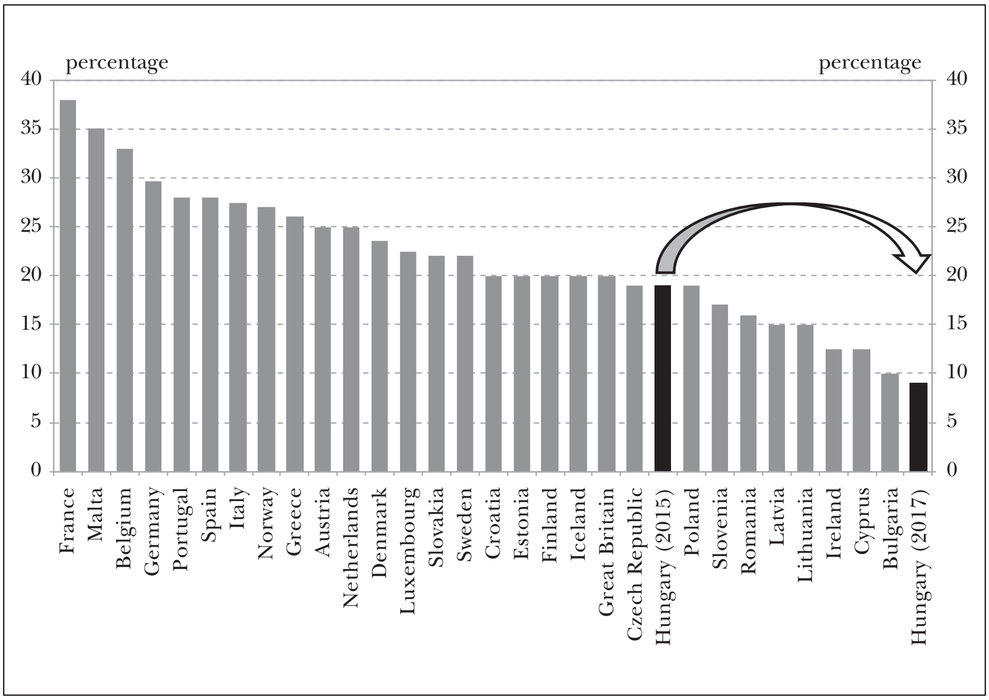
ening of competence- and skill-based curriculum adjusted to labour market needs and the introduction of the 9 grade education is to correct this. The improvement of language skills (in secondary education), and increasing the number of those holding university degrees especially in the field of science and technology, appears as another proposal, which may facilitate the adjustment to labour market needs.

It is concluded that the Hungarian healthcare system struggles with a lack of funding and resources, therefore it would be justified to provide additional resources, and the ideas in the volume see it partly achievable through the involvement of private funds. The volume points out that the health status of the Hungarian population is poor in international comparison: life expectancy at birth is significantly below the level our economic development would suggest. To tackle this effectively strengthening preventive healthcare in Hungary may prove to be a good solution through making regular check-ups more frequent and compulsory, encouragement of sport activity at the workplace and in school (e.g. by reducing the VAT on sports equipment), or raising the public health product tax further. In addition to these "mental health" is an important factor in competitiveness, and every measure that aims to improve the mental state of the public supports this. These measures include the implementation of the elements strengthening mental health into the education programme (e.g. self-awareness, stress management), as well as creating a national network for mental health or supporting telephone counselling services. The creation and implementation of the new National Youth Strategy also serves to strengthen preventive healthcare, which aims at the health promotion of school-age children and young people exploiting the instruments and methods of school social aid.

Increasing the volume of physical capital

Another key factor of creating competitiveness and persistently dynamic real economy convergence is the permanent and yet developed availability of physical capital. From the perspective of competitiveness and further progress the rate of capital accumulation of the corporate sector and its structure are important factors. Basically stability and profitability are required for corporate creditability, which can be supported through the tax system in a number of ways. According to the volume one instrument to achieve this can be the creation of a tax system that promotes productive private investments. In addition, corporate profitability and capital accumulation are supported by the reduction of corporate tax (as income tax) or the simplification of its payment (IMF, 2016), as well as through approaching the corporate income tax towards cash-based taxation. The latter has not been announced, but the former has: the so far progressive – with rates of 10 and 19 per cent – corporate income tax (CIT) is expected to become a flat rate and single-digit system in 2017 (9 per cent, which in turn will be the lowest corporate income tax rate in the European Union), and the conditions to access simplified and preferential small business taxation forms (kata, kiva) will be made easier in 2017, therefore they become accessible for more. In addition, the volume offers setting up a competitive guarantee organisation and the more effective utilisation of EU funds as a proposal, which may promote availability of loans to SMEs from both the demand and the supply side. This might increase employment and economic competitiveness over the short term. The reduction of regulated energy prices is also mentioned in the volume, which has only been introduced in the household sector so far.

Figure 3: The marginal upper rates of corporate income tax



Source: OECD

The improvement of the quality of the physical capital accumulated in the corporate sector

The quality of accumulated physical capital, and the effectiveness and productivity on corporate and macro-economic level can be improved significantly by increasing the expenditures of corporations on research and development (R&D). In this respect Hungary is doing relatively well compared to other competitors in the region; however, its performance is below the average in the European Union. Corporate trainings and spreading research cooperations between universities and corporations may provide an effective tool to improve this (EC, 2016). The volume also suggests increasing the number of researchers and developers in a way that would extend the benefit for researchers and developers available in social contribution tax to researchers with university degrees employed in research bases in the corporate sector. The authors point out that in addition to this the innovative capacity of the SME-sector would need to be increased, because the proportion of corporations with successful innovation activity in Hungary is far below the aver-

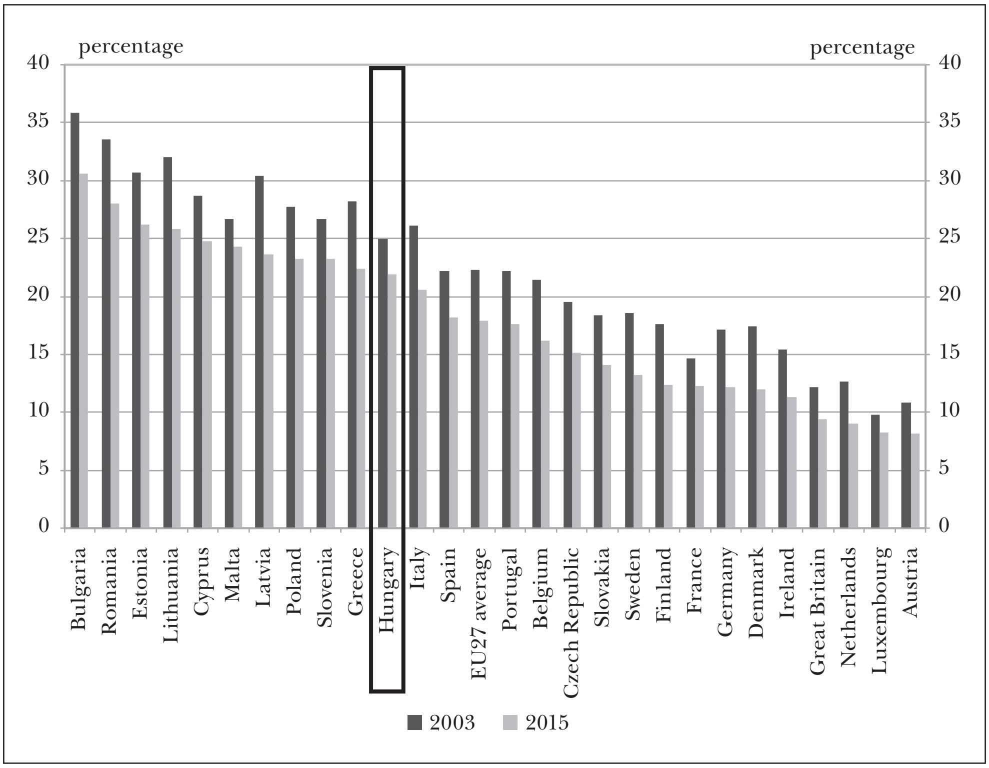
PSZ 2017. angol.szam_beliv_v16.indd 193 2017. 04. 06. 7:29:05

age in the European Union. To close the gap created by this competitive disadvantage the volume proposes setting up non-profit counselling centres as an effective instrument following the English example. A greater proportion of state support provided for R&D activities can be achieved through providing more significant government subsidy to the training of students majoring in the field of science and technology. Research and development can be supported by direct instruments and on the state side.

Reducing tax evasion may have a favorable effect on corporate innovation, which has a positive effect on potential growth through the improvement of productivity (Bobbio, 2016). Tax evasion distorts market competition and the effective allocation of capital, damages fiscal positions, and decreases the social, legal and financial security of employees. With regards to the estimated value of tax evasion as a percentage of GDP (22 per cent in 2015) Hungary is not far off from the competitor countries either, but it exceeds the average in the European Union a little (17 per cent) (Schneider, 2015).

There were several measures created with a view to eliminating the hidden economy in Hungary. As a result, the size of the black economy shrank by more than by 1.5 per cent of the GDP significant budget effect was the connection of online cash registers to the National

Figure 4: The estimated size of hidden economy in European Union member states in 2003 and in 2015



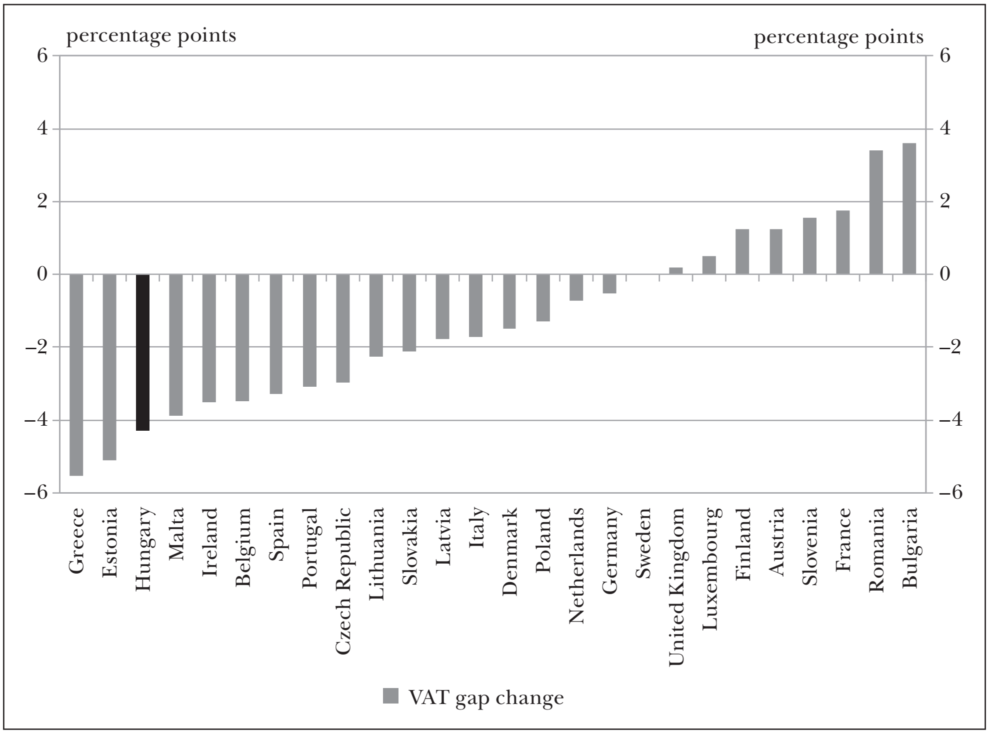
Source: Csomós–Kreisz Hudák, 2015

PSZ 2017. angol.szam_beliv_v16.indd 194 2017. 04. 06. 7:29:05

between 2010 and 2015 (Schneider, 2015). The best-known of these that had the most Tax and Customs Administration (NAV). The number of registers today is close to 200,000, and there will be another 25–30,000 the authority will monitor from 2017. In addition, the introduction of the Electronic Public Road Trade Control System (EKÁER), the targeted VAT-reductions and the application of the reverse charged VAT contributed to the increase of tax revenues from consumption in the past 2-3 years as a result of the reduction of tax rates in numerous cases. These processes and the increase of the estimated implicit VAT-rate by more than 2 percentage points between 2013 and 2015, as well as the steep reduction of the VAT tax gap in 2014 clearly mark the formalisation of the economy (Figure 4). In addition to expanding the group of online cash registers in 2017 the Electronic Public Road Trade Control System (EKÁER) has also been improved since the publication of the volume and the VAT on staple foods will be decreased from 2017 onwards.

The transparent, stable and effective operation of the state is the indispensable condition for the attractive and predictable business confidence required for investments (EBRD, 2016). That is the reason why it is vital that the state should operate a small administration and effective and transparent institutional system. The volume also points out that compared to the European Union the size of the Hungarian state is relatively big

Figure 5: Changes of the VAT gap in EU Member States from 2013 to 2014 (percentage points)



Source: Babos–Kicsák, 2016

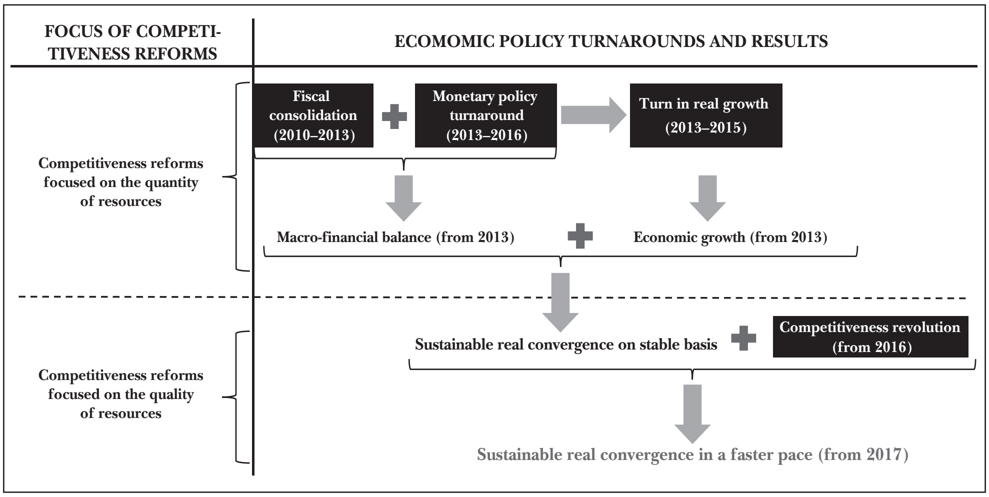
PSZ 2017. angol.szam_beliv_v16.indd 195 2017. 04. 06. 7:29:05

and the state spends too much on itself. For this reason it proposes the revision of the number of state institutions, their labour costs and structure. For the latter the volume puts forward the screening of a wide range of background institutions to ministries and eliminating duplicate institutions as an actual measure. After the volume had been published the government announced significant redundancies in the number of public-sector employees; 44 background institutions were closed to cut bureaucracy. It is also worth mentioning that the volume includes the promotion of the culture of compliance as a measure to increase the effectiveness of the state institutional system. Progress may be expected in this area because the government announced the implementation of a new code of criminal procedure to strengthen the independence of courts and to speed up administration.

Summary

In the last six years there have been numerous structural reform measures to stabilise again the macro-financial balance of the Hungarian national economy as it was at the beginning of the 2000s, and to provide a solid basis for a permanent and successful convergence along with a turnaround in growth through the harmonisation of the branches of economic policy. Over the last six years Hungary has been improving significantly especially concerning the quantitative aspects of competitiveness in national economy resources, the results of which have been recognized by financial and capital markets in addition to international organizations and the three major credit-rating agencies. However, a faster and more sustainable convergence requires an improvement concerning the qualitative characteristics of the economic resources as well, and to that end further competitiveness reforms are needed.

Figure 6: Stylized flow chart of the Hungarian economic policy turnarounds and results after 2010



Source: Own compilation

PSZ 2017. angol.szam_beliv_v16.indd 196 2017. 04. 06. 7:29:06

Filling a gap the MNB's volume was published in recognition of this. It scrutinizes the subject of competitiveness and convergence from various perspectives and in a comprehensive manner, and provides an appropriate basis for the detailed analysis of the Hungarian economic environment an competitiveness. Nearly half of the proposals for measures to be taken in the volume is in the implementation phase, which demonstrates how well-grounded and relevant they are.

The collection of studies entitled Competitiveness and Growth edited by Dániel Palotai and Barnabás Virág may be recommended to both future and practising economists, experts working in the area of public finances and those interested in macroeconomy, as well as domestic non-professional readers who wish to obtain a full comprehension of the theoretical foundations of economic developments in Hungary. The volume is available both in Hungarian and in English, so experts from foreign countries and those interested who face problems similar to those in Hungary may find it a useful reading.

Dániel Palotai – Barnabás Virág (eds.): Versenyképesség és növekedés. [Competitiveness and Growth]. Válasz Könyvkiadó, Budapest, 2016, 832 pages.

Note

[1] The study was created partly by Dr Pál Péter Kolozsi within the Wekerle Sándor Közpénzügyi Tudományos Műhely (Sándor Wekerle Public Funds Scientific Workshop), National University of Public Service, Institute of Public Finances.

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Ágnes Csiszárik-Kocsir

Crisis and Financing – or the Practical Financing Decisions of Hungarian Small and Medium-sized Enterprises[1]

Summary

The standard operational mechanism of economies was substantially overwritten by the economic crisis of 2008. Due to the relative abundance of resources and the lenient banking practices prior to the crisis that focused on bonuses, there were no barriers to lending, which was possible both in foreign or in the national currency. The financial problems that followed the outbreak of the crisis ended the previous lending practice, and the abundance of resources was replaced by poor liquidity, which – along with the macro-economic predicaments – further complicated the struggle by companies to keep their heads above water. The indebtedness of the private sector, increasing input costs, the tightening of the markets and the decline in consumption caused such difficulties in financing enterprises both at a national and international level that after several years a solution had still not been found for them. The negative effects hit the most those small and medium-sized enterprises that had only limited or no access to the international capital markets. The aim of this present paper is to show the transformation of Hungarian small and medium-sized enterprise financing based on the academic literature and the results of questionnaire-based research, and to highlight the main problems and the reactions to them that point the way to recovery. A further goal of the paper is to present the future path for financing the sector and the factors that will influence this path through an improvement in the tax system or support for credit.

Journal of Economic Literature (JEL) code: G01, G30, E51
Keywords: crisis, financing, financing theories, internal financing, external financing

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PSZ 2017. angol.szam_beliv_v16.indd 199 2017. 04. 06. 7:29:06

Literature overview

Dominant theories of capital structure now and then

When we talk about the financing of enterprises and businesses then resources always need to be examined from two aspects. If the structure of financing is examined by the origin of resources, then there are internal resources that derive from the operation of the enterprise, and there are external ones that come from the financial markets. Another interpretation is that resources can be differentiation by their time span, or in other words there are short term (of no more than a year) and long term (of more than a year) resources. Experts in corporate financing have long been interested in the optimal combination of the sources of financing. However, if we think about it, an optimal combination applicable to all businesses cannot exist in any given circumstance, because every company moves in a different market, works with different partners and has potential access to different capital items. In addition to the above, capital structure is also affected by the size and the age of the business, since older and larger enterprises are able to call on external resources more easily, more efficiently and with a smaller cost of capital than their younger and smaller rivals. In the case of older and larger enterprises professional knowledge and the system of relationships are dominant, as a result of which newer and more effective channels are opened up to them in the field of financing (Cabra–Mata, 2003). The choice between internal and external resources also depends on which stage of its life curve the enterprise is in (Ang, 1991). Companies in an early stage do not possess enough internal resources and their financial history is also short so they are not considered to be creditworthy, contrary to companies at the top of their life curve which have sufficient internal resources due to the retaining of their profits, and their history is well-known (Diamond, 1989) to external providers who are keen to lend funds to them.

Financial specialists have been concerned about the theories of capital structure since the middle of the last century. They were trying to find an explanation of the financing decisions of enterprises that could be true in general.

The oldest of the theories is the *classic capital market theorem* of Modigliani and Miller (Brealey–Meyers, 1999), which is also known as the irrelevance principle (Modigliani–Miller, 1958). According to this theory the financing structure has basically no impact on the corporate value, which is calculated using significant assumptions (there are no taxes or transaction costs), so the value of the company – in essence – is subject to the assets on the balance sheet. The theorem received numerous criticisms for its simplifications, and that is why a number of new theories attempted to resolve and modify it.

The *trade-off theory* has been interpreted by several authors. Compared to the classic theorem, it also calculates the value of the interest tax shield, which might make debt financing more favourable than equity financing. The original trade-off theory had also been created by Modigliani and Miller (1963), and then later it was further improved by other eminent authors. The theory states that it would be worthwhile to be in debt, although the financial difficulties caused by indebtedness and the high cost of bankruptcy should not be forgotten (Kim, 1978).

The *principal – agent theory* has been discussed before in connection with many financing issues. The father of the theory is Williamson (1998), who stated that the principal – the owner of the enterprise – does not have an adequate amount of information when making decisions about financing because certain tasks are delegated to the agent or, in other words, to the manager. Managers provide significant help in the operation of business, but the information in their possession may lead to an abuse of knowledge. Hence, due to the information asymmetry, it must also be taken into account that the manager might not choose the financing option most favourable to the company.

The *pecking order theory* (Myers–Majluf, 1984) is related to the previous approach. Information asymmetry is the reason why investors do not possess accurate data on a company's assets, therefore if the company wants to invest, first it will have to resort to internal resources, primarily for reinvested earnings. In cases where they are not sufficient or not available, then the company will need to access external resources. Of the external resources it is mainly the least risky forms that are preferred, such as bond and debt financing, which contain a repayment obligation but do not provide voting rights. Convertible bonds are next in line, followed by a capital increase from an external source.

The *transaction cost theory* (Coase, 1934) states that financing by external capital is cheaper, since it has a lower transaction cost. This is explained by the fact that, in this case, the information is ready to hand. When financing with their own capital, potential investors have significant informational needs, the cost of which is quite high. Investors require all the information regarding the subject of the investment or the securities issued.

Finally, the *classic description of financing theory* (Grochla, 1976) is worth mentioning as well. The theory tries to establish the optimal financing structure by characterizing it according to four aspects: forms of financing, exceptional events, analysis and planning; based on this, the approach shows the advantages and disadvantages of the individual forms.

However, the economic crisis that hit its peak in 2008 significantly rewrote the operational mechanism of economies and, in fact, in many cases it even questioned the legitimacy of the financing theories. Krugmann (2009) noted that these theories had been created by economists thinking in models. The theories often encouraged banks to bring risky credit products to the market that were popular but also very dangerous. Besides this, they prompted financial institutions to promote an extremely strong lobbying strategy for their products towards the financial market authorities. Another consequence of the crisis was the appearance of new theories that can undoubtedly be extrapolated to corporate financing as well. These theories *focus on three alternatives* (Scherer–Marti, 2012):

– positivistic finance conception that helps in predicting and controlling the movements of financial markets, but also has numerous limitations,

PSZ 2017. angol.szam_beliv_v16.indd 201 2017. 04. 06. 7:29:06

– postmodern perspectives on finance that concentrates instead on the financial market actors, and puts the emphasis on better communication and understand between them,

– constructive perspectives on finance that focuses on common language and understanding each other.

The impact of the crisis on lending and the answers to the problem from the SME side

Money and lending are essential elements of modern economies. The formula for macro-economic income also puts the banks and their reallocation of funds in a central role. Nevertheless, it should not be forgotten that this reallocation of funds also ends up at companies in the form of investments – that is to say that banks, on the basis of classical economic doctrines, provide the collected savings as loans to businesses that use them for investment purposes.

It is of the utmost importance for companies and businesses to receive sufficient operating funds. The rapidly changing environment and the competitive situation do not allow the companies to delay their investment needs until they possess sufficient resources of their own to carry them out. This is why the role of lending is crucial. Borrowed funds are especially important for smaller companies (SMEs), since their capital-market relationships are not as developed as those of larger companies, who can acquire the necessary resources directly from the financial markets. Moreover, in a crisis situation the financial intermediaries also tend to be oriented towards the larger companies because they can be monitored more easily and have more stable positions, and therefore the credit provided represents a lower risk than lending to the SME segment. Therefore, the accessibility of resources is an indispensable condition for the growth of companies and, of course, the supporting macro-economic background is just as important (Beck et al., 2001). The significance of lending and the effects of the decrease of lending are show in the figure below:

Small and medium-sized enterprises play an important role not only in Hungary but at an international level as well. Although their productivity is below that of larger companies, they are nevertheless the backbone of the economy. Two-third of employees are concentrated in their hands and, if we examine the number of these enterprises, we can see that they make up 99 per cent of the Hungarian total.[2] This sector produces more than 40 per cent of the turnover[3] and gross value added of all Hungarian companies.[4] The number of SMEs has been continuously growing according to statistical data for the past three years, which confirms the ever-increasing role of the sector. The competitiveness and economic situation of this sector fundamentally determines the economic development and prosperity of a country (Varga, 2014).

In view of the above, it is extremely important for the existence and growth of the SME sector to be secured in Hungary both in the short and in the long term. To keep these businesses afloat, seamless operational financing is not enough; attention must be paid to investments too. As we know from macro-economics, the previously mentioned income equation shows that for the economy to expand we need investments

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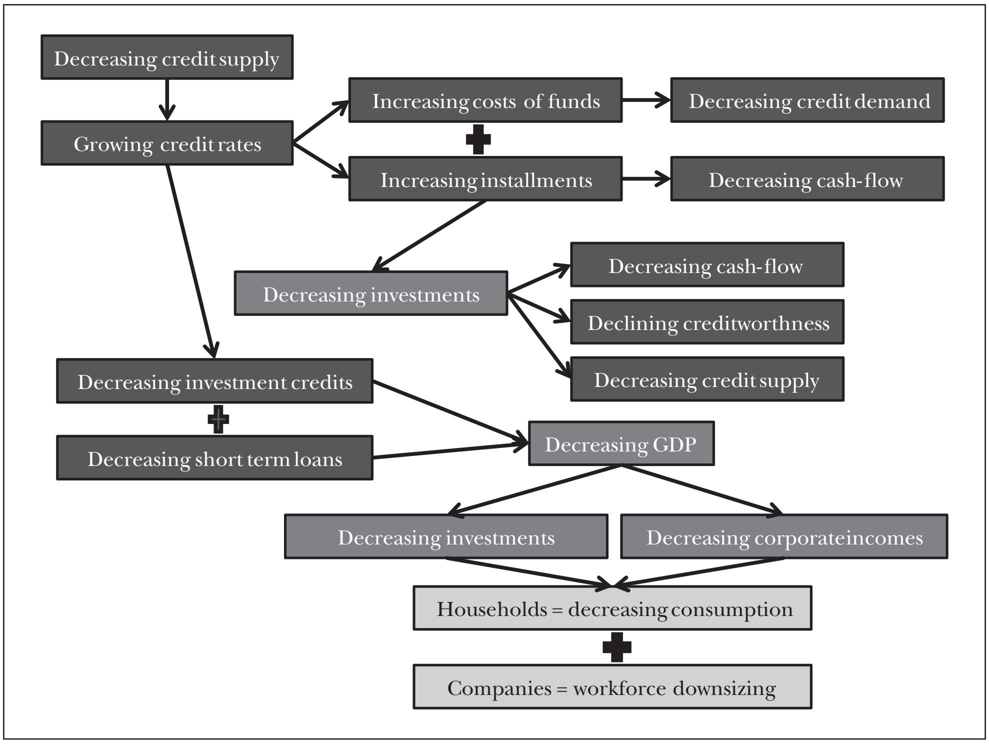
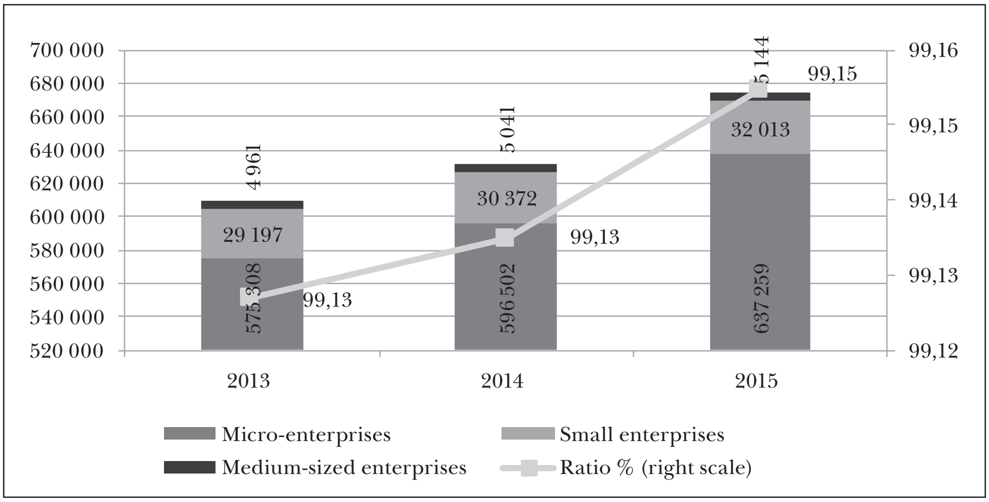
Figure 1: The effects of the decrease of lending for the macro-economy as a whole



Source: The author based on Bauer–Oláh, 2016

Figure 2: The evolution of the number of small and medium-sized enterprises in Hungary between 2013 and 2015

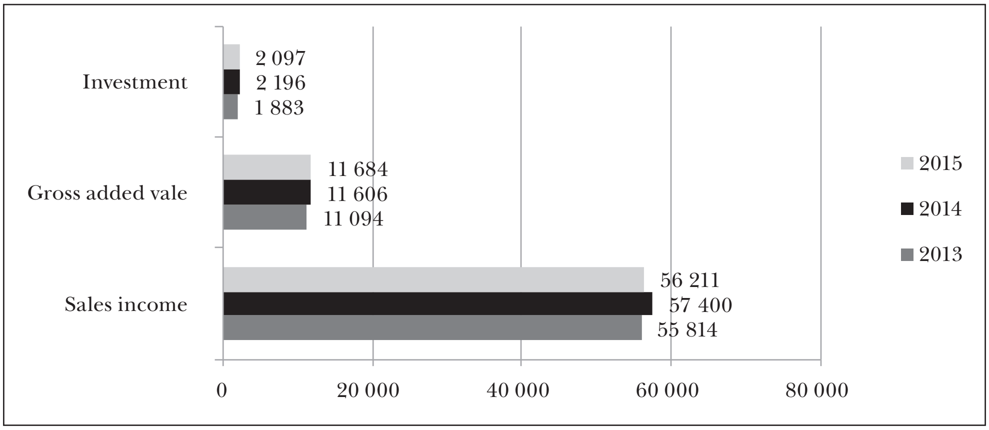


Source: Based on KSH

PSZ 2017. angol.szam_beliv_v16.indd 203 2017. 04. 06. 7:29:06

on top of consumption, government purchases and income deriving from external relations. Unfortunately, in all respects we had lived beyond our means prior to the crisis. We consumed and bought on credit and made investments funded by loans, and for that reason there remains no way out of the crisis other than the rationalization of income from external sources (Lentner–Kolozsi–Tóth, 2010; Borzán–Lentner–Szigeti, 2011). However, the maximisation of export revenues and constraining of imports cannot be a satisfactory solution in the long term because the SME sector is only marginally involved due to the large-scale concentration of export relationships. That is why it is crucial for this sector to be able to invest and to receive the necessary funds to make investments; it is not able to do this on its own or only to a limited extent. Nearly 35 per cent[5] of all the investments carried out by Hungarian companies can be attributed to the SME sector, and is mostly manifested in machines, equipment and construction projects. On the other hand, we have to bear in mind that the vast majority of Hungarian SMEs operate in the tertiary sector, which has an influence on their investment activity too. The most typical investment areas of the sector are agriculture, industry and trade.

Figure 3: Performance indicators of Hungarian enterprises (in HUF billions)



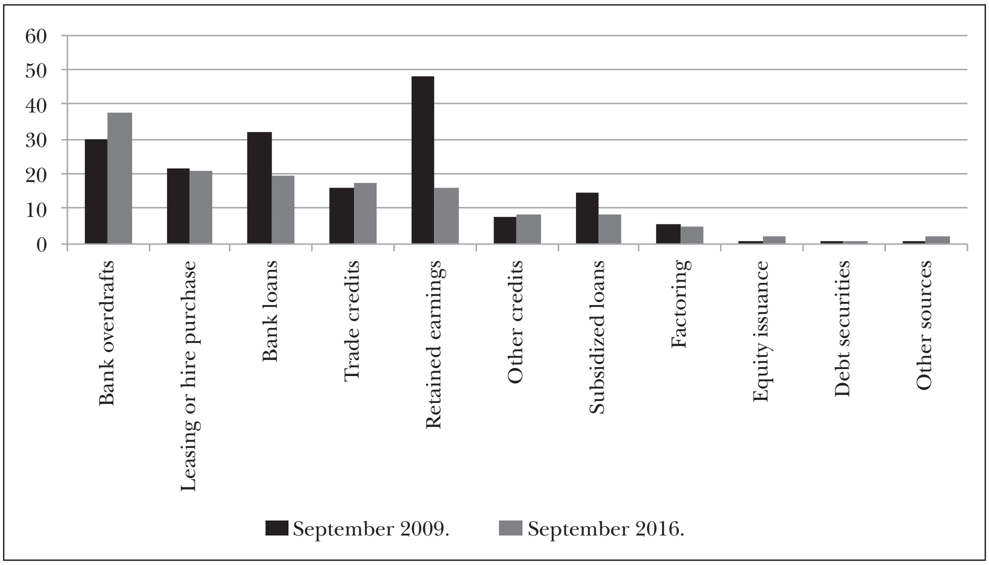
Source: Based on KSH

Accessible external resources have a decisive impact on SME investments. Due to the investments by this sector, the structure and balance of the companies' fixed assets is improving, which increases their efficiency of production. The improving efficiency and better quality of the output also enhance competitiveness, which contributes substantially to the development of the economy. The sector is often criticised for carrying out little investment, and consequently being unable to significantly assist economic growth. Some of the criticism is true, as SMEs do only account for 35 per cent of investment, and so they need to be helped in this. Such an improvement has been attempted by the National Bank of Hungary through its Funding for Growth Scheme.

PSZ 2017. angol.szam_beliv_v16.indd 204 2017. 04. 06. 7:29:06

In banking practice, corporate lending is the segment able to react most quickly to the economic circumstances caused by the crisis. Crises are unavoidable corollaries of modern economies, and so we are obliged to adapt to and prepare for them. Several articles and studies have already dealt with the causes of the crisis in 2008. Some look for those responsible on the demand side (households, companies, and countries), while others blame the supply side (banks and financial institutions), and some opinions accuse the regulators (supervisory authorities and central banks) of escalating the problems (Lentner–Szigeti–Borzán, 2011). The problems of the financial intermediary system first appear in the erosion of resources and in a declining willingness to take risks. Due to decreasing corporate revenues and shrinking markets caused by the crisis, the value of available cash flows is becoming reduced as well, causing difficulties with debt servicing, which will be an obstacle to the further taking of loans within a short period of time. It is, nevertheless, important to note that for the SME sector of European countries, this is the most available and usable external resource after the use of internal resources. Therefore the decline in lending at the same time preserves the financing difficulties of the SME sector, which is supported by the ECB survey.

Figure 4: Financing structure of euro area SMEs on the basis of the frequency of using the funding sources applied



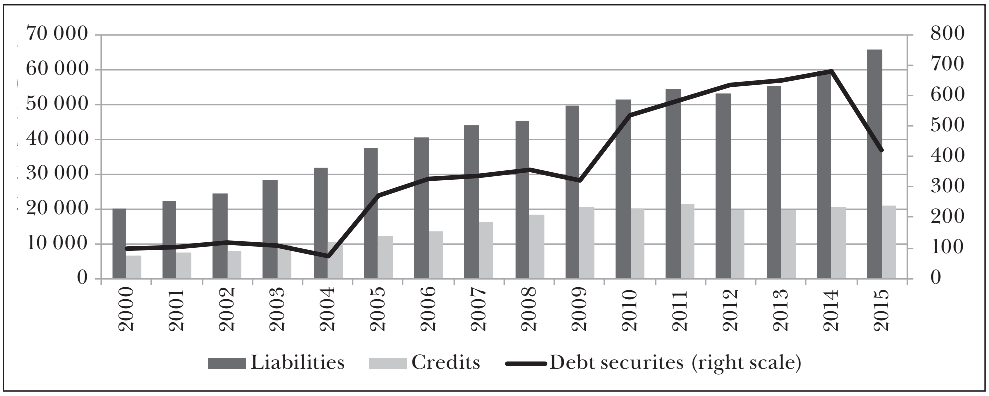
Source: The author based on ECB 2009; 2016

Lending to Hungarian SMEs had been expansive during the years prior the crisis due to the above-mentioned circumstances (Balog–Nagy, 2014), and was completely interrupted when the crisis spread into the country. Because of the drying-up of bank funds, the sector had no choice but to drain its savings and cut down its capacity in

PSZ 2017. angol.szam_beliv_v16.indd 205 2017. 04. 06. 7:29:06

order to stay alive. Due to this survival reaction related to the crisis, necessary investments were not implemented, and for this reason the sector fell further behind its larger competitors. On account of the banks' careful conduct after the crisis, there has been an unprecedented downturn – at an international level too – in the loan stock of the corporate sector (Bauer–Oláh, 2016). As numerous studies have pointed out, the process of lending money to Hungarian companies began very late following the crisis, which can mainly be explained by decisions on the credit supply side (Sóvágó, 2011). As the above-cited study confirms, in our region the drop in lending was largest in Hungary, although the surge of lending had not been spectacularly high before the crisis. Neither did the decline in lending did not stop in 2013 (Fábián, 2014). To that effect, the National Bank of Hungary launched an interest rate subsidy programme in 2012 that did improve the conditions of companies in terms of lending, but it failed to bring decisive results, as market-based lending recovered only very slowly or not at all (Bauer, 2016). Lending to non-financial companies (including SMEs) is illustrated in the figure below, which clearly shows the setback in stock data during the post-crisis years.

Figure 5: Holdings of non-financial companies' obligations – and more specifically of their debt securities – between 2000 and 2015 in Hungary



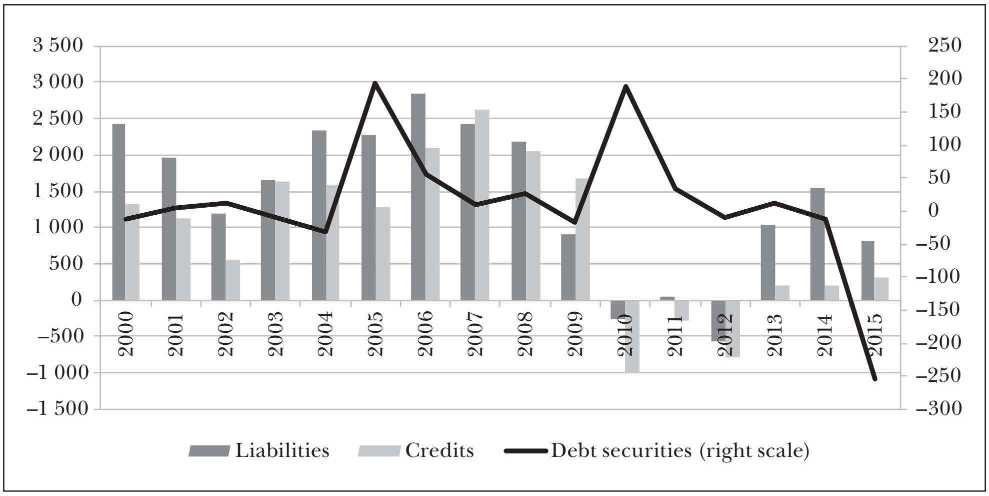
Source: The author based on MNB, 2016

The effect of the crisis is best demonstrated by the value of transactions made within the same period of time. We can see from this that companies tried to eliminate debts instead of substantially increasing their stock of loans after the end of the crisis, with this being due to demand and, above all, supply factors. It also becomes clear from the graph that the lending crisis that followed on from the economic crisis could only be fully solved in 2013.

The low level of lending activity, plunge in the investment ratio and protracted impact of the crisis triggered the Funding for Growth Scheme (FGS) in Hungary, as has been previously mentioned. The explicit objective of the programme is to provide funds for the SME sector that are able to reverse the dominant lending tendencies of

PSZ 2017. angol.szam_beliv_v16.indd 206 2017. 04. 06. 7:29:06

Figure 6: Transactions of non-financial companies' liabilities – and more specifically of their debt securities – between 2000 and 2015 in Hungary



Source: The author based on MNB, 2016

the post-crisis era. Since market-based lending did not open its gates to this sector, or did so only slowly, there remained no means to change the situation other than the intervention of the Central Bank. The FGS has been subject to countless criticism ever since its launch. Some call it a "shaky air rifle" while others define it as a "machine gun" (Plajner–Pulai, 2016), but it is nevertheless inevitable that without it many small and medium-sized enterprises would not have been able to acquire enough resources for their operations and investments.[6]

Financing anomalies of Hungarian SMEs based on the results of a questionnaire survey

Material and methodological background

The basis of the study is primary research conducted in 2016 through a pre-tested and standardized questionnaire.[7] The research is still ongoing and the results shown here are only partial ones, reflecting the opinion of 592 companies that have filled out the questionnaire form. The questionnaire assessed the opinions of the companies in three areas: financing, investment activity and project management. The present paper deals with the evaluation of the results on financing. The finalization of the questionnaire was preceded by in-depth interviews, and the questionnaire form was then created using the outcome of the qualitative research. The questionnaire contained only closed questions in the interests of a better assessment of the sample and the answers. There was an earlier round of research between 2013 and 2015, prior to the present form of the questionnaire, where the same thematic areas were assessed

PSZ 2017. angol.szam_beliv_v16.indd 207 2017. 04. 06. 7:29:06

but with fewer questions. The sample consists mainly of SMEs because of their weight and economic dominance. The questionnaire was filled out anonymously by the companies, with their identity not being revealed in any way. Due to the segmentation of the sample, the research dealt only with the type of company, scope of activities, ratio of domestic ownership, and the main balance sheet and income data (net sales revenues, earnings after taxes, and balance sheet total). The results are not considered representative, but they allow for the possibility of establishing and conducting representative research at a later date. The above-mentioned sample was assessed using SPSS 19.0 and MS Excel 2010.

In the present study the sample was analysed by balance sheet and income data of the previous full financial year. The composition of the sample is shown in the table below:

Table 1: Composition of the sample by sales revenues, earnings after taxes and balance sheet total

	Sales income		**Net income**		**Total assets**	
	count	**Sample %**	**count**	**Sample %**	**count**	**Sample %**
0–50 million HUF	318	53.7	437	73.8	360	60.8
51–100 million HUF	61	10.3	65	11.0	72	12.2
101–250 million HUF	73	12.3	26	4.4	44	7.4
251–500 million HUF	36	6.1	12	2.0	18	3.0
501–1000 million HUF	20	3.4	19	3.2	36	6.1
Above 1000 million HUF	84	14.2	33	5.6	62	10.5

Source: Research by the author, 2016, N = 592

Results

In the part of the research presented in this paper the preferred financing forms of Hungarian companies was assessed. They were first asked whether, from among the available sources of financing, they preferred internal ones from the owners or created by the operation of the enterprise, or external resources deriving from the financial and capital markets. 71.1 per cent of the 592 companies in the sample chose internal financing, whereas 28.9 per cent of them preferred external finance. However, during years of economic crisis when the revenues are becoming lower, and therefore usable and recyclable cash-flow is decreasing as well, companies do not much opportunity to reinvest significant resources into the company, because they need them to stay afloat and to finance daily operations. In line with this, the resources available for investment are so scarce that enterprises cannot use them to implement meaningful developments.

Next the resource preference of companies was examined by individual segment. The results are illustrated in the table below. Based on the results, it can be stated that more than 70 per cent of the smallest companies rely on internal resources (catego-

PSZ 2017. angol.szam_beliv_v16.indd 208 2017. 04. 06. 7:29:06

ry %). Interestingly, based on sales revenues, earnings after tax and the balance sheet total, medium-sized companies use external resources more often, with the average being around 40 per cent.

Table 2: Percentage of the usage of internal and external resources by groups by sales revenues, earnings after taxes and balance sheet total; and the tendency of Pearson's chi-square values

	Sales income				**Net income**				**Total assets**			
	Internal		**External**		**Internal**		**External**		**Internal**		**External**	
	Sample	**Category**	**Sample**	**Category**	**Sample**	**Category**	**Sample**	**Category**	**Sample**	**Category**	**Sample**	**Category**
0–50	41.7%	77.7%	12.0%	22.3%	53.4%	72.3%	20.4%	27.7%	46.8%	76.9%	14.0%	23.1%
51–100	6.4%	62.3%	3.9%	37.7%	7.6%	69.2%	3.4%	30.8%	7.8%	63.9%	4.4%	36.1%
101–250	6.9%	56.2%	5.4%	43.8%	2.4%	53.8%	2.0%	46.2%	3.5%	47.7%	3.9%	52.3%
251–500	3.7%	61.1%	2.4%	38.9%	1.5%	75.0%	0.5%	25.0%	2.5%	83.3%	0.5%	16.7%
501–1000	2.4%	70.0%	1.0%	30.0%	2.5%	78.9%	0.7%	21.1%	3.9%	63.9%	2.2%	36.1%
1001 above	10.0%	70.2%	4.2%	29.8%	3.7%	66.7%	1.9%	33.3%	6.6%	62.9%	3.9%	37.1%
Pearson Chi	0.002				0.396				0.000			

Source: Research by the author, 2016, N = 592

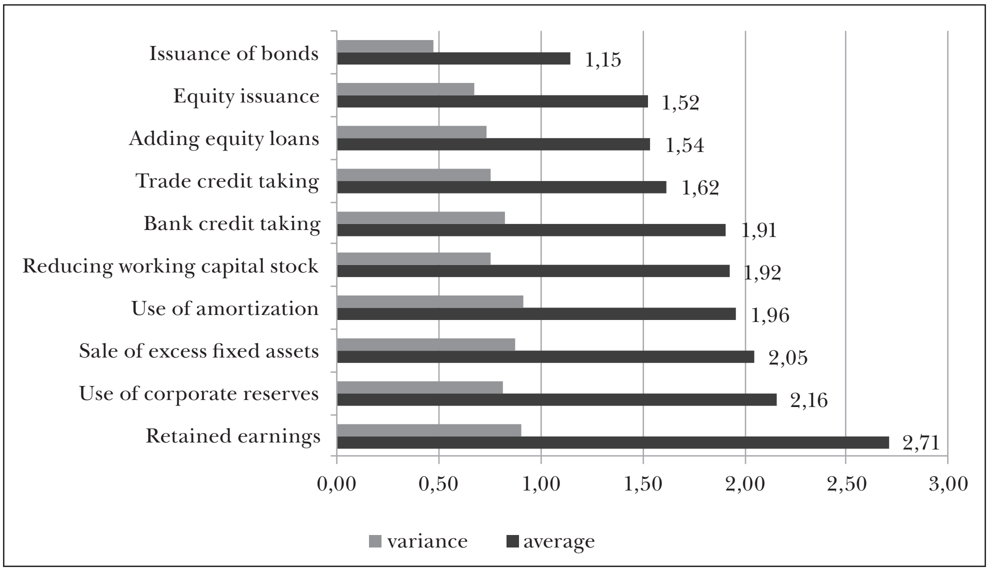
In order to determine if there is a correlation between preference for internal or external resources and classification by the main balance sheet and income data, Pearson's chi-square values were also analysed. Based on these, there is a correlation between the two factors if the chi-square value is lower than 0.05. The data from the sample shows that the sales revenues and balance sheet total of the respondent companies substantially influence the resource preference, as confirmed by the values obtained.

Following in a similar vein, in the next block the respondents were asked to rank their preference for internal and external resources when making financial decisions on a scale of one to four.[8] As the table below shows, Hungarian SMEs prioritize internal resources. They mostly use reinvestment of the after-tax profit, since in this way the operation of the business produces the necessary resources to later serve as a foundation for investments. The resources with the next highest average rating are linked to rationalization, i.e. companies use their reserves first and then they reduce their assets. But what is interesting s that this confirmed the common belief about amortization. Instead of functioning as a real reserve for future development, amortization works only as an additional resource prior to decreasing the stock of working capital, which acknowledges that this form of financing exists as an operative resource in the day-to-day activity of companies. In other words, amortization

PSZ 2017. angol.szam_beliv_v16.indd 209 2017. 04. 06. 7:29:06

is considered to be a factor that reduces profit, and which is not reserved for subsequent development but instead is reinvested into the company's operations. The answers clearly show that it is the opinion of companies that external resources are used only after fully exploiting internal ones. Among external resources bank loans are clearly at the top, which coincides with the results of the ECB surveys. Bank loans are followed by commercial loans, meaning that companies are keen on turning to financing through suppliers. Unfortunately, in many cases this also involves the phenomenon of circular debt. Securities financing transactions is the least popular form, which can be explained by the underdeveloped capital-market relationships of Hungarian enterprises.

Figure 7: Assessment of internal and external resources on a scale of 1 to 4 by their usage, by mean and standard-deviation



Source: Research by the author, 2016, N = 592

The estimates of each type were further assessed by average rating, in order to judge whether the balance sheet and income data of companies have a decisive impact on the choice between internal and external resources. It can also be seen in the groups formed by sales revenues that the most favoured resource with the highest average rating was reinvestment of profits after tax, and in all cases the least favoured was the issuing of bonds. It is clear too that the companies with the lowest sales revenues place the use of commercial loans in second last place. The reason for this is that, due to their lower bargaining power, these companies are unable to exert significant influence on payment deadlines, or in other words the suppliers do not like giving them credit. By analysing the highest ratings it can be established that for the two groups with the highest sales revenues bank loans are the third most used source

PSZ 2017. angol.szam_beliv_v16.indd 210 2017. 04. 06. 7:29:07

of funding. The largest enterprises are more likely take advantage of this opportunity more, since they are more creditworthy, and even when considering their income they are more stable with regard to the repayment of loans.

Table 3: Assessment of individual types of resources by groups formed on the basis of sales revenues by average ratings, and the tendency of Pearson's chi-square values

	0–50 million HUF	**51–100 million HUF**	**101–250 million HUF**	**251–500 million HUF**	**501–1000 million HUF**	**1000 million HUF above**	**Pearson Chi**
Retaining of earnings after tax	2.63	2.69	2.77	2.72	2.90	2.92	0.014
Reducing working capital stock	1.85	1.87	2.05	2.14	2.20	1.98	0.080
Sale of excess fixed assets	1.97	1.97	2.19	2.33	2.30	2.10	0.003
Use of amortization	1.80	2.15	2.18	1.94	2.00	2.24	0.003
Use of corporate reserves	2.16	2.11	2.16	2.53	1.75	2.10	0.011
Bank credit	1.73	2.02	2.12	2.22	2.20	2.13	0.000
Issuing bonds	1.10	1.08	1.21	1.42	1.10	1.21	0.007
Equity loans	1.55	1.49	1.68	1.56	1.40	1.45	0.709
Issuing equity	1.47	1.51	1.70	1.42	1.40	1.67	0.034
Commercial credit	1.45	1.80	1.88	1.83	1.55	1.85	0.000

Source: Research by the author, 2016, N = 592

Pearson's chi-square made it obvious again that there is a connection between the majority of the resource types (with the only exception being equity loans) and the groups formed by sales revenues, and so we can state that the choice of resources is undoubtedly affected by the size of a company's income.

Earnings after tax is the kind of income category that can be determined by fate, while their reinvestment or payment as a dividend is decided by the company. As these earnings are clear, meaning that creditors and taxes have been paid, they provide a much more accurate picture of the operation of companies than sales revenue. At the two end points of the assessment of resources are still earnings after tax and issuing bonds, but there is a high variance in preference for other types of resource. Companies with lower profits prefer rationalization (utilization of reserves and sales of surplus assets), but above the level of 50 million HUF bank loans come to the fore as one of the favoured sources of funding. Companies with earnings higher than 501 million HUF also opt for financing through bank loans, but the largest enterprises clearly turn to internal resources. Small and medium-sized enterprises are again the ones that deprioritize financing through suppliers.

PSZ 2017. angol.szam_beliv_v16.indd 211 2017. 04. 06. 7:29:07

Table 4: Assessment of individual types of resources by groups formed on the basis of earnings after taxes, by average rating, and the tendency of Pearson's chi-square values

	0–50 million HUF	51–100 million HUF	101–250 million HUF	251–500 million HUF	501–1000 million HUF	1000 million HUF above	Pearson Chi
Retaining of earnings after tax	2.67	2.69	2.65	2.83	2.95	3.12	0.090
Reducing working capital stock	1.88	1.97	2.12	2.17	2.11	2.06	0.150
Sale of excess fixed assets	2.01	2.05	2.23	2.25	2.05	2.33	0.004
Use of amortization	1.89	2.00	2.19	2.42	2.42	2.21	0.008
Use of corporate reserves	2.19	2.05	2.08	2.33	1.95	2.03	0.824
Bank credit	1.81	2.20	2.19	2.00	2.32	2.21	0.000
Issuing bonds	1.10	1.23	1.19	1.17	1.47	1.33	0.000
Equity loans	1.56	1.54	1.42	1.67	1.42	1.39	0.692
Issuing equity	1.47	1.58	1.50	1.67	1.74	1.88	0.016
Commerical credit	1.54	1.77	2.00	1.50	1.95	2.00	0.001

Source: Research by the author, 2016, N = 592

According to the chi-square values, there are several types of resources for which there is no demonstrable correlation between the source of financing and the groups by earnings after tax (reduction of net working capital, utilization of corporate reserves, and equity loans). Therefore it is safe to say that the assessment and usage of external resources are more influenced by the amount of earnings after taxes than the assessment and usage of internal resources.

The most varied picture can be seen by balance sheet total. Once again, the companies with the largest assets are the ones that put bank loans as their resource of choice. Smaller companies instead rationalize, scale-back surplus assets and this is how they try to obtain funding. In general, the utilization of reserves is also a highly ranked type of resource. Hence it can be restated that companies with a large capital base are not afraid to borrow, and if needed they make use of this possibility. The least preferred resources clearly include equity loans, capital increases and the issuing of bonds.

The chi-square values again reveal a correlation in numerous cases. The balance sheet total shows no relationship with the types of resources in only two areas, namely the reduction of working capital and equity loans. Similarly to earnings after tax, it can also be established that the majority of the resources used depend on the balance sheet total of the company.

PSZ 2017. angol.szam_beliv_v16.indd 212 2017. 04. 06. 7:29:07

Table 5: Assessment of individual types of resources by groups formed on the basis of balance sheet total, by average rating, and the tendency of Pearson's chi-square values

	0–50 million HUF	**51–100 million HUF**	**101–250 million HUF**	**251–500 million HUF**	**501–1000 million HUF**	**1000 million HUF above**	**Pearson Chi**
Retaining earnings	2.65	2.63	2.91	2.83	2.78	2.94	0.014
Reducing working capital stock	1.90	1.92	1.93	2.17	2.00	1.97	0.474
Sale of excess fixed assets	2.04	1.85	2.23	2.50	1.89	2.19	0.000
Use of amortization	1.86	2.03	2.14	2.11	1.94	2.34	0.037
Use of corporate reserves	2.15	2.19	2.34	2.44	2.03	1.98	0.008
Bank credit	1.76	2.13	2.05	2.17	2.17	2.21	0.000
Issuance of bonds	1.11	1.13	1.16	1.44	1.25	1.23	0.001
Equity loans	1.58	1.49	1.61	1.50	1.53	1.37	0.400
Issuing of equity	1.48	1.53	1.59	1.50	1.39	1.77	0.038
Commerical credit	1.48	1.83	1.86	1.89	1.75	1.89	0.000

Source: Research by the author, 2016, N = 592

Conclusion

The analysis above confirms that it has not been easy for Hungarian companies to emerge from the economic crisis. While companies in Europe and around the world already began to recover two to three years after the financial crisis with the help of available sources of financing, their Hungarian counterparts were still struggling with everyday operational problems. The banks did not move the recovery forward either, because several years after the end of the crisis market-based lending still had not started up, because at that time the banks were trying to solve the issues of forex loans and ease the difficulties caused by bank losses. So in the fifth year after the crisis there was no other choice remaining but to resolve the situation in a centralized way through the credit programme launched by the Central Bank. As the research results show, most companies need loans, regarding these as the most promising external sources of financing and that internal resources are insufficient. In terms of Hungarian companies, it can be established that following the financial crisis they endeavour to be cautious and rely primarily on internal resources, although there are companies with such small growth potential that they cannot collect enough internal funding for individual investments at all, or can do so only in the very long term, which is an approach that resembles the pecking order theory. In conclusion it can be stated

PSZ 2017. angol.szam_beliv_v16.indd 213 2017. 04. 06. 7:29:07

that, for the sake of competitiveness and for the growth of the economy, external resources are indeed important for making necessary investments, especially loans, even if companies are reluctant to use them, because they must turn to these sources in order to maintain their market positions. Therefore, credit-based resources (even if in the form of aid) are necessary since they generate change both at the micro and the macro level, whether they function as an "air rifle" or as a "machine gun".

Notes

[1] Supported through the New National Excellence Programme of the Ministry of Human Capacities.

[2] 2013 = 99,13%, 2014 = 99,13%, 2015 = 99,15%

[3] 2013 = 43,2%, 2014 = 42,9%, 2015 = 42,4%

[4] 2013 = 44,3%, 2014 = 43,5%, 2015 = 43,0%

[5] 2013 = 35,5%, 2014 = 34,8%, 2015 = 34,1%

[6] The effects and benefits of the FGS are explained in detail by the publications of the Central Bank of Hungary: MNB 2014; 2016 and its thematic articles, in addition to what has been quoted above.

[7] I would hereby like to thank the assistance of the students of Óbuda University, who contributed to the dissemination and filling out of the questionnaires.

[8] Where 1 meant the least used resource and 4 represented the most often used type of resource.

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Tamás Rózsás

China in Europe

Hungary's Key Role in a Strategic Partnership[1]

Summary
One of the major trends in the world economy in the past two decades was the ascent of China. The fast-growing Chinese economy is already the second largest in the world with an outlook to take the first place from the United States within ten years. Moreover, China is already the world's largest trading nation. At 3225 billion dollars, its volume of trade surpassed the trade volume of the United States in 2010 (Scott–Sam, 2016). With its economy growing, China is also becoming more ambitious. U. S. – China trade approaching 600 billion dollars in 2015, China's economic ties with the United States are already strong. Within the framework of its new land and maritime silk road initiative, China is now reaching out to Europe. As one of the largest economies and markets, and new global companies like Huawei and Alibaba, China is an important trade and economic partner. On the other hand, it is also a potent competitor for markets and resources. Is the ascendance and expansion of China an opportunity or threat? Does China naturally look for partners for mutual benefits and development or does it seek to control the world? Probably both. We attempt to help the reader answer these questions for themselves by looking at various aspects of Chinese expansion towards Europe including investment, trade, Chinese companies in Europe, and some characteristics of Chinese economy and society that may guide its path of future development.

Journal of Economic Literature (JEL) code: F21, F23, F52, F02
Keywords: China, Hungary, European Union, international investment, international business

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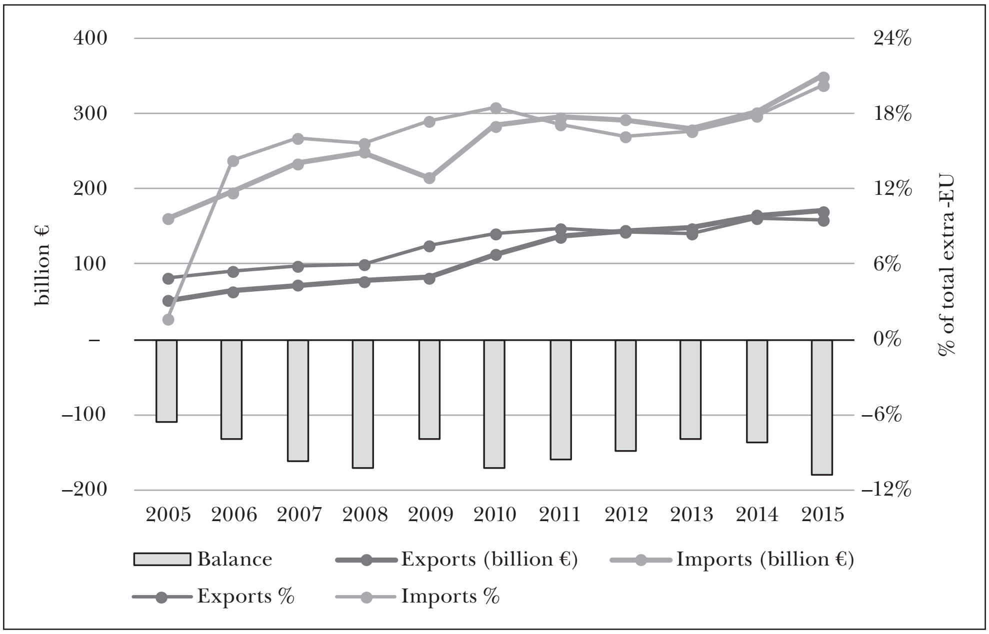
PSZ 2017. angol.szam_beliv_v16.indd 216 2017. 04. 06. 7:29:07

Trade

China is the largest trading nation in the world and an important trade partner of the European Union. In 2015, China was the top partner of EU for imports, and after the United States, the second largest partner for exports. Roughly a fifth of all EU imports came from China and almost a tenth of all EU exports was to China. According to a news release on the EU-China summit last July in Beijing, EU deficit in trade in goods with China reached a record high of 180 billion euros in 2015, while trade in services reached a record surplus of 10.3 billion euros the same yea (Eurostat, 2016a). Trade with China has been growing dynamically in the past decade as shown on Figure 1 and Figure 2.

Figure 1: Development of EU exports and imports of goods with China, 2005–2015



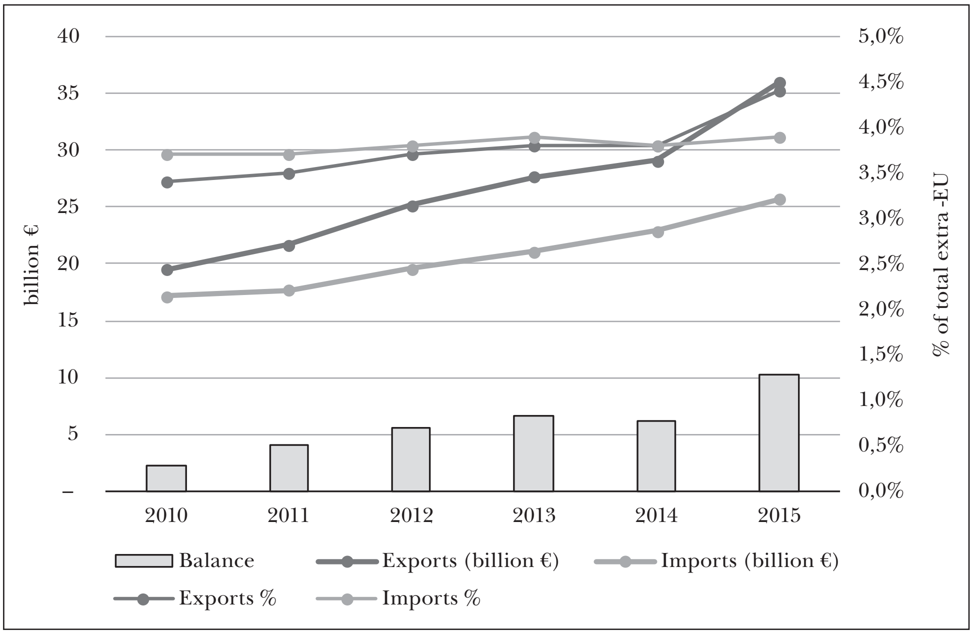
Source: Eurostat, 2016a

Within the EU, Germany is undeniably the largest trade partner of China with exports of goods reaching 71 973 million euros and import of goods reaching 69 036 million euros in 2015. Exports and imports of other EU countries are displayed on Figure 3 below.

The share of Chine from the total exports and imports of goods of EU Member States is shown on Figure 4. For all EU Member States except Finland China has a larger share of the country's imports than of its exports. However, for some countries, namely Germany, the United Kingdom, France, Sweden, and Denmark, China is also a major export destination. On the other end of the spectrum, China has a large share of the total imports of the Netherlands and Luxemburg but not of their exports.

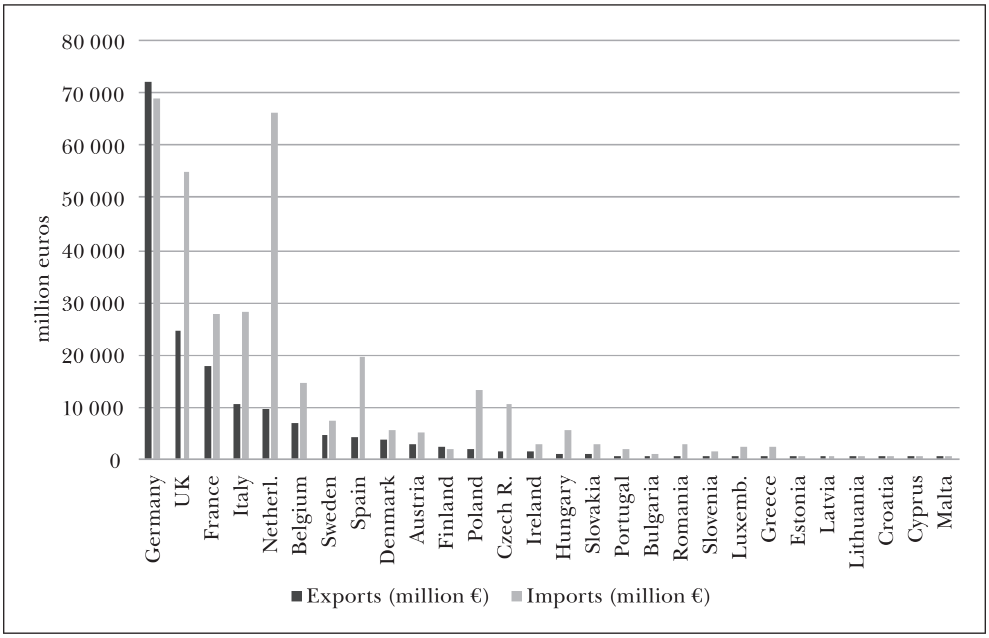
PSZ 2017. angol.szam_beliv_v16.indd 217 2017. 04. 06. 7:29:07

Figure 2: Development of EU exports and imports of services with China, 2005–2015



Source: Eurostat, 2016a

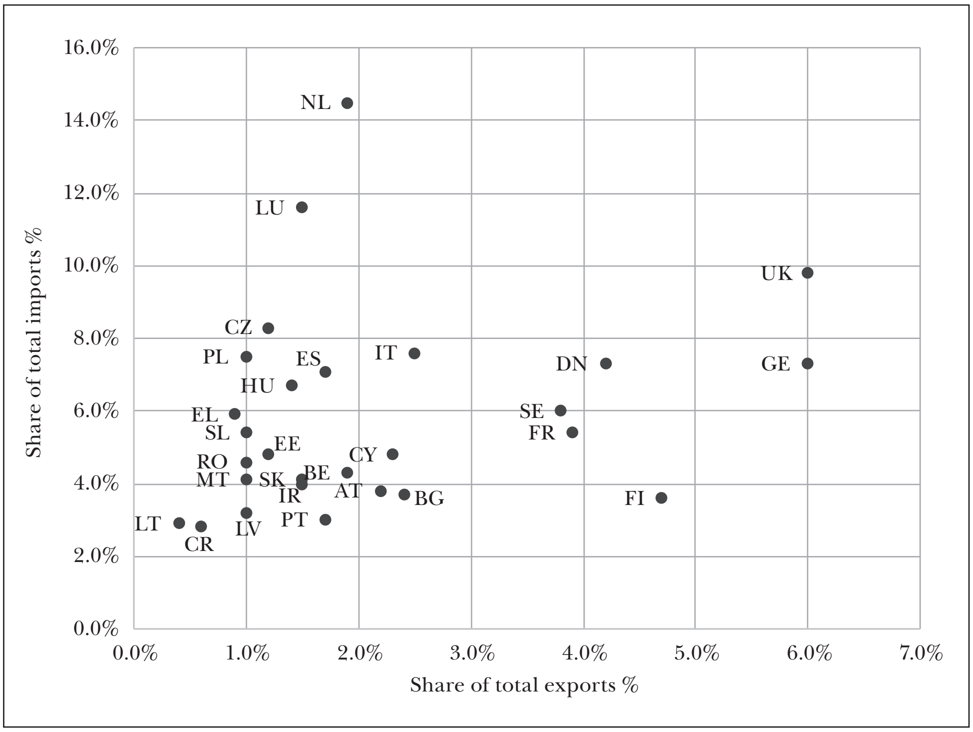
Figure 3: Exports and imports of EU Member States in goods with China, 2015



Source: Eurostat, 2016a

PSZ 2017. angol.szam_beliv_v16.indd 218 2017. 04. 06. 7:29:07

Figure 4: Share of Chine from total exports and imports of EU Member States in goods, 2015



Source: Eurostat, 2016a

The Hungarian Central Statistical Office reports different numbers for the imports of goods to Hungary in 2015. According to the Hungarian Central Statistical Office, Hungary imported 7901.8 million euros of goods from China in 2015, 9.65 per cent of a total imports of 81 864.9 million euros. China is the largest source of Hungarian imports outside the EU, followed by Russia (4.35 per cent) and the United States (2.70 per cent). However, Chinese imports still dwarf beside the import from Germany, which is 22.50 per cent of the country's total imports (KSH, 2016).

China is the largest single source of imports for the European Union but may not be the most important source. At 23.9 per cent, the share of European countries that are not EU members exceeds the 20.3 per cent share of China. Other major import partners are the United States with a share of 14.4 per cent, and Russia with a share of 7.9 per cent. European countries outside the EU also take the largest share of EU exports at 22.9 per cent. The second largest share, 20.7 per cent, goes to the United States and China is only the third largest EU export destination with a share of 9.5 per cent (Eurostat, 2016b).

Regarding the composition of Chinese exports and imports in goods, manufactured goods, mainly machinery and vehicles dominate both the exports and the imports (Eurostat, 2016a).

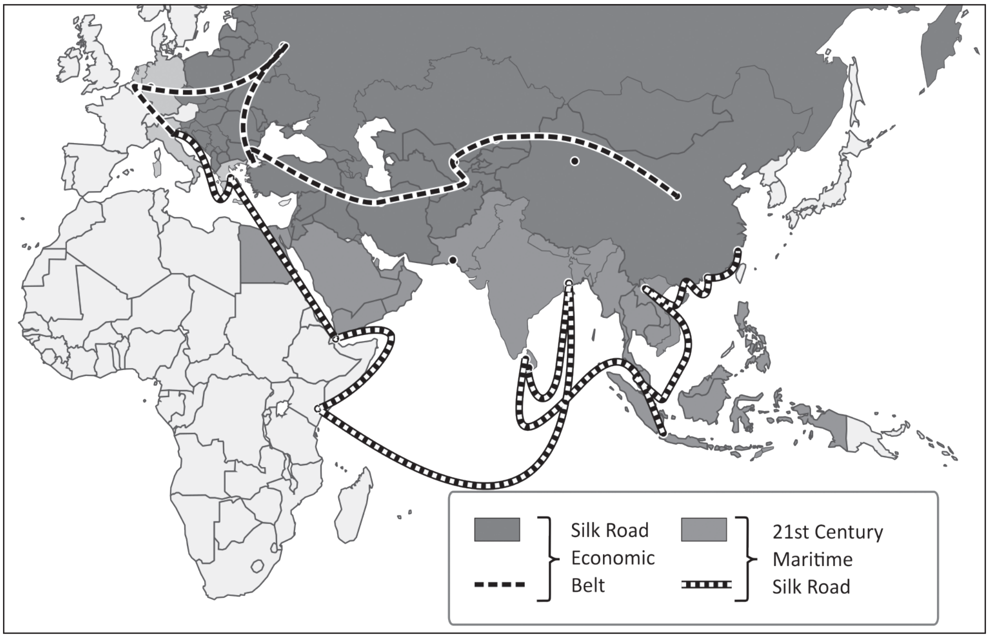
PSZ 2017. angol.szam_beliv_v16.indd 219 2017. 04. 06. 7:29:07

OBOR

With a growing economy and deepening trade relations, China recognized it is time for more. In 2013, President Xi Jingpin of China announced the One Belt One Road initiatives, a strategy for open and advance the country's neighborhood diplomacy. The initiative aim at the joint development of huge economic zones on the Eurasian continent and reaching out to Africa with the leadership of China. One Belt stands for the economic belt along the ancient silk road, a network of trade routes connecting major civilizations across Asia, Europe, and Africa. One Road refers to the 21st century concept of a maritime silk road connecting countries of the Malay Archipelago, and countries along the shores of the South China Sea, and the Indian Ocean (Yi, 2015).

China says its initiative is open to all nations (Yi, 2015) and indeed there is no country list in its official news release about the initiative (NDRC, 2015). A group of 64 countries, including China, however, is frequently mentioned. Figure 5 displays a map of the countries involved and approximate conceptual paths of the Belt and the Road based on analyses of think tanks actively researching the OBOR initiative.

Figure 5: The Silk Road Economic Belt and the 21st Century Maritime Silk Road



Source: Map based on Jinchen, 2016, country shading based on HKTDC, 2017 and Chin et al., 2015

A usual measure to highlight the importance of the OBOR initiative is the share of the OBOR area of the total world land area, population, and the like. According to Fung Business Intelligence Centre, a Hong Kong based think tank, OBOR countries represent 38.9 per cent of the total world land area, 64.2 per cent of total world

PSZ 2017. angol.szam_beliv_v16.indd 220 2017. 04. 06. 7:29:08

population, 37.3 per cent of world GDP, and 31.4 per cent of total world household consumption (Chin et al., 2015). Their calculations are based on a list of 58 countries, including China, Greece, Italy, Germany, and the Netherlands but excluding most Central European countries with Hungary, Romania, Slovakia, and the Czech Republic among them (Chin et al., 2015, Appendix I.).

The OBOR initiative is a framework for international economic cooperation. China claims that the initiative upholds the Five Principles of Peaceful Coexistence: mutual respect for each other's sovereignty and territorial integrity, mutual non-aggression, mutual non-interference in each other's internal affairs, equality and mutual benefit, and peaceful coexistence. In other words, China wants to exclude nudging for democratization or discussion of sensitive issues from the negotiations of development programmes.

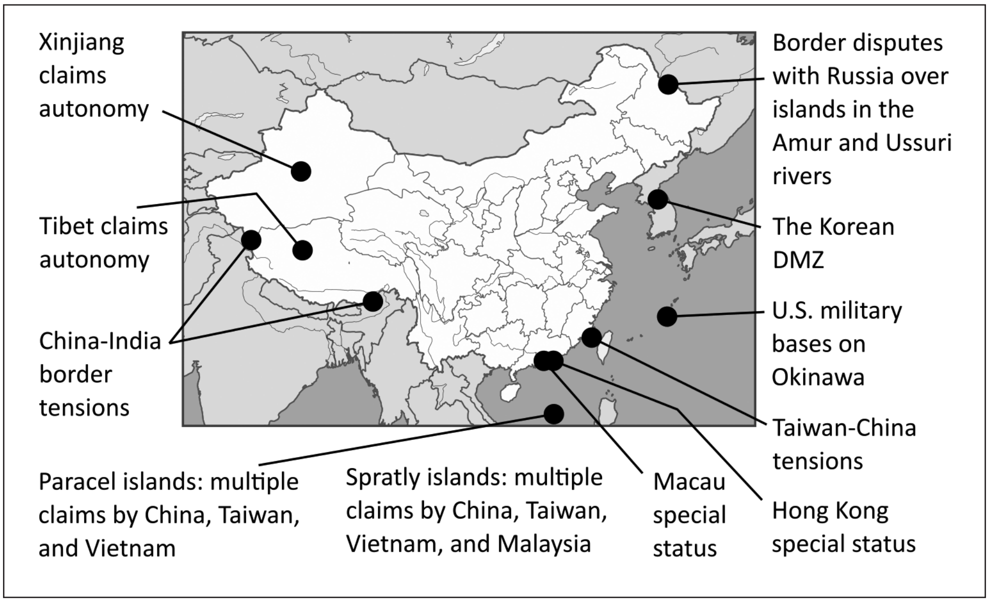
The OBOR initiative is organized around five priorities. First priority is policy coordination which covers multi-level communication and harmonization of macroeconomic policies as well as political support of large-scale projects along the Belt and Road. Second is facilities connectivity which means better integration of infrastructure of the OBOR countries. The third principle is unimpeded trade or in other words, promoting free trade according to liberal principles. The fourth principle is financial integration. This includes deepening of financial cooperation, building a currency stability system, investment and financing system, and credit information system in Asia. Establishing the Asian Infrastructure Investment Bank also belongs to this principle. Finally, developing a people-to-people bond along the Belt and Road is the fifth priority. This priority includes cooperation in the fields of education, tourism, healthcare, science and technology, employment and entrepreneurship, social security, and public administration, and also the communication between political parties and organizations of the countries along the Belt and Road (NDRC, 2015).

The OBOR initiative has its strengths but there are also challenges from domestic constraints to regional tensions to great power rivalries. China's impressive economic growth has also brought about large regional inequalities with wealth and development concentrated on the South Eastern coastal provinces of the country (Pop, 2016:4). This itself poses a challenge as infrastructure connecting the bulk of China's economy to the Silk Road Economic Belt area has to cross thousands of kilometers through underdeveloped Chinese provinces first. Additionally, the initiative is based on voluntary cooperation between partners but there are tensions in the neighborhood almost everywhere on China's perimeter as illustrated on Figure 6 (Pop, 2016:8). Although these are not necessarily high intensity conflicts, problems may make agreements on project scopes and plans more difficult.

What is in OBOR for Hungary and Hungarian companies? It mainly depends on our own approach to participating in the initiative. "The time has come for elevating cooperation between Central-Europe and China to a higher level, the level of strategic partnership, and this could take place next year" said Prime Minister Viktor Orbán in October 2016 at the conference titled Dialogue Between China and the Central-Eastern-European Political Parties (MTI, 2016d). While a comprehensive strategy to

PSZ 2017. angol.szam_beliv_v16.indd 221 2017. 04. 06. 7:29:08

Figure 6: Tensions and challenges around China's perimeter



Source: Map edited by the author based on Rowntree et al., 2005

utilize the OBOR initiative to Hungary's advantage is yet to be drafted, Tekes, the Finnish government agency for funding innovation, published a short report about the opportunities in participating in OBOR for Finland and Finnish companies (Enright, Scott and Associates, 2016). The report, compiled by Enright, Scott and Associates, a Hong Kong based strategy consultancy firm, says that Finland and Finnish companies have opportunities in OBOR in the fields of development, operation, and maintenance of infrastructure; financial and professional services; transportation and logistics; information and communication systems; commerce, manufacture, and supply chains; and energy, natural resources, and agriculture. In order to benefit from these opportunities, Finland and the Finnish companies should proactively seek and develop projects that can be put under the OBOR rubric, based on their own special strengths and advantages (Enright, Scott and Associates, 2016). Hungary should follow a similar strategy building on its own strengths and active participation.

China reaches out to Europe

The Silk Road Economic Belt stretches through Eurasia but its fundamental goal is obviously to reach Europe. With 18 per cent of China's total export, the United States is the largest export market of the country and also the second largest source of imports at 8.95 per cent of total imports. Exports to Germany, the largest trading partner of China in Europe, were only 3.03 per cent of total exports (The World Bank, 2016.) On the other hand, the 28 countries of the European Union combined constitute

PSZ 2017. angol.szam_beliv_v16.indd 222 2017. 04. 06. 7:29:08

the largest economy in the world and the largest consumer market (Bryan, 2015). Accordingly, the European Union combined has already been China's biggest trading partner for more than a decade (Hansakul–Levinger, 2014).

Investment relations are also developing. The European Union is among China's top FDI sources European investments accounting for around 18 per cent of China's FDI stock in 2012. However, this is only 2 per cent of the total FDI stock hold by the European Union. Although Chinese investment in Europe started to rise sharply in 2010, China's FDI in the EU is still tiny and Chinese investment has often been labelled as strategic in the sense that it allows Chinese companies access to European technology in return for financing (Hansakul–Levinger, 2014).

The dynamics of the development of economic relations is also impressive. According to a 2015 report of BusinessEurope, a Brussels based advocate of European enterprises, changes in trade and investment between 2009 and 2013 were as follows (BusinessEurope, 2015:3):

– EU exports in goods to China grew by 80 per cent to 148.3 billion euros in 2013;

– EU imports in goods from China grew by 30 per cent to 280.1 billion euros in 2013;

– EU exports in services to China grew by 71 per cent to 32.2 billion euros in 2013;

– EU imports in services from China grew by 47 per cent to 20.6 billion euros in 2013;

– EU outward direct investment to China grew 1 per cent to 8.2 billion euros in 2013;

– China inward investment to EU grew 1100 per cent to 1.1 billion euros in 2013.

Development of economic relations between Europe and China is a good thing but Europe needs to think about a strategy to enjoy all the benefits without the drawbacks and risks involved. Why should we study China's expansion towards Europe more closely? Because China's tightly controlled economic and industrial policies strongly affect the economic wellbeing of the European Union while its policies in Africa are transforming parts of a neighboring continent whose development is important to Europe. An even more important reason, however, is that treating China as the emerging power it used to be, rather than the global force it has become, is a dangerous mistake.

The present emerging China strategy of Europe is unconditional engagement based on the anachronistic belief that China, under the influence of European engagement, will liberalize its economy, improve the rule of law and democratize its politics. This approach, however, ignores China's economic and political strength and disregards its determination to resist foreign influence. Thus, the EU allows China to throw many more obstacles in the way of European companies that want to enter the Chinese market than Chinese companies face in the EU. Besides, China systematically exploits the division among EU Member States seeing the EU as an economic giant which is weak, politically divided and militarily noninfluential (Fox–Godement, 2009:1–3).

Member of the European Union are split over two main issues about China: 1) how to manage its impact on the European economy and 2) how to engage China politically. Four distinct groups of European countries can be identified:

PSZ 2017. angol.szam_beliv_v16.indd 223 2017. 04. 06. 7:29:08

– The small group of Assertive Industrialists (Czech Republic, Germany, and Poland) are the only EU members willing to stand up to China vigorously on both political and economic issues. Members of this group do not agree that market forces should shape the nature of the EU-China relationship. They are ready to pressure China with sector-specific demands, to support protective "anti-dumping" measures agains unfairly subsidized Chinese goods, or to threaten other trade sanctions.

– Another small group, the Ideological Free Traders (Denmark, the Netherlands, Sweden, and the United Kingdom) are mostly ready to pressure China on politics and mostly opposed to restricting its trade. Free trade ideology also serves the economic interest of these countries. Their high technology and services oriented economies and labor markets benefit, or perceive to benefit, from Chinese growth rather than being threatened by cheap Chinese imports.

– The largest group, the Accommodating Mercantilists (with Hungary among them), share the assumption that good political relations with China lead to commercial benefit. These countries follow protectionist policies on the one hand but shun confrontation with China on political questions on the other. These countries have often kept the EU from more assertive stance on issues like Tibet or human rights and some of them even act like proxies for China in the EU.

– Member States belonging to the fourth group, the group of European Followers, rely on the EU in their policies towards China, support EU policies, but reluctant to participate actively in the debate, feeding the perception that China is not a key EU priority.

The division among Member States makes China perceive the EU as disunited. Any attempt to strengthen the European position must start with the acknowledgment that no member state is big enough to match China alone (Fox–Godement, 2009:3–7).

At first, China saw the EU as a serious political partner, even a counterbalance to the United States. One result of European division, however, is that China is now approaching the EU as an economic space to be used for its own development rather than a serious political partner. While Europeans rely on a strategy of trying to win over China by unconditional engagement, China uses a strategy based on the following three sets of tactics (Fox–Godement, 2009:33–35):

– Taking advantage of the mismatch between its own centralized authority and the rule-based system of government of the EU. China makes full use of the openness of EU markets while using fuzziness of its own administrative channels to restrict access to its own markets.

– China channels EU pressure on sensitive issues, such as human rights, by accepting formal dialogues about them and then turning them into inconclusive talking shops. China reassures the EU by using soothing language about the virtues of multilateralism but the real goal is to deflect European efforts.

– China exploits and also fosters the division between EU members with unusual ruthlessness, targeting individual Member States with punitive measures when national interests are at stake or short term goals require it. One example: in the building of the high-speed railway between Beijing and Shanghai in the early 1990s, for example,

PSZ 2017. angol.szam_beliv_v16.indd 224 2017. 04. 06. 7:29:08

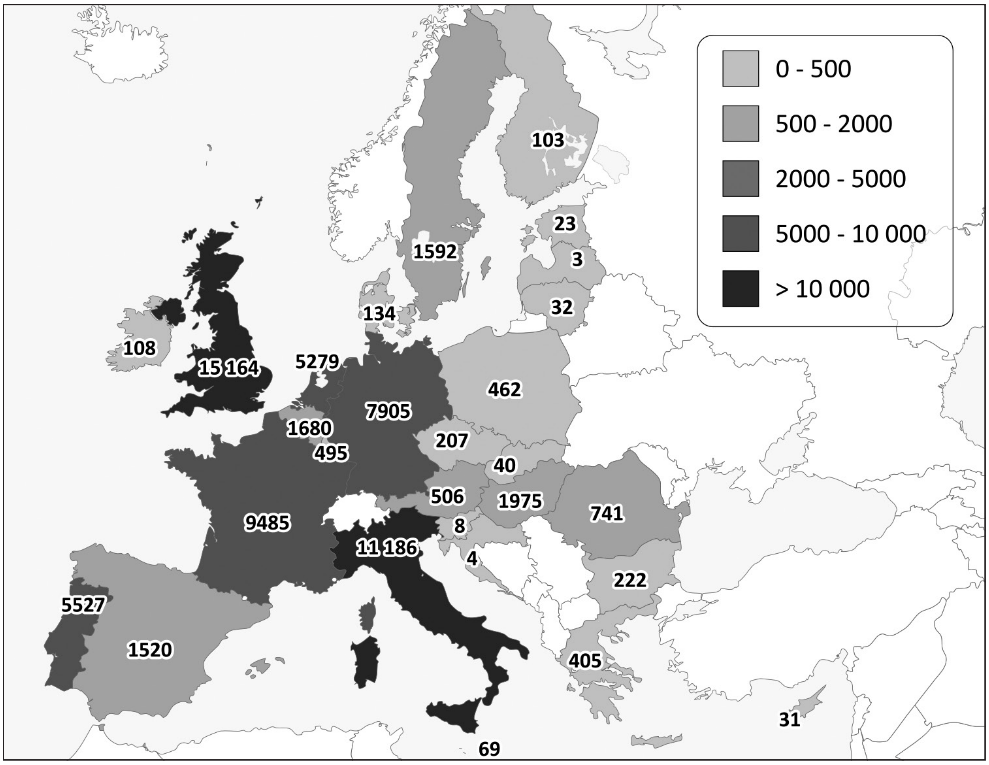
China played German interests against those of France by requesting more and more technology transfers from companies such as Siemens and Alstom (Le Corre, 2015).

No wonder there is a deeply ingrained disappointment within the EU with the direction of Chinese political reform and also a disenchantment in Europe's commercial relationship with China with the two sides having long past their honeymoon (Nicholson, 2015). On the other hand, the attitude of most Chinese towards the European Union or its citizens is positive with trustworthiness emerging as the most characteristic perception (Dekker–Noll, 2012).

EU–China FDI

After three decades of trade integration and significant investment of European businesses in China, the first wave of Chinese capital has arrived in Europe. Annual outbound foreign direct investment by Chinese companies now exceeds 100 billion dollars and has shifted from natural resources in developing countries to technology,

Figure 7: Geographical distribution of Chinese greenfield and acquisition FDI in the European Union with value of cumulative investment from 2000–2015 for each country in million euros



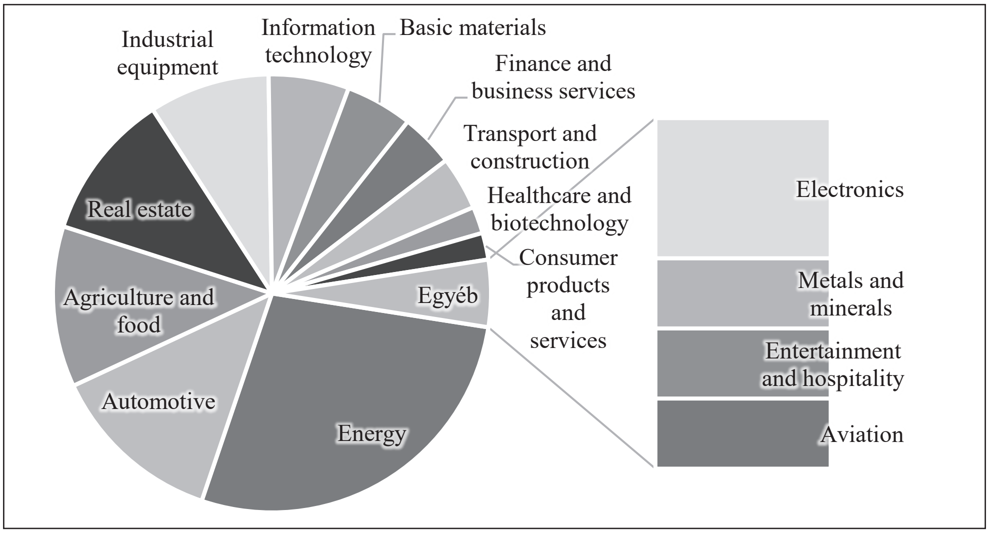
Source: Map edited by the author based on Hanemann–Huotari, 2016, Figure 5

PSZ 2017. angol.szam_beliv_v16.indd 225 2017. 04. 06. 7:29:08

brands, real estate and other assets in advanced economies. Annual investment by Chinese companies in EU Member States also soared from virtually zero in the mid-2000s to 14 billion euros in 2014. From 2000 to 2014 there were over 1000 greenfield projects and acquisitions in the European Union with a total worth of over 46 billion euros (Hanemann–Huotari, 2015:5). Geographical distribution of Chinese FDI is displayed on Figure 7 below. The figure shows data also including 2015 already.

State owned companies play an important role in China's investment in Europe, but growth in recent years is mostly driven by private companies and financial investors from the most advanced eastern coastal provinces. The sectors that attracted the most Chinese capital are energy, automotive, food, and real estate (Hanemann–Huotari, 2015:5). Composition of Chinese investment by sector is shown on Figure 8.

Figure 8: Sector composition of Chinese FDI in the European Union from 2000–2014



Source: Data from Hanemann–Huotari, 2015, Figure 8.2

The growth of Chinese FDI in Europe is a good opportunity to attract much needed capital that can also help in restarting investment and economic growth, and generating spill overs and backward linkages to the Chinese consumer market. However, Europe needs to take some steps to maximize benefits from Chinese investment. First, it needs to implement structural reforms in order to be able to successfully compete with other advanced economies for Chinese FDI. Second, it needs to rethink its approaches to investment promotion and investor support, including an increase of capacities on the ground in China. Third, policymakers need to be prepared to defend the principle of investment openness against populist and local criticisms.

There are also concerns about Chinese FDI because of the unique political and economic system of the country. The EU needs to act on this front as well. The first priority should be a robust bilateral investment agreement between the EU and China

PSZ 2017. angol.szam_beliv_v16.indd 226 2017. 04. 06. 7:29:08

that addresses the existing asymmetries in market access through pre-establishment rights for European companies and a short negative list for sectors restricted to foreign investment. Second, Europe should develop a strategy to push China on promised reforms especially in issues of state subsidies and other non-market elements distorting global competition. Third, greater coordination of the security review process in needed to increase the efficiency and coherence of such reviews ensuring there is a functioning solution in place to monitor and mitigate potential security risks (Hanemann–Huotari, 2015:6–7).

From security perspective, China poses new challenges for host countries. In addition to economic risks, FDI can also raise national security concerns for host countries. For example, it can be an additional channel for foreign interests for infiltration, surveillance, and sabotage of critical infrastructures in energy, transport, cyber and financial networks. Another example is the transfer of technology or expertise to a foreign-controlled entity that might be deployed in a harmful way against the interests of a nation.

In recent decades, all major source countries of FDI in Europe were democratic market economies with the only significant exceptions of Singapore and Russia. Newly emerging capital exporters, like Japan, were either military allies or simply not large enough to matter. China, however, is different. It is the world's second largest economy, and one of the top five outbound FDI exporters, but it is a country with an authoritarian political regime, a unique economic system, weak security relationship with most major recipient countries and increasing assertiveness on the global stage (Hanemann–Huotari, 2015:41). It also has a completely different concept of war, peace, conflict, and advancing a nations interests (Handel, 1996).

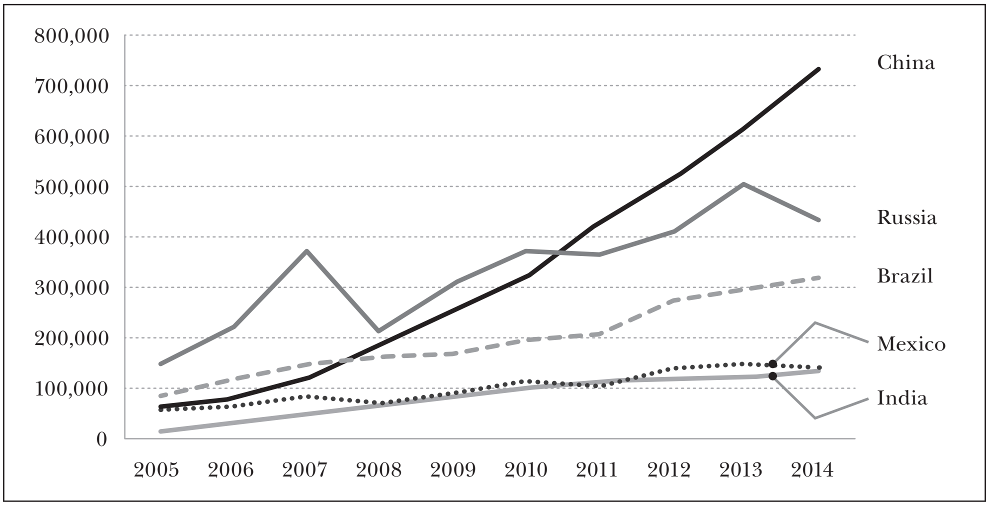
In their 2016 update to their report published in 2015, experts of the Mercator Institute for China Studies and Rhodium Group say the trends of a growing Chinese investment in Europe, together with the related opportunities and concerns, continued. Additionally, slower growth and transition to a new economic model turned Chinese investors even more towards advanced industrial assets, modern services, and real estate, while Chinese investment also increasingly extended beyond the Big Three economies (Germany, France, and the United Kingdom), fueling an intra-European competition for Chinese capital (Hanemann–Huotari, 2016).

In the past decade, China also became the largest outbound FDI investor among emerging economies, surpassing Russia in 2011 as shown on Figure 9. Chinese companies are present in 184 countries and the principal recipient region of Chinese investment is Asia. Europe is only the third, following Latin America and ahead of North America, Africa, and Oceania. Regarding the nature of ownership of Chinese firms with overseas investments, state owned enterprises are still predominant but private companies are rapidly gaining ground (Casaburi, 2016:21).

The largest non-financial Chinese transnational companies in terms of assets held abroad are listed in Table 1. The list is based on data from the Chinese Ministry of Commerce (Casaburi, 2016:21).

PSZ 2017. angol.szam_beliv_v16.indd 227 2017. 04. 06. 7:29:08

Figure 9: FDI accumulated abroad between 2005 and 2014 in emerging economies



Source: Casaburi, 2016, Chart 2

Table 1. Main non-financial Chinese transnational companies in terms of assets held abroad

1	China Petrochemical Corp.
2	China National Petroleum Corp.
3	China Resources
4	China National Offshore Oil Comp.
5	China Unicom Corp.
6	China State Construction Engineering Corp.
7	China Merchants Group
8	Sinochem Corp.
9	China Ocean Shipping
10	China National Cereals, Oils & Foodstuff
11	Aluminium Corp. of China
12	China Mobile Communications Corp.
13	Beijing Enterprises Group Comp.
14	China Minmetals Cor.
15	Guangzhou Yuexiu Holdings
16	Citic Group
17	China Communication Construction Comp.
18	China Power Investment Corp.
19	BOE Technology Group
20	Huawei Technologies

Source: Casaburi, 2016, Table 1

PSZ 2017. angol.szam_beliv_v16.indd 228 2017. 04. 06. 7:29:08

The sectors most targeted by Chinese investment in Europe are energy, real estate, and manufacturing. This pattern differs from China's global investment preferences where business services and leasing, finance, and mining and energy are the most preferred sectors. The main differences between China's investment strategy in Europe and elsewhere are (Casaburi, 2016:47):

– There is very limited Chinese activity in the mining sectors and extraction industries within Europe because of both the smaller deposit of resources and the stringent environmental controls imposed on extraction projects.

– There are more acquisitions of manufacturing companies by Chinese firms in the EU than in other regions the main objectives being the acquirement of technological capabilities and know-how.

– There are more investment projects related to scientific and technical research than in other regions in the world.

The key Chinese investment in Europe between 2010 and 2014 with a value of at least 1 billion dollars are summarized in Table 2.

Table 2. Key Chinese investments in Europe with a value of at least 1 billion dollars 2010–2014

Year	Chinese company	Amount in million USD	Sector	Involved party	Country
2013	China National Petroleum Corp.	4,210	energy	Eni SpA	Italy
2011	Three Gorges	3,510	energy and electricity	Energias de Portugal	Portugal
2011	CIC	3,240	energy and electricity	GDF Suez	France
2014	State Grid Cor. of China	2,811	energy and electricity	Cassa Depositi e Prestiti SpA	Italy
2012	Bright Foods	1,940	agriculture / consumer[2]	Weetabix	United Kingdom
2011	Wanhua Industrial Group Co.	1,552	basic materials	Borsod Chem Zrt.	Hungary
2014	Hony Capital Ltd.	1,540	agriculture	Gondola Group Ltd.	United Kingdom
2012	Sinopec[3]	1,500	energy and electricity	Talisman Energy	United Kingdom
2012	Huawei	1,500	telecom and IT	greenfield	Hungary
2012	Huawei	1,500	telecom and IT	greenfield	Spain
2010	Geely Auto[4]	1,500	manufacturing	Ford	Sweden
2010	China Huaneng Group Corp.	1,232	utilities	InterGen NV	Netherlands
2014	COFCO	1,210	agriculture	Nidera	Netherlands

PSZ 2017. angol.szam_beliv_v16.indd 229 2017. 04. 06. 7:29:08

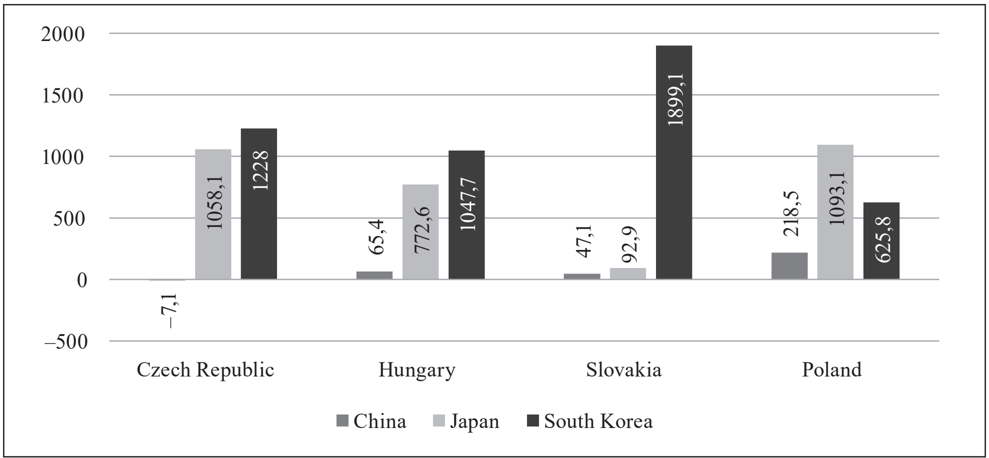
Year	Chinese company	Amount in million USD	Sector	Involved party	Country
2012	Weichai Power Co. Ltd.	1,136	industrials	KION Group AG	Germany
2014	Dongfeng	1,100	manufacturing	Peugeot	France
2011	Petro China Co. Ltd.	1,015	energy	Ineos Ltd.	United Kingdom

Source: Casaburi, 2016:48–55; Hansakul–Levinger, 2014:14

One more transaction from 2008 deserves to be mentioned: Aluminum Corporation of China, teamed with Alcoa Inc., acquired a minority stake in mining giant Rio Tinto of United Kingdom for 14.135 billon dollars (Hansakul–Levinger, 2014:14; Dean–Batson–Matthews, 2008).

As we can see from Table 2, Hungary is also on the map of Chinese investors with Huawei's 1.5 billion dollar greenfield investment in 2012. In their 2015 study, Éltető and Szunomár from the Hungarian Academy of Sciences reviews East Asian investment activities in the Visegrád countries until 2012. Comparing Chinese investment with Japanese and South Korean FDI in the Visegrád countries, she found that Chinese investment was still lagging behind investment from Japan and South Korea in the region as shown on Figure 10.

Figure 10: FDI stock in the Visegrád countries from China, Japan, and South Korea in 2012



Source: Éltető–Szunomár, 2015

The authors also report that Chinese investment in Hungary exceeded 3 billion dollars by 2014, representing about 2-2.5 per cent of Hungary's total FDI stock. About half of that was from the investment of China's Wanhua in Hungary's Borsod Chem, the largest Chinese investment in the Central Eastern European region. Other major investors in Hungary were Huawei, ZTE Corporation, Lenovo, Sevenstar Electron-

PSZ 2017. angol.szam_beliv_v16.indd 230 2017. 04. 06. 7:29:08

ics Co., BYD Electronics and Comlink. Most of the Chinese transnational companies operate in manufacturing and Hungary is also a significant distribution center in the region. In addition to manufacturing, Chinese companies also invest in the chemical industry, telecommunications, trade, wholesale and retail commerce, banking, hotels and catering, logistics, real estate and consultancy. In terms of numbers, most of the Chinese companies operating in Hungary are small businesses in the service and retail sector (Éltető–Szunomár, 2015:16).

In the spring of 2012, Hungary launched a new foreign economic policy focusing on diversifying foreign economic relations by strengthening and developing Eastern economic relations while maintaining its strong existing relations with Western industrial countries. The strategy also includes investment promotion from Eastern countries with China being one of the most prominent partner among them. Despite the efforts, only minor amounts of new Chinese investment have arrived in the country since the start of the new strategy. One reason can be the difference between the approaches and interest of the two sides. Hungary prefers greenfield investments with cheap Chinese financing while China expressed it interest in public infrastructure investment projects and offered forms of financing not compatible with EU regulations (Éltető–Szunomár, 2015:21–24).

Uncertainties ahead

China's recent investment surge highlighted by the economic slowdown created positive excitement in Europe. Indeed, Chinese capital may contribute to the revival of European economies but there are also uncertainties ahead. Will the trend of raising Chinese investments endure? Does China purely follow its business and economic interests or are there hidden political motives? How will China solve its own problems and how will those solutions affect its investments in Europe?

As Chinese banks and investment funds are state controlled, even commercially motivated investments might be leveraged to pursue political goals in the future, while the EU does not have a central investment review system similar to those of other developed countries such as the United States, Australia, or Japan. Without the review system, the EU lacks an important capability to prevent it from losing its industrial capabilities and preserve its technological leadership (Sonzogni, 2012).

One example is both promising and illuminating about Chinese intentions and strategy. In the hope of countering European sanctions for its invasion of Ukraine, Russia tried to strengthen its alliance with China on energy, defense, and agricultural trade and investment. Moscow's strategy, however, has failed as China continued to diversify its energy sources so that rather than playing Europe by engaging with China, Russia is getting played by China (Eder–Huotari, 2016). Two lessons can be derived from Russia's example. First, China seems to follow its economic interest. Second, China was ready to use Russia's weakness to promote its own interests. In other words, China looks for business opportunities but it is not responsible for our own interests, it is up to us to negotiate for a deal that also benefits us.

PSZ 2017. angol.szam_beliv_v16.indd 231 2017. 04. 06. 7:29:09

Another source of uncertainty is that although Chinese investments in Europe are growing, they are still a small share of the total Chinese outbound FDI, and only a few acquisitions are successful either from a profit and value point of view or from a strategic perspective. The successful takeovers are results of synergies with the Chinese partner contributing to competitiveness in specific markets or industries instead of merely funding the acquired company (Sonzogni, 2012).

Regardless of its international ambitions and strategy in Europe, China also has its own internal problems that may add to the uncertainties. Maybe the two most important from the uncertainty point of view are demographic trends and the large income and regional inequalities accompanying its rapid economic growth. These two problems lead China to an economic and political watershed that the country may not pass without trouble.

With life expectancy growing and fertility rate plunging, many fear that China's population ages faster than the country can accommodate. In 2014, people older than 60 reached a 15 per cent share in China's population, a share expected to double by 2050 with median age rising from 35 to 46 during the same period. With a growing number of older people and a shrinking number of younger people, the country's working age population has started to shrink, from roughly 941 million in 2011 to 916 million in 2014. This shrinking work force may raise wage levels, making China lose competitiveness to countries like India, Indonesia, and Vietnam.

There are also good news, however. Employment rate has increased and productivity is expected to rise as people entering the work force are better educated than those exiting. China has also been improving its pension system although this may also rise labor cost while providing more old age security.[5] Regardless whether the state or the family will be the primary provider of eldercare, the problem of an aging society remains. The offspring of today's aging baby boomers were born under China's one child policy, which means that they will need to care for two parents, and sometimes four grandparents, without the help of siblings (Lou, 2015).

An aging population will not only bring economic uncertainties but also challenges to the government of China. Demography, however, is not the only challenge. At the Royal Society in London in 2011 Chinese premier Wen Jiabao declared, "Tomorrow's China will be a country that fully achieves democracy, the rule of law, fairness, and justice. Without freedom, there is no real democracy. Without guarantee of economic and political rights, there is no real freedom" (Huang, 2013:47). Despite the bold statement, however, the Chinese Communist Party has not adopted any genuine political reforms since 1989. This strategy of relying on economic growth cab work only when the economy is booming and China's economy already started to slow down. Additionally, according to 2003 surveys, 72.3 per cent of the Chinese public believes that democracy is desirable, and 67 per cent believes that it is suitable to China so that what has held China back from democracy is not a lack of demand but a lack of supply (Huang, 2013).

Changes may already be under way. Some argue that with the ascension of Deng Xiaoping, China has started its third, and still ongoing, 20th century revolution and

PSZ 2017. angol.szam_beliv_v16.indd 232 2017. 04. 06. 7:29:09

even political reforms has "taken place quietly and out of view" (Lampton, 2014:74). The reason for the need for political change is the fact that it is becoming harder to govern for Beijing under the current framework. China's leadership must now confront a population with more resources, in terms of money, talent, and information, than ever before. In addition, the Chinese society, economy, and bureaucracy have fragmented with powerful new economic interest groups, stronger and larger private businesses, a growing number of educated middle class, and more than half a billion Chinese internet users (Lampton, 2014). While the need for change is obvious now, the direction and pace of change is not, contributing to the uncertainty of China's future economic development, including its investment strategy in Europe.

Maybe the most important factor contributing to this uncertainty is the exhaustion of the main driving force behind China's fast development, the seemingly inexhaustible surplus labor from China's rural hinterland. In the past decades, rapid growth of China's industry could be explained by the two-sector model in which the industry is facing a perfectly elastic labor supply curve until there is surplus labor in the agriculture. Under these circumstances, wages do not rise until the industry absorbs all surplus labor (Gillis et al., 1996). However, wages already do rise in China. Since 2001, hourly manufacturing wages in China have risen by an average of 12 per cent a year. Additionally, Chinese industry have been transforming from cheap manufacturing to technologically more advanced industries also including design (Jiaxing–Yangon, 2015).

A more advanced industry requires more advanced skills, making the absorption of surplus labor from the rural hinterland more difficult. This not only means that China hits the wall of the exhaustion of growth based on surplus labor but also means that the two sector of the Chinese economy is decoupling, leading to an unbridgeable gap between the two. As industrial development in China is concentrated on the coastal provinces, this also means that the country itself is divided into a dynamic coastal region and a lagging hinterland putting one more layer of pressure on the Chinese government.

What this has to do with China's presence and investments in Europe? Trends of Chinese outbound investments can be affected by the country's economic growth as well as its need to turn its resources to domestic consumption or developing its welfare system. Since Europe has only a relatively small share of China's outbound investments, effects of these factors on the level of investment are likely to be amplified.

Crocodile in the Yangtze

When looking at Chinese development and investment, many focus on the role of the state and try to win the goodwill of the Chinese government to promote Chinese investment in their economy. They often fail to notice a new player in the Chinese economy that will be more important and interesting in the future: the Chines global private enterprise. Huawei, with its large greenfield investments in Hungary and Spain, and Geely, the Chinese company buying Volvo, are two examples. Alibaba, the

PSZ 2017. angol.szam_beliv_v16.indd 233 2017. 04. 06. 7:29:09

operator of the world's largest global e-commerce platform for small and medium sized businesses is another example.

Why are these companies interesting and important? Because they are the fastest growing new cornerstones of the Chinese economy, and they are also global players already. Moreover, they think and act differently than Chinese state owned companies, and in an environment less supportive towards private businesses than that of their global competitors, they focus more on their customers. In his recent book, Porter Erisman, former vice president of Alibaba, let us peek into this new kind of companies.

Alibaba started as a modest website to make Chinese businesses visible to the world on the internet. Realizing the opportunities, its founder, Jack Ma, wanted to build a global e-commerce portal based in China but serving customers all over the world. Alibaba is a completely private enterprise. It has never got subsidies from the state. Instead, the early growth and development of the company was financed by Japanese and American venture capital. As the company grew, the founders realized the need for professional management and they hired experienced professionals like Savio Kwan, COO of Alibaba. Born in Hong Kong, he studied in London and worked for GE in China bringing both Western management expertise and local Chinese experience to the company. Another example of the author of the book on Alibaba himself, Porter Erisman, a former vice president of Alibaba and one of the Americans working for the company in its early years of development (Erisman, 2015).

Alibaba is a Chinese company. Its headquarter is still in Hangzhou, the home town of its founder. On the other hand, it is also a global company. When on September 19, 2014, Alibaba has done the largest IPO in history, it was in New York. Leaders of Alibaba are familiar with the realities of the Chinese economy and they adapt to that but they think and act like any global company. Even more so, because in fact, they can rely less on the state, not more than their Western counterparts. If we want to attract Chinese investment to Europe and Hungary in the future, we need to think value for the customer instead of pleasing the Chinese government.

Hungary and China – an evolving strategic partnership

Hungary's solution to the problem of a divided Europe is accepting reality and abandoning "the illusion of federalism" instead of following the utopia of a federalist Europe, and accepting China's lead (Cabinet Office of the Prime Minister, 2017; Lui, 2017). The idea of multipolarity is also present in the implementation of Hungary's eastern opening strategy. Aligned with the Chinese interest of forging closer ties with East Central European Member States instead of dealing with a unified European Union, Hungary pursues a stronger strategic partnership between China and East Central Europe (MTI 2016d; 2016a; Miniszterelnök.hu, 2016).

Hungary's eastern opening strategy is already generating results. One example is the refurbishment of the Budapest–Belgrade railway line to be implemented by a Chinese-Hungarian joint venture (Ministry of Foreign Affairs and Trade, 2016). Another example is Chinese telecom giant Huawei which employs more than 2000 people in

PSZ 2017. angol.szam_beliv_v16.indd 234 2017. 04. 06. 7:29:09

Hungary already (Ministry for National Economy, 2016) with further talks about an increased cooperation including Huawei's participation in the Digital Welfare Programme of the Hungarian Government (MTI, 2016c). Several Chinese enterprises also seek cooperation with Hungary in the fields of e-mobility, intelligent transport systems, autonomous cars, and smart cities (Ministry for National Economy, 2017) The Hungarian Government also signed a partnership agreement with Chinese automotive industry supplier Yanfeng Automotive last year (MTI, 2016b).

This year also started with success in Chinese–Hungarian relations. The Hungarian Government has signed a strategic cooperation agreement with the Bank of China, accompanied by other agreements between the Bank of China and the National Bank of the Budapest Stock Exchange, the Government Debt Management Agency, and Eximbank (MTI, 2017a). As a result of the agreement, the Bank of China will be developing closer relations with the Hungarian Investment Promotion Agency and Eximbank, and will also be promoting Hungary in China as a European investment destination (MTI 2017b).

Conclusions and recommendations

Chinese investments in Europe grew rapidly in the last few years but Chinese outbound FDI in Europe still represents a small share in both total Chinese outbound FDI and total FDI in Europe. While China's ambitious One Belt One Road initiative shows an intention to further develop economic relations between China and Europe, there are also uncertainties ahead.

Chinese investments have been concentrated on the European core with the United Kingdom, Germany, and France as the main targets but the regional scope of Chinese investments in Europe is already expanding. While one of the main motivators of China's European investments is gaining access to technology, successful investments require synergy between partners with the Chinese partner also contributing to competitiveness beyond merely providing finance.

There are also concerns about Chinese investments in Europe. The largest Chinese investors are state owned companies and letting them gain access to European technology and exerts may even pose a national security risk beyond the economic concerns. Another problem is trading fundamental European values and political interests for potential economic benefits. The division among Member States of the European Union on these issues also poses a risk and China has not been shy to use this division to its own advantage.

On the other hand, China is the second largest economy of the world and an integral part of the world economy so that developing economic relations between Europe and China, and specifically, between Hungary and China benefits both sides. With its One Belt One Road initiative, China expressed its intention for a closer cooperation. It is best to take the OBOR initiative as an opening bid for doing business with China on mutually beneficial terms but finding and negotiating for our own benefits are not China's responsibility. The best European, and also Hungarian, strat-

PSZ 2017. angol.szam_beliv_v16.indd 235 2017. 04. 06. 7:29:09

egy, therefore, is developing our own strategies along our own economic and political interest and negotiate lasting deals with China whenever our interests are aligned. It is also advisable not to let China divide the EU and not to trade European unity and values for short term benefits. China can be a great economic partner but like any great power, it has the tendency to expand its sphere of influence and impose it values, and political system, and interests on others. Holding back China on these fronts and doing business on mutually beneficial terms is our responsibility. Without doing our own homework, simply following China's advice will lead to serving its interests and giving up our own.

Notes

1 The views and opinions expressed in this article are those of the author and do not necessarily reflect the official policy or position of the Central Bank of Hungary or the Doctoral School of Geography.

2 Deutsche Bank reports the transaction as a deal in the consumer sector at a value of 1165 million dollars

3 Deutsche Bank reports China Petroleum & Chemical Corp. as buyer of Talisman Sinopec Energy UK Ltd.

4 In a Deutsche Bank report, the acquisition of Volvo Personvagnar AB by Zhejiang Geely Holding Group for 1.8 billion dollars is listed but the two transactions are most likely the same as Geely acquired Volvo from Ford (Hansakul–Levinger, 2014:14).

5 Despite developing welfare programmes, family is still the primary source of eldercare in China where the constitution says that "children who have come of age have the duty to support and assist their parents" (Lou, 2015).

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PSZ 2017. angol.szam_beliv_v16.indd 238 2017. 04. 06. 7:29:09

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István Stumpf

The Hungarian Constitutional Court's Place in the Constitutional System of Hungary

Summary
This paper presents the achievements of the "Rule of Law Revolution" and the role of the Constitutional Court in the different stages of Hungary's rule of law evolution. Special attention will be placed on the current Hungarian practice of rule of law, the topics of rule of law, constitutionalism and the division of powers within the framework of legal and political constitutionalism will be discussed. The paper also will summarize the views that criticized the activism of the Hungarian Constitutional Court, and those that have laid down the groundwork for the expansion of political constitutionalism after the 2010 Parliamentary elections. Finally, the challenges of rule of law and constitutionalism will be examined, with regard to the role of the Court as the principal organ for the protection of the Fundamental Law in the context of Hungary's membership in the European Union.

Keywords: constitutional court, Fundamental Law, fundamental rights, decisions of the Court

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PSZ 2017. angol.szam_beliv_v16.indd 239 2017. 04. 06. 7:29:09

The position of the Constitutional Court in the division of powers

In Hungary's previous legal system, the principle of the division of powers was only mentioned in the preamble of the Act on the Constitutional Court. The Fundamental Law, however, explicitly sets forth the principle of separation of powers: "the functioning of the Hungarian State shall be based on the principle of division of powers." (Article C paragraph 1).

Following the regime change, although the principle of separation of powers was not explicitly mentioned in the Constitution, but the Constitutional Court has consistently enforced it in its decisions as an integral part of the rule of law.[1] Unlike the well-developed system of the rule of law, the Constitutional Court did not give a detailed description of the separation of powers, rather the Court expressed their opinion in connection with a specific case. Therefore, when defining its own legal status in the early period of its functioning, the Constitutional Court ruled that when exercising powers directed to specific parts of the Constitution, the principle of division of powers has to be taken into consideration, as one of the most important organizing and functional principles of the Hungarian governmental system.[2] The Constitutional Court consistently rejected the idea of taking the responsibility of the government or the legislature onto itself in connection with preliminary norm control[3]. The Court accepted the traditional three-part division of the branches of government, mostly because of a practical consideration, rather than a theoretical one, thus making it obvious that they would not follow the latest fashion of discovering more and more branches of power (media, local governments, unions).

In its landmark decision on the appointment of judicial leaders, the Constitutional Court defined the characteristics of the judicial branch in the system of powers. "When interpreting the principle of the separation of powers (as a part of the rule of law) the Constitutional Court based its decision on the way the principle of separation of powers is used in today's parliamentary systems, and on the way it is written in the Constitution. The 'separation' of the legislative and executive branches today basically means the division of powers between the parliament and the executive branch, although they are politically connected. The parties in the governing majority of the parliament are entitled to form a government, and the parliament votes on the bills the government introduces. […] Under these circumstances the main character of the judicial branch, as opposed to the other two 'political' branches, is that it is constant and neutral [even if the judiciary enforces the bills and decrees that are often created to enact political programmes]. This neutrality is expressed by article 50 paragraph 3 of the Constitution by declaring that the judges are independent and are only subordinated to law. […] Therefore the judicial branch is independent from the political motivations of the other two branches, and in this sense it is constant and continuous. Hereinafter the Constitutional Court interprets the neutrality of the judicial branch as described above."[4] Early decisions of the Constitutional Court show that the Court interprets the separation of powers not as a hierarchical relationship

PSZ 2017. angol.szam_beliv_v16.indd 240 2017. 04. 06. 7:29:09

but as a balanced system of mutual control mechanisms. Besides the separation of powers, the Constitutional Court also emphasized the obligation to cooperate: "From the principle of the rule of law (Article 2 paragraph 1 of the Constitution) comes the obligation of the institutions described in the Constitution to carry out their constitutional powers with *bona fide*, in cooperation, mutually helping each other."[5] Finally, I would like to cite a decision concerning the separation of powers that was made under the socialist-liberal coalition government,that won a two-thirds majority in the 1994 election. In this decision the Court committed itself to principles that became the center of attention twenty years later.

"The separation of powers not only means that one branch cannot take the powers of the other, it also means that in a democratic state based on the rule of law there is no unlimited and unlimitable power, therefore some branches do limit the powers of other branches."[6]

How can we define the activism of the Hungarian Constitutional Court?

When the founding generation left the Constitutional Court, several evaluations were made on the work of the Court. Every one of them emphasizes the activist approach of the Court and the metaphor of the "invisible constitution". Many members of the Constitutional Court did not consider the text of the Constitution, which was enacted in the turmoil of the system change and was intended to be only temporary, such a masterpiece that could not have been enhanced by the law professor members of the Court. It is not surprising that the founding president said the following in an interview later: "for the sake of coherence our constitutional jurisdiction – especially in difficult cases – is often bordering constitution-making, I never denied that" (Sólyom, 2000). Although the Court was divided when it came to the interpretation of its own role, the majority believed that in the given historical situation the Constitutional Court had to have an activist role. President of the Constitutional Court László Sólyom expressed the concept of the "invisible constitution" in his concurring opinion attached to the Court's ruling on death penalty: "The Constitutional Court has to continue its work to formulate in its interpretations the fundamentals of the Constitution and the rights it contains; to create a coherent system with its decisions over the Constitution that is often amended for short-term political interests; as an "invisible constitution" it serves as a solid constitutional measurement, and therefore it surely will neither contradict the Constitution to be adopted, nor any future constitutions."[7]

It is definitely unprecedented that a "doctrine" written in a concurring opinion should have such a career. Even the author of this opinion thinks that many people misinterpreted the point of his argument, because the metaphor of the "invisible constitution" is not a synonym of the "eternity clause", on which basis even the written constitution could be taken under critical revision. Rather he wanted to point out that the constitution is something much higher than technical norms: it is a strict order of

PSZ 2017. angol.szam_beliv_v16.indd 241 2017. 04. 06. 7:29:09

the principles laid down in the decisions of the Constitutional Court. In its decisions the Court has to express, make visible, and use these principles as a coherent system. It is worth noting that in future decisions, the Court avoided even using this metaphor, making sure that their decisions can be connected directly to constitutional rules, and the Court avoided the appearance that its decisions would mean a revision of the written constitution. Nevertheless, the spirit of the "invisible constitution" lived on in Hungarian legal culture, as well in the jurisdiction of the Court.

The functioning of the Constitutional Court was characterized by constant conflicts with the government. After serious internal debates, the Constitutional Court defined its role as a real counterbalance of the parliamentary majority. The Court acknowledged the Constitution as an absolute measure above the Court, a measure which was originally enacted by the parliament. Until 2011, the majority of the Court held that the Court does not demand the power to review the contents of a constitutional amendment, although – as a silent dissenting voice held – "theoretically it could be justified." During the era of the Horn-government which held a two-thirds governing majority between 1994–1998, the governing parties were preoccupied with the constitutional veto of the Bokros-package (a series of drastic cutbacks on the post-communist welfare system), with the idea of a new constitution, not with the interpretation of unconstitutional amendments of the Constitution. Already during this time, there were lively debates on whether the parliamentary supremacy based on people's representation, or the constitutional control safeguarding fundamental rights should be the guiding principle of public affairs. These debates got heated during the time of the second Orbán-government, which had a two-thirds majority.

In the academic discussion, there is no uniform definition of the Constitutional Court's activism. "Most of the time it reflects disapproval: the Court does not hold on to the text of the Constitution, ignores the precedent, used an unacceptable method of interpretation, invaded the territory of legislation, or just made a decision that the critic disapproved on political grounds. The opposition of the constitutional jurisdiction holds that the whole idea of constitutional revision of the parliament's acts is activism" (Tóth, 2009:17). The debate got more attention in recent years through papers of academics supporting political and legal constitutionalism.[8]

Activities of the Constitutional Court got into the center of attention both in Hungary and abroad. The methods of constitutional interpretation served as an example for other countries as well (South Africa, Lithuania, Ukraine, and Albania). Although many critics accused the Court of importing German law, the competences of the Constitutional Court did not contain the German type of constitutional complaint, the review of court decisions. The Court was believed both in Hungary and abroad as "the most active and the most powerful constitutional court in the world" (Brunner, 1992:539). The most important decisions of the Court (abolition of death penalty, decisions on compensation and transitional justice acts, drawing the line between the competences of the president and the executive) often generated strong political reactions, sometimes even anger. According to critics, the Court only chased the acknowledgement and legitimacy provided by the West in the early nineties, and did

PSZ 2017. angol.szam_beliv_v16.indd 242 2017. 04. 06. 7:29:09

not show any empathy for everyday reality from its "ivory tower". According to Csaba Varga, one of the most radical critics of the Constitutional Court: "the Court encroached on the whole political process, and in many cases it determined the course of the process, therefore they forced the whole society, the political class, the parties and among them the legislative, executive, and judicial branches that represent society under their arbitrary philosophies, views, and the obligations and restrains that go with them; therefore restraining the chances of a will to change the system – a will to substantially overcome the past and enter into a new phase of nation building" (Varga, 2006:540) Varga claims that the professorial style of the Constitutional Court shackled the system change with its "devastating liberal doctrinaireism". They created an invisible constitution out of mere abstraction, and based on foreign law. By creating constitutional principles themselves, on which basis they nullified the will of the sovereign, they carried out an unconstitutional protection of the constitution. As opposed to the legal nihilism of the one party state they fetishized law, putting the rule of law in the center of the new catechism. The decisions of the Constitutional Court were irrevocably built into the legal system that acquired constitutional power.

Beside the general criticism, the most important decisions of the Court, such as the so-called "transitional justice act" decision, invoked especially heated reactions. Zsolt Zétényi, one of the co-sponsors of the "justice act" which would have lifted the statute of limitation for crimes under communism that were not prosecuted for political reasons, proposed the following argument during the parliamentary debate: "Rule of law should not be a shield against injustice. Restoring the rule of law has to mean punishing capital crimes, so that no criminal offence shall remain unpunished. […] Limitation and the general principles of the rule of law are not intended to perpetuate or transfer unlawful or pre-law conditions. Summarizing: rule of law regulations have to apply in a rule of law state, but not in a way that it means excluding unlawful conditions from the scope of criminal justice forever. I do not doubt the logic of the argument that the requirements of formal law are violated by the above method, but I do doubt that in this case there is no other way than doing nothing. […] In a country where law was trampled upon it would be like slapping rule of law in the face to use these exact same trampled upon laws against natural law."[9] Supporters of the bill tried multiple times to help justice triumph over formal rule of law but all of their attempts have failed the test of the Constitutional Court.

From among the first professional critics of fundamental rights activism the five-point criticism of Béla Pokol is worth noting:

"1. Activism overtly transfers the weight of the most important decisions affecting the society from the parliament to the Constitutional Court, therefore it erodes the fundamentals of the parliamentary system based on elections and the parliament.

2. The favorite fundamental right formulas of activism are the most abstract constitutional declarations with no normative directions behind them – being at least covered by the consensus of some circles of legal professionals. Therefore activism has no more legitimacy than the inner moral bravery of a constitutional judge. The argument, which is sometimes used in the context of forcing the parliament to the

PSZ 2017. angol.szam_beliv_v16.indd 243 2017. 04. 06. 7:29:09

background, that "this way the logic and predictable arguments of law take the place of political fights", is completely unfounded.

3. In activism deduction from abstract principles takes the place of the compromising ad hoc decision making mechanism of a pluralist political system, and this paralyzes society. This decision making method is unable to harmonize the thousands of inner conflicts of a complex society, and is therefore also unable to maintain society through it.

4. The appearance and gaining strength of constitutional jurisdiction in matters of fundamental rights in the past 40 years in the western world has brought tension to the traditional texture of law: the cooperation of political legislation, legal dogmatic processes, and formulation of law by courts. Activism dangerously enhances this tension, making fundamental rights "dynamites", which will eventually damage the legal system.

5. Finally the above mentioned problems in the Hungarian political system may lead to the point where major political forces consider cutting back constitutional jurisdiction, or, in radical movements, completely abolishing it. Activism is dangerous not only to the political system and parliamentarism, but to the institution of constitutional jurisdiction itself" (Pokol, 1992:154).

Beside frontal attacks the group of friendly critics could be seen, most of whom considered fundamental rights activism acceptable, or even supportable, while in matters of the scope of jurisdiction and the organization of the state they considered sticking to the text of the Constitution primarily.[10]

In his analysis of constitutional democracy János Kis identified three types of activism (Kis, 2000:112–114). In his view, activism in the scope of jurisdiction is when the Constitutional Court starts a procedure or makes a decision to which they weren't entitled by law, as well as when they broaden the scope of inquiry to legal acts not challenged by the original proposal. Activism of interpretation is when the Court doesn't just use the Constitution, but changes or amends its regulations, most often by comparing the legal act in question to rules not explicitly written in the Constitution. If the Court makes a decision that is biased on the grounds of political reasons, we talk about activism based on political bias. János Kis thinks that the border of fundamental rights interpretation should be drawn somewhere beyond traditional legal positivism, but not as far as to reach natural law, therefore not making it possible to overrule the text of the Constitution on moral grounds. Arguing with Béla Pokol, Gábor Halmai, who subscribes to Dworkinian ideas, protects fundamental rights activism on moral grounds, but criticizes activism in the field of the scope of jurisdiction and the governmental system: "judges should decide on concrete cases not only on the ground of the words of the Constitution but based on principles formulated from the abstract clauses of the Constitution. Activism in the sense of founding arguments based on such principles will probably not be taken away from constitutional jurisdiction" (Halmai, 1994:85).

The debate didn't bring consensus as regards to the question of what theoretical basis does supporting fundamental rights activism and rejecting activism in the

PSZ 2017. angol.szam_beliv_v16.indd 244 2017. 04. 06. 7:29:09

scope of jurisdiction have. As Gábor Attila Tóth put it:"the question is not whether there exists an acceptable form of activism, but whether the solutions supported by fundamental rights activists are equal with amending or rephrasing the Constitution" (Tóth, 2009:24).

The revolution of political constitutionalist arguments

The 2010 elections brought a landslide victory for the Fidesz–KDNP coalition. The governing forces, having the majority to adopt a constitution, began preparing a new constitution. The strategic decision-makers of Fidesz have long prepared to do away with a system based on the compromises bargained by the economic, political and philosophical elite of the status quo elite, and to break the "clotted post-communist structures".[11] Analysts close to the national-conservative side kept emphasizing, that "what was carried out on the behalf of the rule of law by limiting multi-party parliamentarism, is considered as choking democracy today."[12] They believed that serious distortions have happened within the constitutional system, drastically limiting the governments' scope of action. Therefore excessive separation of powers is to be cut back, in order to restore the supremacy of the elected parliament, and to build a strong government with an effective public administration. Several proposals were formulated to change the constitutional system and to introduce innovations to the new constitution.[13] Some analysts suggested radically breaking ties with the previous era, and initiated a rehabilitation of "the doctrine of the Holy Crown", and the restoration of the legal continuity that was broken by the Soviets taking away Hungary's historical constitution. Others thought that the progress of the new rule of law system is a dead-end, arguing that "constitutionality and rule of law cannot be created otherwise than as a particular answer to a particular challenge",[14] therefore it is time to stop copying foreign examples. Behind the European Union's attack of the Prime Minister Orbán was the PM's effort to re-politicize political matters and to enforce the mandate given to him by the majority of voters. This contradicted the main trend of European Union politics of turning political matters into legal problems, meaning that solving social problems should happen in the legal/judicial arena. "European politics characterized by the extreme dominance of human rights logic and the downright limitation of the majority principle is in sharp contrast with the principle of total sovereignty of a one-party parliamentary majority" (Pócza, 2012). This argumentation is the main pillar of political constitutionalism.

The adoption and the amendments of the Fundamental Law of Hungary show that the national-conservative majority seized the "constitutional moment"[15] and carried out the largest scale reform after the system change as regards to the contents and the structure of the Hungarian legal system, in many points motivated by criticisms of the previous constitutional system. The Fundamental Law, adopted exactly one year after the 2010 elections, was intended to symbolize – even in its name – breaking with the previous system based on the pacts of the old elite. A new political generation introduced its demand for position that is not bound by the compromises

PSZ 2017. angol.szam_beliv_v16.indd 245 2017. 04. 06. 7:29:09

of the previous era, that doesn't accept "nullifying" the historical constitution, considers the importance of the family in maintaining the community, and does not give up the idea of uniting the nation without moving the borders. The preamble of the Fundamental Law, the National Avowal, symbolizes breaking with the former, politically neutral constitutional identity.[16] From the political constitutionality point of view we could interpret the first chapter of the Fundamental Law as a symbolic dethronization of the "invisible constitution" and the rehabilitation of the historical constitution. It demonstrates the returning to the traditional form of government by not even mentioning rule of law, and having the following instead: "We hold that the common goal of citizens and the State is to achieve the highest possible measure of well-being, safety, order, justice and liberty." The National Avowal is not only intended to lay down the emotional basis of the new constitutional identity, but it may play an important role in the interpretation of the constitution. According to Article R paragraph 3 of the Fundamental Law: "The provisions of the Fundamental Law shall be interpreted in accordance with their purposes, the National Avowal contained therein and the achievements of our historical constitution." The message of this triad of constitutional interpretation – especially when connected with the fourth amendment discussed later – is to replace the "invisible constitution", which served as a measure of fundamental rights activism.

If we sum up the criticisms of the previous constitution, it can be seen that the Fundamental Law incorporates the most important provisions that the old constitution lacked according to critics. Community-centered regulation is built in next to the human rights catalogue of the Fundamental Rights Charter; citizens' obligations also appear beside citizens' rights; among the legal interpretation requirements of courts common sense and public good appears, as well as the presumption of legal acts serving moral and economical purposes (Article 28). Strengthening the role of the state, the limits of selling national wealth, and the – much debated – pension rules and the proportional sharing of taxation also became parts of the Fundamental Law.

The new constitution shows an interesting dichotomy: "it identifies itself as the finisher of the system change – but it does not build continuity on the constitution of the past 20 years. […] It suggests a returning to the historical roots of Hungarian statehood in its rhetoric, but it is connected to the democratic constitution of 1989 in its normative contents."[17]

The sharpest conflicts of the new constitutional system arose between the Constitutional Court and the government as it relates to the legislative branch, and appearing as constitution enacting power. The writers of the Fundamental Law intended to create a constitution "carved in granite". However, the democratic and professional deficit of the "revolutionary legislation", the "purposeless lawyering" of the Constitutional Court, and the "intriguing of globalist circles" hiding behind the Venice Commission forced the parliamentary majority to tailor the Fundamental Law to the political challenges through several amendments. After the fourth amendment, and only a few months before the 2014 elections, the constitutional conflicts have not ruled the political agenda anymore. If we want to draw a picture "after the war", we could say that the government considers the first stage of constitution-making closed, and it now intends to consolidate the achievements of the second constitutional revolution. The opposition thinks of a kind of "restorative constitution making", while the radical side argues in favor of returning to the constitutional fundamentals of 1989, and the moderates propose a reconciliation with the national-conservative side. Constitutional jurists try to process the changes through academic conferences and research projects.[18]

Constitutional conflicts or 'checks and balances'?

Unlike the old constitution, the Fundamental Law explicitly declares the principle of separation of powers: "the functioning of the Hungarian State shall be based on the principle of division of powers" (Article C paragraph 1). The new constitution – contrary to previous presumptions and the concept of the ad hoc committee in charge of preparing the new constitution – maintained the republican form of government, and did not make radical changes to the governmental structure. However, some shifts have happened in the relationship between constitutional institutions. As a new actor in the system of checks and balances the Budget Committee appeared which can significantly limit the actions of the parliament, because no central budget may be adopted without the consent of the Committee. Although the President did not acquire the right to dismiss the parliament (in times of serious constitutional or political crisis due to lack of confidence), as the preparatory committee first suggested, he is still capable of shortening the term of the parliament if the parliament does not adopt the central budget of the year until March 31. The previous constitution also included the right of the President to dismiss parliament if parliament does not elect a prime minister within 40 days of the first candidate being introduced. Beside the President's power of political veto (sending a bill back to parliament for reconsideration), the President's power of constitutional veto (sending the bill to the Constitutional Court if the President finds it unconstitutional) was broadened. However the Fundamental Law sets forth that if the President does not exercise his veto rights, he has to sign the bill into law within 5 days.

As for the government, the Fundamental Law strengthens the position of the Prime minister (chancellor type of government). The institution of the so-called "constructive no-confidence vote" was upheld. As a new constitutional regulation, besides the government, the Prime minister can now assign duties to the ministers. The inclusion of local governmental institutions and autonomous regulatory organs (with the power to issue decrees) in the Fundamental Law also adds a new player to the system of separation of powers.

The most important changes occurred with regards to the position of the Constitutional Court within the system of powers. During the first phase of the constitution-drafting process many experts supported the idea of turning from the centralized (European) model of constitutional jurisdiction to the decentralized (American) model. According to these experts, a system of constitutional protection should have

PSZ 2017. angol.szam_beliv_v16.indd 247 2017. 04. 06. 7:29:09

been created where the Curia (Supreme Court of Hungary) takes the role of the Constitutional Court, and lower level courts would have become the primary institutions of fundamental rights protection. The creation of a separate administrative court also came up. Eventually, the parliamentary majority didn't take the conflicts that would have come with the radical reform of constitutional protection and the judiciary, the *de facto* abolishing of the Constitutional Court, but many significant changes were made.[19] With the constitutional amendments of 2010 and 2011 the governing majority assumed a dominant position in nominating judges to the Constitutional Court, limited the powers of the Court in the field of economic freedom, put the election of the president of the Court in the hand of the parliament, and finally raised the number of judges to 15.

These steps however did not prevent the Constitutional Court from making decisions according to rule of law norms in politically sensitive cases. In December 2011 the Court annulled several provisions of the Media Act.[20] The following year the Court decided on the conditions under which the Court can use arguments that the Court set forth in decisions made prior to the new constitution coming into force;[21] the Court ruled that it was unconstitutional to arbitrarily set the retirement age of judges at 62;[22] the Court also annulled the criminalization of homelessness;[23] finally when reviewing the Act on the Protection of Families, the Court deemed the Act's definition of a family too narrow.[24] The decisions of the Court clearly showed that the 'rule of law institutions' are still alive and well, and that the Court, accused of having a majority of judges loyal to Fidesz, is able to carry out the constitutional control over legislation passed by the governing majority.

Tensions increased in late 2012, early 2013, when the Court partially nullified the Transitional Provisions of the Fundamental Law,[25] and then, initiated by the preliminary norm control request of the President of Hungary, ruled several provisions of the Act on the Electoral Process unconstitutional.[26] These two decisions were in connection with each other, because the need for voters to register themselves before elections had been written into the Transitional Provisions by the second amendment of the Fundamental Law, therefore partial nullification gave the chance to carry out the constitutional review of the registration.[27] Elaborating on the decision on the Transitional provisions the Court faced grave questions, such as whether the Constitutional Court has the competence to review the Fundamental Law itself and its amendments, and the question of which legal source category to put the Transitional provisions into. The firm practice of the Court was that the Court may not review the constitution itself, but the Court did not rule out the possibility of a review if the legal validity of the amendment is challenged. The Court based the possibility of reviewing the Transitional provisions on the assumption that the sovereign, by enacting the Fundamental Law, intended to create a stable, permanent constitutional system, defining the Fundamental Law's scope, contents and structure. The Court ruled that based on the criteria deriving from the Fundamental Law there may only be one single source of law on the top of the hierarchy of legal sources. The Transitional provisions disrupt this coherence, the Court argued, because the provi-

PSZ 2017. angol.szam_beliv_v16.indd 248 2017. 04. 06. 7:29:09

sions intend to elevate multiple provisions to the top level, which are not built into the text of the Fundamental Law. It can cause uncertainty in the constitution if the contents and scope of the Fundamental Law is obscure or it can be defined multiple ways. “The Fundamental Law obliges the Constitutional Court to examine all those laws that break up the internal unity of the legal system, in particular the ones that violate the unity of the Fundamental Law itself. Accordingly it is not only a right but a constitutional obligation of the Constitutional Court to protect the Fundamental Law against any legislative decision that would hinder or deteriorate the enforcement of the provisions contained in the Fundamental Law, making its legal contents, scope and its position in the hierarchy of the sources of law, as well as the contents of the Fundamental Law as a constitutional standard uncertain. The Constitutional Court’s obligation to protect the Fundamental Law includes the duty of protecting it as a single and unified document.”[28] The Constitutional Court made it clear, that without incorporation no new provision shall become part of the Fundamental Law. The “incorporation order” also means that the amendments shall not create insoluble contradictions between the regulations of the Fundamental Law. The decision set forth that “As appropriate, the Constitutional Court may even examine the free enforcement and the constitutionalization of the substantial requirements, guarantees and values of democratic States under the rule of law.”[29] The majority reasoning of the decision left open the possibility of reviewing the contents of constitutional amendments. These two decisions should have created a balance in the system of the separation of powers between the forces of political constitutionality and legal constitutionality. The parliamentary majority however considered it as the Constitutional Court crossing the Rubicon and violating fundamental political interests of the parliamentary majority, which had the mandate of voters. The parliamentary majority retreated in the case of voter registration but took up the hatchet in the case of constitutional amendments.

The Fourth Amendment not only incorporated most of the Transitional provisions in the Fundamental Law but also included several other regulations that have been previously deemed unconstitutional by the Court. The Amendment rearranged the system of the separation of powers, by attempting to reign in the scope of authority of the Constitutional Court. Indirectly, the Amendment prevented the Court from reviewing the text of all other amendments, except in case of a breach of procedural regulations. The Amendment also stipulated that the Court is bound to the content of the initiative, and that the Court may only broaden the scope of inquiry in the case of close connection; the Fourth Amendment also annulled all previous decisions of the Court, but it did not rule out the possibility for the Court to come to the same conclusion. The amendment set forth a close deadline for the constitutional review of court petitions, and created the partial publicity of the proceedings of the Constitutional Court. Understandably, the Fourth Amendment stirred up heated political debates, many have seen it as the end of the principle of separation of powers, and sanctions were demanded from the Council of Europe against Hungary for the breach of European Union law.

PSZ 2017. angol.szam_beliv_v16.indd 249 2017. 04. 06. 7:29:09

The rule of law-inseparable part of the constitutional culture

With the Fourth Amendment meant the constitutional confirmation of a notion of rule of law that held that the democratically elected parliament is the main constitutional power in a democratic state, and that the legislature having a constitutional power through its members, accepts no limits in exercising this right. The Court can review the constitutionality of the amendments but only from a procedural point of view. It means that if the parliament with a majority to amend the constitution thinks that the Court made a "bad" decision, it can overrule the Court's decision by making the annulled regulations a part of the Fundamental Law. Supporters of political constitutionalism believe that the legislators with democratic mandate are much more capable and have a stronger legitimacy to solve problems caused by "reasonable disagreements" within society. The judges of the Constitutional Court on the other hand ignore the majority opinion of society, and regularly represent minority opinions, that are not shared by the wider political community. Political constitutionalists believe that the substance of the constitution is not about the boundaries that the constitutional regulations enforce upon the legislator through the human rights catalogue, but about democratic decision-making which leaves the final decisions in the hand of elected politicians. As for the separation of powers, checks and balances are not constituted by the veto actors (e.g. the Constitutional Court), but by the parties competing in free elections.[30]

According to this argumentation, the constitution-making power of the legislative branch is theoretically unlimited, although it has to respect international *ius cogens*, the formal regulations guiding the process of adopting the constitution, and the integrity of the constitution (it shall not incorporate regulations that are in an insoluble conflict with the other regulations of the constitution).

Since in a democracy no power shall be unlimited, the constitution-amending power is not limitless either; other than the above-mentioned limits, it is bound by the stipulations of the current constitution, the Fundamental Law. This created the constitutional system of separation of powers in which the Constitutional Court as the protector of the Fundamental Law is obliged to stand up against any attempts to limit the effectiveness of a fundamental norm or attempts to hollow out the content of the constitution. The Constitutional Court has to function as a way of constitutional protection as long as it is allowed by the Fundamental Law and the eligible legal instruments. The review of the constitutional amendments shall not mean taking over the legislature's constitution-amending power. The Constitutional Court is obliged to respect the Fundamental Law and it has to make decisions based on it. At the same time, Parliament is responsible of respecting the Fundamental Law that itself crafted in order to maintain the rule of law. The Constitutional Court ruled that the regulations becoming parts of the Fundamental Law though amendments have to be built into the structure of the Fundamental Law (incorporation order) in a coherent manner. The amendments shall not create an insoluble contradiction within the Fundamental

PSZ 2017. angol.szam_beliv_v16.indd 250 2017. 04. 06. 7:29:09

Law. The idea of coherence is a rule of law requirement based on Article B paragraph 1 of the Fundamental Law that the legislator has to respect.[31]

"The unified and coherent character of the constitution is not a concept for its own sake. It is a precondition of successful constitutional jurisprudence and is therefore the foundation of the constitution's legitimacy to make sure that the legal norm on the top of the hierarchy of legal sources is capable of being the foundation of a coherent Constitutional Court practice. It is worth noting that this is also in the interest of the constitution making body and society at large. Nothing can be the cornerstone of the legal system which is ambiguous and not stable and predictable. In every country coherence has to be provided by the constitutional court" (Csink–Fröhlich, 2013:5–6).

There is no democratic alternative to the rule of law, no effective governance may be carried out without stable constitutional foundations. Just as the historical constitution could not have been ruled out of the Hungarian legal culture, more than twenty years of the Constitutional Court's legal development cannot be entirely edited out from the constitutional culture either. The political elite of the system change cannot shift the full responsibility of their own inability or to counter an activist Constitutional Court. The Constitutional Court has no competence to rule on political decisions, but it does have the competence to rule on the constitutionality of the cases brought before the Court; this is the Court's constitutional obligation. If the parliament's super majority excludes financial and taxation matters from the jurisdiction of the Court, it severely endangers the rule of law and economic constitutionality. If the parliament – without solid theoretical foundation and driven by political necessities – regularly overrules the Court's decisions by "over-amending the Fundamental Law" for policy reasons, this might undermine the coherence of the constitution itself, and make parliament subject to the accusation of abusive constitutionalism.[32] In the system of separation of powers, the constitutional requirement of cooperation has to prevail. In the case of a parliamentary super majority, the Constitutional Court, the only real counterbalance to the legislative body, bears a special responsibility. It is more visible in a consolidated time how much the national parliament and the government has to rely on the guardian of constitutionality, the Constitutional Court. It is the common interest of constitutional institutions – I should say it is a national interest – that the values and the normative contents of the Fundamental Law win the sympathy of the people so that they themselves are willing to follow the rules. If we sacrifice rule of law values and constitutional stability on the altar of ad hoc political interests, the whole society may have to pay a price which is simply not worth it. In a democratic rule of law state, separation of powers has to give answer not to the question of who defeats whom, but to the substance of the system of constitutional responsibility which ultimately serves the common good. Instead of restricting certain competences of the Constitutional Court or overruling some of its concrete decisions, it is preferable to establish procedures, which enable the government or the parliament to more effectively channel policy considerations and other public interests (eg. a sustainable budget) in the Court's decision making process. A good example for this

PSZ 2017. angol.szam_beliv_v16.indd 251 2017. 04. 06. 7:29:09

kind of measure is Article 24 paragraph 7 of the Fundamental Law, introduced by the fourth amendment.[33]

The Constitutional Court in the context of the supranational European legal order

Hungary's European reintegration, the adaptation of "western democratic values" and the unconditional acceptance of the primacy of European community law was the entry ticket into the "Western club". Now, when the future operation of club "Europe" is at stake (cf. Sulyok, 2014:48), it is time to review what a fair and sustainable balance is between national and European community interests. It is time to look for legal notions and procedures through which this balance can be ascertained in concrete cases.

The importance of this problem was raised by the development of European Union itself: with the Treaty of Lisbon (signed in 2007, entered into force in 2009) the Union has reached a "critical mass", staying between being a community of states and a federal state. This makes it necessary for the Member States to delineate the boundaries of their sovereignty (cf. Sulyok, 2014:46). The general rule set out by the European Court of Justice (ECJ) is that the Member States may not even refer to their constitution in order to avoid the execution of European Union law. The same Treaty of Lisbon which consolidated the European Union also introduced an explicit restriction on the application of community law: the concept of "national identity". As the amended Article 4 Section 2 of the Treaty on European Union stipulates:

"The Union shall respect the equality of Member States before the Treaties as well as their *national identities*, inherent in their fundamental structures, political and constitutional, inclusive of regional and local self-government. It shall respect their essential State functions, including ensuring the territorial integrity of the State, maintaining law and order and safeguarding national security. In particular, national security remains the sole responsibility of each Member State."

The question of how to define the concept of "national identity" is sensitive: the interpretation of sovereignty and identity decides where the boundary for the primacy of European Union law lies and where that core of competence is that the member state may keep for themselves (Szakály, 2015:35). For this reason, the question whether the ECJ or the member state's constitutional courts (supreme courts) is to decide the content of a member state's national identity, is crucial for the sovereignty of the Member States. It is for this reason, that national constitutional courts, beside their traditional role of enforcing the constitution against the domestic lawmaker and courts, gain a new and important role in the context of the supranational European legal order.

In the case of Hungary, the switch from the 1989 Constitution to the Fundamental Law – a few years after the Treaty of Lisbon entered into effect – ended the era of politically neutral constitutionality and set a normative base for articulating Hungary's constitutional identity. The main foundations for this undertaking are the principles

PSZ 2017. angol.szam_beliv_v16.indd 252 2017. 04. 06. 7:29:09

for interpreting the Constitution in Article R paragraph 3 referring to National Avowal and the achievements of our historical constitution, furthermore the interpretation principles for judges set forth in Article 28 (the presumption that laws serve moral and economical purposes which are in accordance with common sense and the public good). These rules embrace Hungary's historic perspective in interpreting national identity and bring a characteristic value-orientation to build upon.

Based on all these, a challenge has been set for the Constitutional Court, namely to develop a new test for the protection of "national identity" through which the core of national sovereignty – which is untouchable for European community law – can be delineated. The first opportunity to commence this task could have been the constitutional review of the Act on the promulgation of the Lisbon Treaty, however, the majority of the Court did not deal with this notion at that time.[34]

A new development in this field is the 22/2016. (XII. 5.) ABH Constitutional Court Decision on the interpretation of Article E) Section 2 of the Fundamental Law. In this decision, the Court declared that "[t]he Constitutional Court, exercising its competences based on a petition containing a request to do so, can review whether the joint exercise of competences based on Article E) Section 2 of the Fundamental Law infringes on human dignity, other fundamental rights, the sovereignty of Hungary, or the identity based on its historic constitution." This can be considered as a great step in the direction of unfolding and protecting Hungary's national (constitutional) identity, so I agreed with the merit of the decision, however, the majority's reasoning left a series of constitutional questions unanswered. It is not yet clear – among others – what forms of "joint exercise of competences" may be reviewed, in which competences of the Court and what legal consequences can be established if the Court finds the violation of one of the protected norms. The reasoning of the decision – in line with the theoretical considerations which I previously mentioned – sets an important general thesis regarding the notion of "constitutional identity", stipulating that the content thereof shall be construed case-by-case, based on the whole and on specific regulations of the Fundamental Law, as prescribed in Article R paragraph 3, in accordance with the National Avowal and with the achievements of our historical constitution.[35]

Practically it is the first declaration of the National Avowal that states that "[w]e are proud that one thousand years ago our king, Saint Stephen, built the Hungarian State on solid foundations, and made our country a part of Christian Europe." King Saint Stephen made a decision over one thousand years ago and the Fundamental Law pledges symbolic continuity with his decision. In Article E) of the Fundamental Law, this commitment goes way beyond the symbolic level. Article E) paragraph 1 stipulates that "[i]n order to achieve the highest possible measure of freedom, well-being and security for the peoples of Europe Hungary shall contribute to the achievement of European unity." These provisions of the Fundamental Law imply that European identity is also part of the Hungarian constitutional identity.

When a member state transfers parts of the exercise of its sovereignty to the institutions of the European Union, the citizens of the affected Member States have to be involved in the direct decision-making. Nevertheless, on the one hand, it would not be reasonable, nor would it be feasible to hold a referendum on each – possibly disputed – measure of the institutions of the European Union. On the other hand, the constitutional courts of the Member States may be capable to protect – constantly, cost-effectively and with due foresight – the most eminent circle of the national interest of their country.

Hungary has started to go down this road. The Constitutional Court – when adequate cases come by where the application of national constitutional identity seems necessary – shall wisely further develop the notion in order that Hungary remain in the "club" in a way which benefits both the club member and the club. How should the Hungarian Constitutional Court serve this task? Firstly, the Court shall act according to its competences established by the Fundamental Law and by the Act on the Constitutional Court. Secondly, it shall also take into account European community law, in a constitutional dialogue with the ECJ. Thirdly, the historic dimension, the constitutional traditions of Hungary, the achievements of the historical constitution shall be taken into serious consideration when ascertaining the exact constitutional principles and values to be protected. At the same time, fourthly, the Court shall enforce the constitutional identity of Hungary faithfully to the Fundamental Law and within the framework set forth thereby. The Constitutional Court's derivation from the Fundamental Law – adopted by the constitution making body – would amount to an activism that not only infringes on the principle of the rule of law, but also on the principle of popular sovereignty.

Notes

[1] The executive branch that is strongly tied together with the legislature, based on the authorization they won at the elections, often criticized the Constitutional Court, saying that the Court limits the functioning of the most important representative of people's sovereignty. The fundamental dilemma of constitutional jurisdiction as counter-majoritarian activity is: on what basis and to what extent can a non-representative body overrule the decisions of the parliament, which has a direct legitimacy (Dorsen et al., 2003:108–109).

[2] 31/1990 (XII. 18.) ABH Constitutional Court Decision.

[3] Constitutional review of Acts adopted by the Parliament but not yet signed by the President of the Republic and not yet published in the Official Gazette.

[4] 38/1993 (XII. 18.) ABH Constitutional Court Decision.

[5] 8/1992 (I. 30.) ABH Constitutional Court Decision.

[6] 28/1995 (V. 19.) ABH Constitutional Court Decision.

[7] 23/1990 (X. 31.) ABH Constitutional Court Decision.

[8] Basically the legitimacy and effectiveness of constitutional jurisprudence is questioned by University College London professor Richard Bellamy in his recently published book (Bellamy, 2007). Among Hungarian authors Pócza Kálmán (Pócza, 2012) and Antal Attila (Antal, 2013) wrote on the subject.

[9] Day 12 of the 1991 autumn session of the Parliament, 8 October 1991. In: Országgyűlési Értesítő 1990–1994, 10656–10658.

[10] In the first part of his book G. A. Tóth gives a good summary on the academic standpoints concerning activism, with special regard to the criticisms by Tamás Győrfi, Béla Pokol, János Kis, and Gábor Halmai (Tóth, 2009:15–30).

PSZ 2017. angol.szam_beliv_v16.indd 254 2017. 04. 06. 7:29:10

[11] The introduction of this concept in the political discourse was done by Gyula Tellér, who characterized the socialist-liberal coalition, which followed the first freely elected government, the following way. "There were enormous economic and social forces behind the coalition parties of 1994. On one hand, the financial-administrative apparatus with the structure moving and financing the economy built in the last 20 years according to the recipe of the International Monetary Fund, limiting the scope of action of every government: the three circles of usury; on the other hand, the party clientele of MSZP with its network concentrating significant finances and connections: the "clotted structures". On the surface almost nothing could be seen from these deeply working forces that determined the whole course (Tellér, 1999:51).

[12] According to Béla Pokol "However big of a legislative majority wipes off the previous government and takes control representing the voters' will, its hands are tied by the regulations written in the twenty-thousand pages long collection of the Constitutional Court's decisions, which can be interpreted multiple ways; therefore no government can be sure if they can carry out their will" (Pokol 2011:451).

[13] In the aforementioned study Béla Pokol gives suggestions regarding the more exact contents of constitutional rights and obligations, the significant rearrangement of the Court's functioning and scope of jurisdiction, the rethinking of the judicial hierarchy and the appointment of judges, and such guarantees of the interpretation of the new constitution, which can limit the use of the "invisible constitution". (Pokol, 2011: 453–455.

[14] Csaba Varga gives a very critical description of the Constitutional Court's responsibility in tipping the balance of rights and obligations by overemphasizing the citizen's rights, making the state a public enemy, emptying the law by stripping it of its morals, and rehabilitating the law of the law-denying past. He thinks that rule of law "gave primary protection to the former regime's legal status, players, and rights acquired by them; and by interpreting the present as something that stems from the past uninterrupted, it helped the legal, political, social, and economic survival of the forces of the forces of post-communism… through the theoretical and insensitive legal practice of a retiring scholar it dismissed the virtues of experience and practice from law" (Varga, 2011:488–489).

[15] Bruce Ackerman described the situation this way, when one single political power has got enough majority to adopt a constitution, and no other player with veto right can stop them from reshaping the political rules of play to their own image (Ackerman, 1993).

[16] Péter Szigeti expressed his concerns about this ideological foundation in one of his papers: "The "National Avowal" represents a break with the ideological neutrality of the state, because it raises the historical-value-perception, the values, and the ideology of the Hungarian right wing to a constitutional level. This ideological base is not at all innocent, and one can never know, what they are going to build on this foundation in the future. Will denying the legal continuity of 46 years bring the logic of "sinful era – sinful system – sinful organizations – sinful individuals?" Putting history to trial?" "…the concept based on rule of law and division of powers that we used for twenty years have been replaced by a new course-building, gouvernalistic state of power" (Szigeti, 2013:535).

[17] This contradiction is even more obvious if we take into account that the preamble of the Fundamental Law declares the 1949 constitution "invalid", but paragraph 2 of the Closing provisions is in direct opposition with this, declaring that the Fundamental Law has been adopted with regards to the procedural regulations set forth in the replaced constitution (Jakab–Sonnevend, 2013:122, 125).

[18] The opposition does not consider the Budgetary Committee a real constitutional balance, because its composition (presidents of the National Bank, the State Audit Office, and the Committee) ensures the majority of Fidesz for a long time. They think about its actual functioning, that in the case of a different political composition of the parliament, it can create the possibility of obstructing the government's work, and even forcing a new election.

[19] The strong position of the Constitutional Court was disliked mainly by the former members of the Antall-government, but among the leaders of Fidesz – especially the Speaker of the Parliament. Many thought, that members of parliament, who won in the election, should decide the important questions of society, rather than having a small group of people "read form the constellation of stars, the guts of animals and the bones of birds, what the god of constitutionalism wishes to say to the mortal people".

PSZ 2017. angol.szam_beliv_v16.indd 255 2017. 04. 06. 7:29:10

The governing majority feared that the abolition of the Constitutional Court would mean the abolishment of democracy to the outside world, and that courts of law are not prepared for constitutional jurisdiction. By creating the Curia, the government created the grounds for dismissing the president of the Supreme Court; the National Office for the Judiciary and its president elected for nine years took over the control over the judicial system.

20 With this decision the Court excepted print and online media from the scope of the Media act, abolished the institution of the "media commissioner", deemed the regulation of journalist's source protection unconstitutional, and partially limited the investigative powers of the National Media and Infocommunications Authority.

21 22/2012 (V. 11.) ABH Constitutional Court Decision.

22 33/2012 (VII. 17.) ABH Constitutional Court Decision.

23 38/2012 (XI. 14.) ABH Constitutional Court Decision.

24 43/2012 (XII. 20.) ABH Constitutional Court Decision.

25 45/2012 (XII. 29.) ABH Constitutional Court Decision.

26 1/2013 (I. 7.) ABH Constitutional Court Decision.

27 The Court has 30 days to decide on a preliminary norm control case. Because of Christmas and New Year's holidays this time was reduced to half, and they had to decide on the constitutional status of the Transitional Provisions as a preliminary question. Government politicians created conspiracy theories: "it would take too much of malice for me to think that the Constitutional Court only deemed the Transitional Provisions unconstitutional in order to kick out the constitutional leg of the election registry" (interview with László Kövér in *Heti Válasz*).

28 Decision 45/2012 of the Constitutional Court. English version available: www.mkab.hu/letoltesek/en_0045_2012.pdf (accessed 10 July 2014).

29 The decision was adopted with the concurring opinions of Holló András and Stumpf István, and with the dissenting opinions of István Balsai, Egon Dienes-Oehm, Barnabás Lenkovics, Péter Szalay and Mária Szívós.

30 In a recent publication, Béla Pokol added an international dimension to the arguments of political constitutionalists. "[…] the decisions of the ECHR of Strasbourg, the regulations of the global constitutional-advisory organizations, and the constitutionalized "general" international law would take control over the constitution itself, its amendments, and the constitution making power. Thus, the circle would close, and the most important characteristic of a state, the power to adopt a constitution, would cease to exist." In the end of his article, Béla Pokol envisions the threat of a forming global constitutional oligarchy. *Jogelméleti Szemle,* December 2013.

31 I summarize the practice of the Court and the views concerning the coherence of the Constitution in my concurring opinion attached to the Court's decision 45/2012, and in the dissenting opinion I attached to the decision concerning the fourth amendment.

32 In one of his recent works American legal scholar David Landau has cited Hungary – among Venezuela and Columbia – as an example for abusive constitutionalism. University of California, *Davis Law Review,* vol. 47, 189–260, lawreview.law.ucdavis.edu/issues/47/1/Articles/47-1_Landau.pdf.

33 "The Constitutional Court shall hear the legislator, the initiator of the Act or their representative and shall obtain their opinions during its procedure defined by cardinal Act if the matter affects a wide range of persons. This stage of the procedure shall be open to the public." – Unfortunately, despite the rule being in force since 1 April 2013, the Constitutional Court has not used it so far.

34 143/2010. (VII. 14.) AB of the Constitutional Court Decision. The Court rejected the petition submitted by a private person aimed at establishing the unconstitutionality of the Act on the promulgation of the Lisbon Treaty. It was only the concurring opinion of László Trócsányi that drew attention to the importance of the notion of constitutional identity.

35 Unfortunately, the reasoning of the decision fails to implement this thesis in two instances right after it is declared (see: paragraphs [66]-[67]). In the first instance, the decision accepts certain elements to be part of the constitutional identity, which are directly received from a decision of the German Constitutional Court. In the second instance, the decision practically declares that Hungary's constitutional identity does not derive from the Fundamental Law, the latter only recognizes it.

PSZ 2017. angol.szam_beliv_v16.indd 256 2017. 04. 06. 7:29:10

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PSZ 2017. angol.szam_beliv_v16.indd 258 2017. 04. 06. 7:29:10

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Tamás Prugberger – Andrea Szőllős

Several Critical Issues in the Development of the Administration of Hungarian Constitutional Justice

Summary

This essay intends to show the main characteristics of the two phases of the development of Hungarian constitutional justice. The first part examines the operation of the Constitutional Court in the first two periods starting from its foundation. The first period under the chairmanship of László Sólyom may be characterized as having approaching cases from the perspective of natural law, moving away from the statutes of the Constitution then in force (the invisible Constitution), while in the second period, under the chairmanship of constitutional judge János Németh, decisions were based on the interpretation of the text of the Constitution. The second phase of the Constitutional Court is analyzed by presenting decisions made in taxation cases and in employment and civil service dismissal cases, and it deals in detail with the controversial decision relating to the Magyar Nemzeti Bank (the National Bank of Hungary, hereinafter the MNB).

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PSZ 2017. angol.szam_beliv_v16.indd 259 2017. 04. 06. 7:29:10

The effect of contradictory relations of economic policy and government on the foundation and operation of the Constitutional Court prior to 2010

The evolvement of Hungarian constitutional justice after the change of regime in 1990 was not without contradiction, and depended to a great extent on the frequently-changing direction of government, which significantly influenced its operation. Therefore, the foundation, further development and operation of the Constitutional Court depended significantly on the changes in political direction. These changes have had a significant effect on the foundation, operation and development of the Hungarian Constitutional Court. Consequently, if we want to deal with the CC and its operation objectively, we cannot avoid presenting the evolution of the political trends influencing constitutional justice.

In the course of the change of regime in 1990, Hungary was largely insolvent in part as a result of the running of the MNB during the Kádár regime. At that time, the MNB's management proposed that Hungary should join the International Monetary Fund (hereinafter, the IMF) at the end of the 1960s and it took out significant loans partly from the IMF and partly from foreign private banks, primarily West German financial institutions. The smaller part of these loans was used to maintain a higher level of living than that of the other Warsaw Pact countries. The reason for this was that the Kádár regime did not want a new uprising similar to the revolution of 1956. The larger part of the loans was invested in the modernization of state companies and in the renovation of their technology and stock if machinery.

At the time of the collapse of the real socialist system, Hungary seemed to have the opportunity to partially cancellation and reschedule its debts in a similar way to Poland. Hungary could have received this opportunity from Helmuth Kohl in gratitude for the opening of the Austrian–Hungarian border to East German citizens coming across Hungary, which advanced the process of German reunification. However, the first Hungarian prime minister after the change of regime, József Antall, did not take this opportunity saying that the opening of the borders was a humanitarian duty, for which it would be unethical to demand a reward. Besides the Hungarian Alliance of Free Democrats (in Hungarian 'Szabad Demokraták Szövetsége', hereinafter the SZDSZ), which at the time of the change of regime misled Hungarian voters with its anti-communist and anti-Soviet phraseology – threatened from the opposition side the first civilian government, which was made up of the coalition of the Hungarian Democratic Forum (in Hungarian 'Magyar Demokrata Fórum', hereinafter the MDF), the Christian Democratic People's Party (in Hungarian 'Kereszténydemokrata Néppárt', hereinafter the KDNP) and the Smallholders' Party. Acting aggressively and beyond its competence, the SZDSZ hindered all attempts to cancel or reschedule the debts. The scope for action of the Antall government was significantly limited by its agreement made with the SZDSZ under coercion. Based on this agreement, beside the conservative civilian government and its prime minister, József Antall, Parliament elected the liberal Árpád Göncz as President of the Republic, and György Surányi,

PSZ 2017. angol.szam_beliv_v16.indd 260 2017. 04. 06. 7:29:10

who had the same political orientation, as the head of the MNB. That behind all these steps stood the USA representing the global financial background power is supported by the fact that Mark Palmer, who was delegated to Hungary as the American ambassador, directed the national privatization behind the scenes at the time of the change of the regime, thus taking part in the destruction of the Hungarian food, light, and engineering industries and in the transformation of Hungarian agriculture into the contract farm system similar to large farms in the USA. It was for this reason that they opposed the division of the cooperatives into family farms.

At the end of the 1980s the commercial banks, which previously operated as a department of the MNB, were torn away from the MNB and began to operate independently under left-liberal control, providing preferential loans for the socialist political nomenclature in order to stabilize their existence in the economy, while these banks went bankrupt and needed to be capitalized by the state before their privatization. These processes should have been vetoed by the MNB, but this did not happen. The MNB, led by the liberal György Surányi, continued the previous liberal monetary policy. Therefore, József Antall replaced György Surányi in the autumn of 1991 and Péter Ákos Bod was elected for the position. However, he was forced to resign in 1994 by the first left-liberal government led by Gyula Horn as prime minister, and György Surányi was elected again as the president of the MNB. In the course of his presidency, the pyramid-scheme-like bond issues of the broker firm established by the K&H Bank were brought to light. These bond issues helped the enrichment of many left-liberal politicians and civil servants. All this went unnoticed by the MNB led by György Surányi, though the MNB should have noticed it since it had responsibility for monetary supervision. Presumably, the MNB discovered these illegal acts, however it probably disregarded them, because the MNB itself operated a branch in Vienna illegally and at great loss. During this period, Hungarian public debt did not decrease but stagnated. Significant damage and economic disadvantages were caused, however, by the fact that in the course of the Gyula Horn's premiership, the corrupt, unconditional, and under-priced privatization practice continued, which was characteristic of the previous Antall government too. Moreover, it was Gyula Horn's government which handed over the country's energy resources and energy suppliers cheaply to foreign firms and placed the country, including its inhabitants and small and mid-sized enterprises into dependence on foreign multinationals.

In the spring of 1998, the first government led by Viktor Orbán, officially the second civilian conservative coalition made up of the Alliance of Young Democrats (in Hungarian 'Fiatal Demokraták Szövetsége', hereinafter Fidesz), KDNP and the Smallholders' Party, followed the Horn government. Thanks to the professional economic and financial cooperation between the first Orbán government and the MNB, directed by Zsigmond Járai, the country's debts fell below 55 per cent (Gazdag, 2015:34).

After the parliamentary election of 2002, the first Orbán government was replaced by the second left-liberal government. In its first period, the state debt increased slightly (up to 59 per cent) (Gazdag, 2015:34) driven by the government, led at this time by Péter Medgyessy as its first prime minister, significantly raising the remuneration of civil and public servants, which stimulated the economy and consumption.

PSZ 2017. angol.szam_beliv_v16.indd 261 2017. 04. 06. 7:29:10

However, it overstepped its financial possibilities, and the increased salaries could not be withdrawn. Consequently, collective dismissals, which breached both EU and Hungarian law, were launched at the institutions of civil and public servants (Prugberger, 2005:34–36). The civil and public servants who took legal actions won on the first instance. However, on the second instance they lost because of the 'directive' given to the lower level courts by the Supreme Court, clearly under government pressure. The applications for review were rejected, of course, and in the same 'odd way' the European Court of Human Rights did not find any infringement of law in the procedures of the Hungarian courts, either.[1] It is a pity that no opposition party or individual filed a case to the Constitutional Court before the decision of the European Court of Human Rights, because all the above-mentioned decisions and the government pressure on the courts violated the right to work and the judicial independence laid down in the previous Constitution, as well as warranty rights.

Not long after this, Péter Medgyessy was relieved in a putsch of his position as prime minister by wish of the SZDSZ coalition partner (Csontos, 2016:10). The constitutional nature of this event qualified as a borderline case according to statutes of the Constitution[2] that had been modified several times after the change of regime in 1990 and which preceded the new Fundamental Law of Hungary. That is to say, it was not a putsch coming outside with the aim of bring downing the political system, but rather an inner putsch, which did not affect the governmental authorization of the parties in power. Therefore, the opposition parties did not start constitutional proceedings. The aforementioned broker firm of K&H Bank, in which the Hungarian Socialist Party (in Hungarian 'Magyar Szocialista Párt hereinafter the MSZP) held an interest, and the Ministry of Youth and Sports led by Ferenc Gyurcsány, who followed Medgyessy as prime minister, and the ministries under SZDSZ control led the way in wasting public money and corruption (Prugberger, 2009:7–14). However, because these illegal, anti-public and anti-private property activities were carried out by those left-liberals in power by evading the regulations then in force but not violating the rules of the Constitution, no constitutional proceedings were launched. Similarly, no constitutional procedures began in the "oil bleaching" cases, which happened at the same time and which were committed by the corrupt field-officers of the army, causing damage to the Hungarian state by tax evasion. The then opposition took these cases before a parliamentary committee in vain, the committee members of the left-liberal government making it impossible to start investigations in these cases by their boycott (Prugberger, 2009:7–14).

The government of the left-liberal coalition led by Ferenc Gyurcsány, which gained a mandate for another four-year period at the elections in the spring of 2006, practically handled the country as a business and trade company. There was a peak in corruption and in the privatization of the country at a very low price. The national wealth decreased dramatically under the left-liberal comprador government unconditionally serving transatlantic capital and the economic goals of a USA bent on dominating the world. The state debt, which had decreased to below 55 per cent under the Orbán government, increased to more than 85 per cent during the Gyurcsány era as a result of the corrupt privatization and attempts at privatization (Prugberger, 2009:7–14),

PSZ 2017. angol.szam_beliv_v16.indd 262 2017. 04. 06. 7:29:10

and the dilettante macro-economic and monetary policy. The state budget deficit, which was expected by the EU to be under 3 per cent, increased to above 8 per cent. Pursuant to the Constitution prior to the Fundamental Law, constitutional proceedings could not be launched due to unconstitutional governmental management because the constitutional rules prescribing rational management of public finances were first defined by the Fundamental Law which was enacted in 2011.

That is why the country reached a state of near bankruptcy similar to that of Greece. Gyurcsány had to resign as a consequence of the referendum rejecting the privatization of the state health insurance funds and the state health insurance (Prugberger, 2014:14). The 'expert government' – as it called itself – led by prime minister Gordon Bajnai, who followed Gyurcsány, 'saved' the country from the bankruptcy by taking out IMF loans with tough conditions, the aim of which was to maintain the country's neoliberal transatlantic dependence by requiring high interest and short loan periods, which would have caused the country to take out further loans. Sadly, the Constitutional Court again failed to declare the short-lived Act No. 1 of 2001 on Private Health Insurance Funds unconstitutional in relation to the privatization plan of the Gyurcsány government based on its infringement of the right to health guaranteed by the Constitution. In this case the Bajnai government would not have been able to pass its act aiming at a similar establishment of the private pension funds, which was eventually annulled by the second Orbán government (Prugberger, 2014:18–19).

During this period, the Constitutional Court, founded in 1990, had two operational profile phases. The first phase was characterized by the political and ideological attitude of the founding members. The first president of the body, László Sólyom, as well as its vice-president and the great majority of the judges had a civil democratic and/or Christian democratic bias. Only a minority represented the moderate social-national reform-socialist view, the inner content of which was characterized by the human-faced socialist world view. These two orientations could cooperate in the body. This first body of the Constitutional Court, led by László Sólyom, elaborated the concept of the administration of constitutional justice based on the "invisible constitution". For, although the Constitution of 1949 was completely modified and amended in 1984, it still had the atmosphere of the Stalin-Rákosi dictatorship. And there had been no new constitution as a result of the constant refusal of the constitution drafts of the governments in power after the change of regime by the representatives of the opposition at the time. The concept and standards of the invisible constitution were formed as a synthesis derived from Magna Carta, the written constitutions of Western European countries, and the constitution of the USA.[3] All this was latently influenced by the historical doctrine of the Holy Crown, and the agreement, incorporated in a "Magna Carta", concluded between the Hungarian king Andrew II and the Hungarian estates, and the invisible constitution was based on these documents. This approach resulted in the decision of the Constitutional Court, which deemed the Act No. LXXV of 1995 on the Ownership, Use and Sale of Agricultural Land not to be unconstitutional.[4]

According to the declarations of the first constitutional judges, the Constitutional Court – by means of its decisions – tried to "lay down the basis for the change of

PSZ 2017. angol.szam_beliv_v16.indd 263 2017. 04. 06. 7:29:10

regime" during its first period before the years of 2010–2012 (Sólyom, 2001). For this reason and in order to be able to annul with *"ex nunc"* effect all the regulations which were not in compliance with the Constitution amended significantly by Act No. I of 1989, Act No. XXXII of 1969 on the constitutional court offered a great variety of means for the control of norms, many of which the Constitutional Court could not take advantage of due to the large number of constitutional complaints made by individuals. In the first decades, the Constitutional Court was greatly overloaded by petitions from advocates and individuals who tried to repair their own or their clients' injuries to interest shrouded in a breach of the constitution. There were many *actio popularis* among them, too. Besides this, in this period and later too, the Constitutional Court had to handle the lack of political consensus and the shortcomings in legal techniques in the cases of petitions of interest organizations and the then opposition parties (Sólyom, 2001). For this reason, the Constitutional Court could not declare unconstitutionality in many cases where the legal acts and the principles behind them were formally in compliance with the Constitution, but where the politics, and the civil servants and politicians serving that politics, committed abuses in their ad hoc political decisions that were concealed by legal reasoning. This revealed itself first of all in the field of privatization (Prugberger, 1997). The normative and ad hoc decisions were often influenced by the politics and the duality, i.e. the norms which were the subjects of the Constitutional Court decisions seemed to be in compliance with the Constitution on the basis of strict objectivity, however, they seemed to be contradictory to EU law or the prevailing political interests or vice versa. All this resulted in many controversial or debated Constitutional Court decisions.

The case of the Zétény–Takács Act on Justice[5] was a typical example for the above written. The Constitutional Court declared unconstitutionality in a constrained way in the constitutional control petition of Árpád Göncz referring to the infringement of legal certainty. The same happened in the case of the Zétényi–Csurka–Zimányi bill[6], which had eliminated the constitutional shortcomings of the previous act in vain. Both the act and the bill attempted to discontinue the lapse in the cases of political miscarriages of justice, liquidations and capital treason between 1944 and 1999 and based on these, the perpetrators of the aforementioned crimes committed during World War II and between 1944 and 1990 could have been held responsible as the protection of the dictatorial regime had slipped away (Zétényi, 1999). Regarding the highly controversial foreign privatizations, which were contrary to the interests of the Hungarian state, the Constitutional Court could not intervene effectively, because before the privatizations the left-liberal Horn government made the previously non-transferrable state property transferrable by amendments to the Constitution and other acts on state property and its protection.[7]

The second phase of the operation of the Constitutional Court before the second Orbán government was characterized by the lack of the previous trend of public legal theory due to the chairmanship of János Németh, a legal professor in civil procedure. Consequently, the Constitutional Court started a practise of analysing case law, in which the normative or ad hoc legal norm that was the subject of the petition

PSZ 2017. angol.szam_beliv_v16.indd 264 2017. 04. 06. 7:29:10

or complaint was compared to the relevant constitutional provision, the rights and obligations prescribed by it and it was analyzed in detail as to what extent the legal norm in question was in compliance with or contrary to them. This practice was also followed by the next constitutional chairs and judges.[8] The present administration of constitutional law is not far from this point of view and practice with the difference that judges compare the contested normative or ad hoc action to the new Fundamental Law taking effect in 2011 instead of the repealed Constitution of 1949 which had been comprehensively amended many times.

By the second phase of the Constitutional Court's operation prior to 2010, the cases which could be sent to the Court had been restricted. Despite that, there were left-liberal expectations of influencing the objective decision making, which the Constitutional Court could more or less successfully fight against. This tendency manifested itself in connection with the aforementioned privatization cases, where – as was mentioned before – the government had amended the law, or had the law amended by Parliament to be in compliance with EU law preferring free market competition and with the Constitution having been amended comprehensively in 1989. Even the courts declared many privatizations and other contracts as injuring public interest and violating good morality based on the principle of freedom of contracting. Typical examples of this were the cases where huge amounts of severance pay were given to left-liberal public and civil servants in leading positions at public institutions with reference to the termination of their employment by mutual consent, whereas they continued to be employed in their previous positions in a contract of agency or commercial legal relationship (Prugberger, 2009:7–14; 2010:79–80).

The temporary period after 2010 and the new period starting in 2012 with the going into effect of the New Fundamental Law and the New Act on the Constitutional Court

On the basis of what is mentioned above, the third Fidesz–KDNP civil coalition and the second Orbán government that took office in 2010 faced huge corruption cases and abuses (Prugberger, 2010:79–81). At first, the government attempted to have the aforementioned severance payments paid back into the state and local government budgets by means of court decisions. The courts, with their mainly left or left-liberal attitude biases, rejected to declare these contracts invalid on the basis of being illicit and, moreover, and rather controversially, they declared them valid based on the principle of the freedom of contracting. As a response and in order to return the money to the state budget, the new civil government levied a 98 per cent tax on such remunerations with retrospective effect by amending the Taxation Act. However, because of this, the government officials whose contracts had been unlawfully terminated by the Medgyessy, Gyurcsány and Bajnai governments and who were lawfully entitled to compensation for damages were also negatively affected. This modification of the act came before the Constitutional Court, which annulled it by referring to the principle that nobody can

PSZ 2017. angol.szam_beliv_v16.indd 265 2017. 04. 06. 7:29:10

retrospectively be put in a legally more disadvantageous situation.[9] The Fidesz–KDNP government, thinking that a lot of the judges over a certain age had been socialized under the Kádár regime and therefore had a left-liberal attitude and were loyal to that political view, made amendments to acts stating that although the majority of civil servants could stay in office until the age of 70, judges can work only until the age of 62 and at that time they must retire. This special legal provision was also annulled by the Constitutional Court because of the infringement of the principle of equal treatment.[10]

As far as other officials are concerned, the government provided special treatment for government officials by creating the Government Officials Act (in Hungarian 'kormánytisztviselői törvény', hereinafter the Ktjt[11]) giving them a special legal status, but also placing them under strong subordination and requiring unconditional loyalty from them towards the government. Therefore, the Ktjt prescribed that government officials are required to be loyal to their direct superiors, and if they do not work to the expectations of the government or their superiors, then their public service can be terminated at any time without reason. Since the provision of Ktjt allowing the termination of employment without reason infringes Article 24 of the Social Charter – which states that all notices delivered by the employer must contain valid reasons – and since the termination of employment by the employer without reason results in the infringement of the right to work, the Constitutional Court annulled the provision of the Ktjt allowing termination without reason.[12] The new Civil Servants Act (hereinafter referred to as Kttv[13]) already prescribes the obligation to provide valid reasons for the notice of termination of the civil servant's employment in a similar way to the Labour Code Act[14] and the Public Servants Act (hereinafter referred to as Kjt[15]), but the provision of the Kttv prescribing obligatory reasons for the termination of employment of both government officials and civil servants provides less protection than the Labour Code provides for employees or the Kjt for public servants. That is to say, both government officials and civil servants can be dismissed due to a lack of confidence, which is a reason that can be used anytime in any case, or a so-called "rubber reason". Thus, government officials and civil servants have become very defenceless, especially in that sense that according to the Kttv, civil servants must be loyal to their superiors. Therefore, a talented civil servant is at the existential mercy of their mediocre superior.

These provisions in the Kttv, which provide a possibility for contra-selection, could be attacked before the Constitutional Court based on the fact that they violate the principle of equal treatment and entail negative discrimination towards civil servants compared to the provisions related to termination in the Labour Code and the Kjt (Mélypataki, 2011; 2013).[16]

On the other hand, it must be seen as a positive fact that the Constitutional Court declared unconstitutionality – both before and after the Fundamental Law took effect in 2012 – both in the cases of notices of termination without reason and in the cases of complaints relating to the levying of taxes retrospectively.[17] In these cases, the Constitutional Court – as with the levying of the 98 per cent tax or the obligatory retirement of judges at the age of 62 – was right to question the constitutionality of the way the government handled these issues.

PSZ 2017. angol.szam_beliv_v16.indd 266 2017. 04. 06. 7:29:10

Even so, on the basis of what is described above, the government can be understood, since it tried to reverse and eliminate as quickly as possible the corruption, moral-socio-political depravity, the tendency towards anarchy and the increasing financial instability of public finances, which were the results of the previous 8 years of left-liberal government. Essentially, this was the reason for the negative response by the government in creating the act, in which the scope of power of the Constitutional Court was limited in economic cases. It is, however, in compliance with EU law, and this is reflected in the fact that the Supreme Court is allowed to examine only the validity of the reason given in the notice of termination by the employer, while examining the content of the reason falls outside of its scope.[18] Despite the limitation, the Constitutional Court could declare unconstitutionality in cases affecting the economy where there is an infringement of the Fundamental Law, without contravening economic political interests. The fact that the government enhanced its discretional power in this issue turned out subsequently to be correct because with its professional economic and financial policy in cooperation with the MNB, it was able pull the country out of the economic and financial mud into which the country was dragged by the previous 8-year left-liberal government and the MNB, which followed orthodox policy and was involved in offshore actions through its president at that time.

From this point of view, it is worth judging positively the present unorthodox economic and monetary policy of the MNB, which was especially fiercely criticized by the left-liberal opposition in connection with its policy relating to foundations. Under pressure from the opposition, the President of the Republic filed a petition to the Constitutional Court against the bill on the legislation relating to foundations. The aim of endowing foundations was to promote the training of economic experts in unorthodox economic policy, as opposed to orthodox economic policy, within the framework of the MNB in such a way that it could not be disturbed by the aggressive protest of the opposition, which favours mainstream orthodox economic political policy. In order to achieve this, the government wanted to amend Article 162 of Act No. CXXXIX of 2013 on the National Bank of Hungary (MNB) with Bill No. T/9380 so that that knowledge of the data concerning the foundations and the economic enterprises established by the MNB to fulfil its tasks could be restricted. The reason for this given by the MNB and the government was that although it is a public asset, it comes from the profit of the MNB management and, therefore it is not part of public finances, and thus the supervision of its use and utilization is the responsibility of the Supervisory Board of the MNB. This view was considered a reason for concern by the impartial President of the Republic, therefore he turned to the Constitutional Court. In his opinion – which was accepted by Decision No. 8/2016 (IV.6.) of the Court – the companies owned by the MNB and the foundations established by it manage public funds. Pursuant to Article 39 of the Fundamental Law all the data concerning public funds are of public interest. Organizations managing public funds are obliged to give accounts of their management of public funds. However, the President of the Republic and the Constitutional Court also acknowledged the fact, which was also part of the reasoning of the aforementioned Decision of the Court, that it is legal to restrict

PSZ 2017. angol.szam_beliv_v16.indd 267 2017. 04. 06. 7:29:10

the publicity of such data in the interest of the protection of any constitutional value or fundamental right. Despite this, the Constitutional Court declared the bill to be unconstitutional in its above-mentioned decision. Considering all this, there is some inconsistency in the decision of the Constitutional Court, which is also reflected in the two minority reports attached to the Decision. According to Béla Pokol's minority report, the separation of the economic enterprises established by the MNB from its foundations would be justified, a view which partly coincides with that of the MNB and the government. In his minority report, András Zs. Varga emphasizes that the Fundamental Law does not contain procedural rules relating to the knowledge of data of public interest. Nevertheless, the provision of the Act on the Central Bank of Hungary may be interpreted in a way that data may be requested from the decision-making organization.[19] Since the opposition, being committed to left-liberal orthodox policy, was not in favour of all this, they submitted their complaint to the Constitutional Court asking the court to declare the unconstitutionality of all of the measures related to foundations of the MNB. The Constitutional Court, however, pointed out its constitutional doubts regarding only the qualification procedure for private foundations and the attempt at confidentiality in connection with this, and not regarding the whole package of measures, which is correct from constitutional considerations and very important to the country from an economic point of view. It is very important because empty mainstream neoliberal economic conceptions, literature, "scientific" research and education are made from fiction rather than from mathematical deductions and formulas based on economic and sociological reality, and therefore they are useless. László Csaba, in his monograph about European economics (Csaba, 2014:26, 55) and Csaba Lentner, in his essays on public funds (Lentner, 2015:31–76; 2016), give very strong and in-depth criticisms of that mainstream economic trend that leads to deadlock. Since this trend, which is empty but still maintains its power at any cost, can only be crushed by the MNB establishing – with the support of foundations – educational centres teaching economics within the framework of both the MNB and institutions of higher education, and where the teaching of unorthodox economic trends will prevail, the steps towards the separated management of foundations are legally justified too. European law, in line with the World Bank and the IMF, supports the independence of the MNB. And that is what Matolcsy legally took advantage of. Notwithstanding, the Constitutional Court – with the exceptions of the two minority reports – did not take this fact into consideration. From the view point of legal philosophy, the Constitutional Court approached the question from the traditional "correct law" side, and not from the now-prevailing aspect of positive law, which can be disputed from the point of view of correct law.

Regardless of this case, and besides the issues of economic policy and the existential questions affecting the civil service sector, the Constitutional Court has advanced the rights of its citizens to social security, health, a good environment and human dignity with many of its decisions.[20]

To conclude, we can state that the administration of Hungarian constitutional law may be divided into two different phases. In the first period of the first phase, the decisions were based on a constitutional theoretical approach rather than on the interpretation of the statutes of the constitution, while in the second period of the first phase the Constitutional Court made its decisions based on the interpretation of the statutory provisions of the Constitution. The decisions of the second phase were largely made on the basis of the new Fundamental Law. A significant proportion of the cases has involved labour and civil service status issues, provisions making citizens' rights more burdensome retrospectively and the analysis of the management of financial and central bank foundations. All the phases of the administration of Hungarian constitutional law may be characterized by the fact that it could not avoid being influenced by politics and this applies everywhere since the administration of constitutional law moves along the border of politics and law (Paczolai, 1995).

Notes

[1] In September 2005, a group of those affected, with the help of Dr Csaba Pákozdy and Dr Tamás Prugberger, turned to the Court of Human Rights in Strasbourg, which decided – after seven years of silence and urging – that the Hungarian courts made their decisions, having become legally binding, in accordance with the law.

[2] Act No. XX of 1949 (not effective).

[3] See also Sólyom, 2001 and the parallel opinion attached to No. 23/1990. (X.30.) CC. Decision.

[4] 35/1994 (VI.24.) CC. Decision.

[5] 11/1992 (III.5.) Constitutional Court Decision on the first justice bill (Zétényi–Takács).

[6] 53/1993 (X.13.) Constitutional Court Decision on the second justice bill (Zétényi–Csurka–Zimányi).

[7] 33/1993 (I.28.) Constitutional Court Decision and 21/1994 (III.16.) Constitutional Court Decisions were related to this.

[8] This decision line is described in the detailed interpretation of the Constitutional Court decisions in connection with the social insurance by Rab, 2012:52–112.

[9] 37/2011. (V.10.) Constitutional Court Decision declared the provision of Act No. XC of 2010 which raised the income tax with a retrospective effect unconstitutional and 1268/B/2010 Constitutional Court Decision is about the constitutional control of the act after its modification as a consequence of the above-mentioned Constitutional Court Decision.

[10] 33/2012. (VII.17.) Constitutional Court Decision.

[11] Act No. LVIII. of 2010 on the Status of Government Officials (Ktjt) (not effective).

[12] 8/2011. (II.18.) Constitutional Court Decision.

[13] Act No. CXCIX of 2011 on the Legal Status of Civil servants (Kttv).

[14] Act No. I. of 2012 on the Labour Code.

[15] Act No. XXXIII of 1992 on the Legal Status of Public Servants (Kjt).

[16] Important Constitutional Court Decisions in the cases of the terminations of civil servants' employment: 518/D/2009–518/D/ 2009 AB.; 111/B/2011-29/2011 AB; III. 00505/2012–342012 AB; III. 00506/2012. AB; IV. 01235/214–3049/2015 AB., IV. 01648/2014–3285/2014; IV. 00894/2015–3192/2015 AB.

[17] Ibid.

[18] Act CXIX of 2010 narrowed the circle of the financial acts in which the Constitutional Court may execute constitutional control. See further Naszladi–Tilk, 2015.

[19] 8/2016. (IV.16.) CC. Decision declared unconstitutional – with the exceptions of the Minority Reports of Béla Pokol and András Zs. Varga – the modification of the Act on the Central Bank of Hungary which would have allowed confidentiality in case of the foundations of the MNB.

[20] See, for example, No. 518/E/2006–38/20011. Constitutional Court Decision in capacity case – see further its legal interpretation by Jakab, 2014:109–111, 220.

PSZ 2017. angol.szam_beliv_v16.indd 269 2017. 04. 06. 7:29:10

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PSZ 2017. angol.szam_beliv_v16.indd 270 2017. 04. 06. 7:29:10

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Zoltán Zéman

The New Hungarian Model in Hungarian Economic Science Higher Education

Summary

Due to the effect of historic economic events Hungary learned to react quickly and effectively since this was the only way for the country to remain at the forefront of the global competition of nations. In this continued and long-lasting preparedness, there took shape the values and requirements, such as intellectual and moral excellence and the knowledge enhancement, that are found in the country's Fundamental Law, which is at the same time the national creed. The National Bank of Hungary, too, has placed its faith in this creed, as since its establishment it has striven to represent national sovereignty. The significance, social recognition and independence of the National Bank of Hungary among the national institutions also involves responsibility and obligations for the central bank. It is evident that independence is not the central bank's objective, but its instrument that provides the possibility for it to serve the public good, benefit the whole of society and contribute to social wellbeing. The bank carries this out in such a way that it assumes a committed role in developing financial culture and awareness, and the economics and social thinking that form their foundation as well as the related system of institutions and infrastructure. This study highlights the role of educational and teaching reforms, and how attention must be paid to the knowledge connections of novelties in economic sciences that counterbalance the challenges of the globalised world economy and management organisations, and this requires a new approach and practice in Hungary. The various fields of economics satisfy a significant demand and are among the most popular fields of study chosen

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PSZ 2017. angol.szam_beliv_v16.indd 271 2017. 04. 06. 7:29:10

in Hungarian higher education not only for working in the corporate sector, but also at an institutional level.

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Introduction

Since its accession to the European Union, Hungary has been characterised by an accelerated and modern way of thinking including that the country's established financial culture keeps forming and renewing itself. There are various impulses that must be accommodated since these rapid and, above all, quality reactions determine the values that can be beacons and examples in all situations. In Hungary one of the bastions of responsibility, knowledge and independence is the National Bank of Hungary. The financial crisis of 2008 showed that, in addition to the major societal function of the financial institutions in acting at intermediaries, all the economic players require the unity of trust, accountability and transparency. The corporate social responsibility (CSR) model from the business sector can be applied to financial institutions and central banks just as it can be to economic organisations.

Considering these criteria and summing up the experience of the past few years it is clear that Europe's economic advantage lies in high-quality and competitive knowledge. Hungary is also contributing to this, for example the National Bank of Hungary is placing this constant gaining and renewal of knowledge at the focus of educational efforts. The National Bank of Hungary is deeply committed, even to the detriment of its results, to serving the public good and providing various types of support within the framework of its social responsibility programmes. In terms of short- and long-term tasks, the central bank is aimed at discovering competitive (professional) knowledge, and supporting and enhancing this knowledge both at a Hungarian and an international level, since it believes that the joint goal of citizens and the state is to achieve a good life, security, order, justice and freedom. For this reasons the central bank is striving towards an economic, legal, ethical and welfare balance which lays the foundations for joint cooperation, development, learning and trust within society.

The Hungarian central bank has set itself the especially important objective of becoming an institution able to meet the challenges of the times and, learn from the economic events of the past few decades; it will pay significant attention to providing information and to raising the standard of financial culture through the education. The essential conditions for this are a stable system of values and two key items: independence and the consequent enforcement and realisation of responsibility. These basic concepts are reflected by the Bank's Social and Responsibility Strategy which was passed in 2014 and which details the efforts, guidelines and principles through which

PSZ 2017. angol.szam_beliv_v16.indd 272 2017. 04. 06. 7:29:10

the central bank intends to participate in shaping qualitative public thinking and in developing and innovating in scientific and economic life.

The National Bank of Hungary thinks in the long term in terms of its educational objectives and the strategy. Competitive knowledge and its acquisition have been important from the beginning, and through them the central bank aims to establish the foundation for conscious economic thinking and to develop and support academic activities for the very small through to adults. It pays special attention to the topic of economic education and thinking and intends to support – both professionally and materially – outstanding students, researchers and experts who carry Hungary's fame into the world with their talent and diligence and create new things in their areas of expertise. By matching this objective the National Bank of Hungary, within its Social Responsibility Strategy programme, locates and supports Hungarian experts and researchers who are active in economics and finance in order to create more intellectual works at an internationally-recognised level. This will help Hungarian researchers to better access to new economic approaches and enhance their area of research.

Economic science gains momentum

The contextual cornerstone of the Bolognese system consisted of the introduction of elements of quality education, practical training and life-long learning. In the West, the objectives and principles of higher education experienced no innovation for centuries since the institutionalised system of higher education contained numerous elements that helped in establishing the designated parameters and its operation had long since discovered modern educational methods. In Hungary, the Bolognese restructuring process has not yet come close to finishing since a great deal of experience is the result of practice, and so it was particularly important to review the areas concerned and to designate the competencies that can be derived from knowledge. At an international level this issue has been a preoccupation for more than 10 years, but it has only now arrived in the fields of study of Hungarian higher education. This multi-level restructuring (The World Bank, 2009; Lentner, 2014, 2015; Lentner– Szegedi–Tatay, 2015b) or, more exactly, establishment may be especially important in the future for the dynamic and inductive relationship between knowledge, education and practice. The system of vertical and horizontal connections of the established fields of competency and their interdependencies contribute greatly towards users (in the labour market) having a better view of the output knowledge that a graduate must possess in the far-reaching system of the study of economics. The Economics Committee of the Hungarian Rectors' Conference has had the same objective. In my opinion the new system of educational requirements published in the decree brings serious and effective reform to education and greatly supports the programme of change. In future the role of educational and training reforms must be increased and, at the same time, attention must be paid to the system of academic connections of innovations in economic science that combat the challenges of the globalised world economy and economic organisation which are not unknown in West European and American prac-

PSZ 2017. angol.szam_beliv_v16.indd 273 2017. 04. 06. 7:29:10

tice but that represent a new approach and way of thinking in Hungary. The fields of study of economic science satisfy serious needs, and are among the most popular in Hungarians higher education, being aimed not only at the corporate sphere but also at institutions. The number of undergraduate students is about 40-45,000 and there are about 8-9000 postgraduate students. The number of the full-time students has decreased slightly, but the fall can be felt almost everywhere and negative demographic trends may, unfortunately, bring further decreases.

As a result of what is mentioned above, the dimensions of training and employment need to be more harmonised i.e. made interactive. This is a huge task which also effects the methodology of delivering knowledge while globalisation has a significant impact on traditional educational practices and systems. The only possibility that remains for Hungary is to build an effective and interactive knowledge management through their development, because this will be the basis for competitiveness, i.e. the effectiveness and promptness of knowledge delivery. Competencies can only be acquired if the practical or dual-background basis is established with the appropriate methodology for students to come into their possession. In other words, interactive teaching programmes must be elaborated that can be realised in practice for the educational programmes operating in the current subject framework, and they must be developed at an institutional level even if this means establishing external practical departments (Lentner–Szegedi–Tatay, 2014). This may bring along the synergy that can be realised with the above-mentioned background. There are a couple of examples of a university establishing a relationship with a research institution or company, which can bring new features when this process becomes a bidirectional relationship. One of these is the department of macro-economic finance established by the National Bank of Hungary and Corvinus University in the past few months. These collaborations can enable the practical orientation of Hungarian teaching to become continuous, stronger and more responsive to demand. There are numerous foreign examples of a country's central bank supporting the country's educational system and participating in teaching: for example the Bank of England is cooperating with Warwick Business School. When elaborating the strategies of economics teaching, especially those courses providing financial teaching, the results of research demonstrating the economy's development needs can be very useful. It is worth drawing attention to the fact that in the countries where they would like to establish effective financial education or to evaluate its effects nationally, this issue receives important prioritisation at a social and economic level. Economic leaders are capable of determining the potential needs of a country's economic development and educational culture, and of mapping all the deficiencies that can be brought about by economic development decisions. For this reason, financial education strategy plays a huge role in the entire educational system (Bárczi– Zéman, 2015; Borszéki, 2010).

The support of the central bank provided through dual education is similarly successful. The objective of this programme is to create modern economic research, development and education centres, via the support of the central bank, where there can take place the establishment of a competitive database that is aligned with the

PSZ 2017. angol.szam_beliv_v16.indd 274 2017. 04. 06. 7:29:11

changing needs of the labour market. Dual education was established with the Faculty of Mechanical Engineering and Automation of Kecskemét College, where students take part, within the mechanical engineering and business and mechanical engineering departments, in a high level of teaching by the standards of institutions and departments that provide an engineering degree.

Although there have been significant steps forward in the elaboration of these, methodology issues are often forgotten or not dealt with at all. In my opinion the harder a syllabus is, the more attention has to be paid to the process of delivery or acquisition of knowledge, i.e. the methodological background for difficult areas must not be forgotten. It is notable that the faster a society has developed, the bigger the need to moderate micro- and macro-economic risks that are hidden in economic-financial behaviour. Naturally, we can only be forward-looking in terms of research if there are useable results from economic science that bring solutions to problems in practice. There are programmes in post-graduate education that are accepted at international level – as a good example I would mention the DProf course being organised by the National Bank of Hungary together with the accredited programme of an outstanding foreign university – and that stress transdisciplinarity, providing the opportunity to reveal the academic interdependencies of problems through a totally different academic approach. Often uncertainty is caused in the social and economic sciences regarding how multidisciplinary, interdisciplinary and trans-disciplinary issues can be harmonised in the educational (doctoral) programmes. It is also notable that in an accelerated economy these appear first as needs then as requirements, stressing again the methodology of knowledge delivery that needs to be renewed in every area including in "internationalisation". Considering all this, Hungary is not becoming valued on the international stage because of the number of foreign students, but because of the international programmes we can offer to citizens of the world. I believe that the employment of foreign guest lecturers and professors and their connection to doctoral programmes can help to a significant degree. The central bank's educational programme leads in this regard, for example, in the finding of points of linkage in geopolitical courses and international trends. It is notable that it was accepted at the Doctoral School without breaching any accreditation requirements. This is unique because, as far as I know, adaptation at such a high level (to the doctoral programme) has not taken place yet within Europe. The United States and Australia are at the leading edge in this process but we now it can be stated that there is a Hungarian example that can "mature". It is notable that this kind of activity, such as has been assumed by the National Bank of Hungary management, has developed in the Western countries (through patronage) across many centuries through the support of the civil sphere (Gábor–Bárczi, 2015). Through total chauvinism certain institutions have deprived themselves of the serious advantages and opportunities of collaboration but they will be compelled to live with this in the current institutional restructuring of the higher education. The universities of Western countries towards each other and towards taking each-other's methods and syllabuses. This is why *Marketing Management* by Philip Kotler, *Mathematics for Economists* by Sydsaeter–Hammond and *Modern Corporate Finance* by Brealey–Myers are used and

PSZ 2017. angol.szam_beliv_v16.indd 275 2017. 04. 06. 7:29:11

accepted all over the world at every economics faculty (Lentner–Szegedi–Tatay, 2015a; 2015b). Research organised through similar collaboration (analysis and evaluation of international programmes) and doctoral programmes can new and innovative scientific results that may provide significant information to the areas of science both at the macro- and micro-economic level.

At professional forums I have stressed many times that in the future the dynamic and inductive relationship between science, education and best practice is of particular significance. Naturally this works when we increase their connectivity and the functional effectiveness between them. In this process the methodology for and effectiveness of delivering knowledge becomes important. This does not mean there is no time to teach or educate, but that the most important knowledge must be acquired quickly to a high quality. The continuous development of competency has the same objective and can still rely on the knowledge established by research.

At the same time, I would like to note that the didactic conclusions and continuous development has emerged as a new element in of knowledge management culture and methodology, as pursued by the major centres (e.g.: Oxford, Harvard, Scandinavian countries); this can supported researches through the operation of effective knowledge transfer.

What does knowledge management mean?

The management of knowledge-based processes describes a bidirectional task:

– on one hand, it focuses on the interactivity of external players (e.g. synergistic competence development serving the labour market), and within this orientation toward best practice and life-long acquisition of knowledge, i.e. learning,

– on the other hand, it is adjustment to the internal operating mechanism of faculties and academic programmes – naturally not disregarding scientific needs – which includes innovative thinking in education. The approach of the above-mentioned units – science–education-best practice–methodology–innovative political scientific thinking – may represent a significant step towards qualitative higher education. Thus we have to abandon "traditional" educational forms.

It can be concluded that one of the motivators of future knowledge enhancement will be the harmony of these units which will naturally also affect the quality of higher education. In terms of Western partner institutions where the teachers have pedagogical qualifications, there is at least one nation-wide education, methodology, and learning conference every years for the teachers. With all this considered, it is not a coincidence that Western higher education – from America to Austria – seems to be completely uniform from this perspective. Qualitative education, practice-oriented training and the principle of life-long learning prevails everywhere, and there are valid modern educational-methodological solutions such as IT support, cooperation, the teacher-student relationship, playfulness, interactivity and numerous other contemporary methods. I believe that the quality of higher education is determined by the following 5 basic components:

1. preparedness of the teachers;
2. quality of the students' knowledge;

PSZ 2017. angol.szam_beliv_v16.indd 276 2017. 04. 06. 7:29:11

3. efficiency of the functioning of the education system as a system of institutions;

4. how up-to-date are the manuals, books and digital material;

5. possibility of adjusting the applied methodology – which determines the degree of speed of knowledge delivery and acquisition – according to economic and social level.

When analysing Hungarian higher education it can be stated that the development of the first three components is a huge task – through the characteristics of each institution rather vary – which is naturally not good but is still acceptable. However, the syllabuses and applied methodology are not uniform and so this is a quantitative and qualitative problem too (Czakó–Husz–Szántó, 2011; The World Bank, 2009). Attention must be drawn again to the fact that the patronage of the National Bank of Hungary is causing a historic change not only in economic education but across the entirety of Hungarian higher education. If it proves the case that there is a model in economics education for producing a modern syllabus and an applicable institutional structure that is self-financing, modern and continually innovative, then higher educational institutions specialising in other subject areas are probably also applying this practice. At the same time nobody can consider serious the criticism that the National Bank of Hungary, through its patronage, hurts institutional autonomy and freedom. New thoughts, approaches and solution must be discussed in academia and, in the end, in practice and thus in real life. Hungarian innovations have always played and keep playing an important role in the world's development, even if this is mainly the result of the isolated, individual, intellectual efforts of geniuses. In the near future, however, besides discovering geniuses – there is a need for the intellectual discoveries of the masses (even they are not geniuses) in order to make innovative developments widely known and applied. There is need for a justified, vast knowledge for the predicted radical technical and technological revolution that will encompass the whole of society. Smart tools and innovative solutions are only being used in smart and prepared societies. Those who missing the preparation will miss the development. The main task for the near future will consist of producing qualitative knowledge and its proper management, which will evidently takes place at universities. In this case the enhancement of concrete financial knowledge, educational forms supported by the government or financial institutions, and educational materials may be potential instruments for solving the situation, a task which the National Bank of Hungary has assumed and is trying to fulfil. In the Hungarian economic policy model, the central bank is trying to provide increased support not only in the harmonisation of fiscal and monetary politics but also for the above-mentioned educational issues (Lentner, 2015).

Research experience and results that show the development needs of the population or some of its segments (subgroups) can be utilised well when elaborating the strategies of financial education in terms of the entire educational system. Consequently the measuring of the level of financial culture is an important task both for society and the economy since it is conducted and managed by the members of society. The task is similar in the case of the SME sector, and so this task has an impact mechanism at macro- and micro-economic level. Attention should be drawn to the fact that, in the countries that wish to establish effective financial education or intend

PSZ 2017. angol.szam_beliv_v16.indd 277 2017. 04. 06. 7:29:11

to evaluate its impact at a national level, this issue receives considerable priority both at the social and economic level. The leaders of the economy – who form the specific political strategies – are able to determine the potential needs of the national financial culture of a country or economy, as well as survey all the deficiencies in order to decide which groups of society need help the most. The results of the first evaluation of financial culture performed in a country can be considered a starting point, and they may serve as reference when elaborating financial educational programmes, during which there are often huge steps forwards but methodology issues are often forgotten or not dealt with. In my opinion the more difficult a body of knowledge, the more attention needs to be paid to the process of knowledge delivery or acquisition which can be complemented well in terms of methodology, meaning that the methodology background should not be forgotten in connection with difficult areas. Recurring surveys and the analysis of the connections between particular factors can help in determining what changes have taken place in the meantime.

Summary

The role of the National Bank of Hungary in society and its future objectives should be connected to the definition of its mission. The independence and responsibility of the central bank surely represents a pillar of social wellbeing since its activity exerts a direct impact on the economic environment, on companies and on the lives of citizens. In terms of its objectives, one of the central bank's main missions consists of supporting the realisation of the professional and global social objectives that reflect authenticity, create values, strengthen the unity between society and communities, strengthen scientific thinking and, not least, support the development of talent and develop financial culture. In accordance with this thinking towards value creation and preservation, the central bank's social responsibility programmes encompass a wide range of education, research, scientific activities, financial information, culture and donation to charity, with a special emphasis on the acquisition of knowledge, on value creation and on the preservation of values.

In terms of strategic objectives related to the education and financial thinking the National Bank of Hungary:

– experts and strategic cooperation partners intend to play leading roles in the renewal of the education of economic and financial experts through the foundations established to meet the objectives aligned to the central bank's tasks,

– considers its task to develop financial culture, information distribution and financial consciousness and economic and social approaches that support this, as well as the related system of institutions and infrastructure,

– intends to encourage the renewal of the financial, economic and socio-political thinking by establishing professional workshops and by supporting economic, financial, social science and interdisciplinary education programmes of carious levels,

– supports the operation of academic and cultural journals,

– operates research, teaching, educational and trainee scholarship systems,

PSZ 2017. angol.szam_beliv_v16.indd 278 2017. 04. 06. 7:29:11

– supports, as part of the Pallas Athena Public Thinking Programme, talented Hungarian researchers in creating more internationally recognised intellectual products in the areas of social science, especially economics, finance and related subjects,

– organises trainee programmes for undergraduate and master's students learning at Hungarian higher educational institutions,

– tries to establish a national and international cooperation network and build connections with the world's top universities, research centres, institutions and experts,

– intends to play a role, where possible, in creating value and in preserving national values and the intellectual and cultural heritage and in transmitting values.

Based on the above, it is evident that the central bank has chosen for a base of knowledge that always insures competitiveness and helps those who decide on continuous learning and development. The National Bank of Hungary itself conducts research and provides education while creating the conditions needed for those who really wish to learn. It is a difficult yet noble task that requires the cooperation of citizens, students and the academic world. It must be clearly seen that there is a new world order in which knowledge and, innovative thoughts represent a competitive advantage, and this has become a condition of remaining in the market. With the professional and material support provided by the National Bank of Hungary is able to create economic and academic products that place it in the first rank in Europe and the world. The Social Responsibility Strategy announced by the central bank lays down the elements of a long-term process. The objective is clear, however the conscious forming of public thinking is a multi-step, innovative, fast-reacting and time-consuming process.

Some elements of this programme have already been realised, but in order to make qualitative and lasting change happen, a lot of time still needs to pass. It is promising that numerous Hungarian colleges, universities and doctoral schools recognised at a European and international level have cooperated with the central bank and launched successful projects such as the dual education, the National Bank of Hungary professorship or the Pallas Athena Geopolitical Doctoral Programme.

In the future projects like these are going to increase in number since in many cases only the initial steps have been made and preparatory works undertaken for cooperation. However the objective is always the same: to create knowledge and value with responsibility.

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PSZ 2017. angol.szam_beliv_v16.indd 280 2017. 04. 06. 7:29:11

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József Kandikó – Judit B. Varga

A Successful Programme to Help Hungarian Intellectuals Beyond the Border

Summary
Collegium Talentum, a support system for Hungarian talent beyond the border, has been operating since 2011 in the Carpathian Basin. The aim of the programme is to train young researchers to become scientifically well-grounded specialists by both national and European standards, to attract fresh blood to academic institutions, and to inspire them to convey national cultural values in addition to having a scientific career. The programme supports the progress of 90 young doctoral students, thus significantly contributing to mitigating the crisis caused by the lack of intellectuals beyond the borders. More than 300 intellectuals from all over the Carpathian Basin have been involved in the programme to date, and a successful network has been organized of professors and researchers committed to national values.

Keywords: crossborder support, young researchers, Carpathian Basin

Collegium Talentum students from beyond Hungary's border gathered for a celebration on 11 June 2016 in the Auditorium of the Hungarian Academy of Sciences. In the 2015–2016 academic year, 24 out of 74 active Collegium members came to receive certificates attesting to their performance during the three-year support period, and complimentary copies of the volume of studies entitled *Smart Net 2016,* containing the research results of graduate Collegium members, published for the third time.

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PSZ 2017. angol.szam_beliv_v16.indd 281 2017. 04. 06. 7:29:11

Collegium Talentum was established as an organization in the summer of 2010, based on a decision of the Senate of the College of Modern Business Studies, and set out on its activities using funds contributed by Bethlen Gábor Alap Zrt in January 2011. Its mission, modelled on the former Selye János College, is to provide support to and form a community of the Hungarian scientific and educational elite on territories detached from the main body of the nation. The goal was to patronize the thirty most talented out of 30,000 Hungarian students living and studying beyond the borders, and to provide them with international-level talent management for three years. This system, which is built on the principle of "invisible fraternity", is based on personal specialised tutoring, offers extensive education and financial support, and has a unique role in the formation of communities beyond the borders. Our mission is to set up academic teaching staff with the ability to teach in Hungarian for the Hungarian-speaking tertiary educational institutions that have been established in neighbouring countries.

Its political background is provided by a document published by the Ministry of Public Administration and Justice in 2011 and entitled *Strategic Framework for a National Policy* (KIM, 2011), which stipulated the following in relation to talent management in section 3.2.4: "The fulfilment of the role of young people with a high standard of knowledge can contribute greatly to the cultural and economic potential of Hungarians. For this reason, special attention must be paid to talented young people. They should be identified, selected and educated within the framework of various special and targeted programmes. Collegium Talentum is an important example of just such a talent management programme that aims to support outstandingly talented Hungarian youth abroad and to offer them specialised knowledge of a high standard that will help them excel in international academic life."

In the past five and a half years, Collegium Talentum has become a stronghold of Hungarian intelligentsia growing up abroad, connecting young Hungarian talent being developed in five countries with Hungary and with renowned researchers and professors in various academic fields. The fundamental goal is to inject fresh blood into Hungarian intellectuals abroad, and strengthen the academic teaching elite beyond the borders by opening up prospects to set research careers in motion. To this end, Collegium Talentum trains young people who are interested in the transmission of national values in addition to their professional careers, to become academically well-grounded and well-informed at a national and international level. The programme facilitates the co-ordinated professional development of young researchers, thus contributing to the solution of a crisis in the Hungarian elite abroad. This also means that Collegium Talentum has assumed a role in various master's degree programmes (or from the 5th year in combined degrees) for native speakers of Hungarian, and in the preparation of post-graduate students for their doctoral degrees. In the framework of the three-year support programme, personal tutors are selected from among the professors of their respective fields to help the Collegium members in their research. There is no differentiation between disciplines during selection. The members of the Collegium are forged into a strong community and into a smart network for the Carpathian Basin in quarterly train-

PSZ 2017. angol.szam_beliv_v16.indd 282 2017. 04. 06. 7:29:11

ing courses that strengthen their national identity and solidarity. Collegium Talentum creates the organizational and infrastructural conditions for the Collegium members to become, alongside their university studies, members of a community building a national and academic network operating at a high standard.

Over the past five years, Collegium Talentum has fulfilled this goal. Its main achievement has been to set up a platform for young teachers and researchers in the Carpathian Basin where post-graduate history students from Oradea and Uzhgorod, microbiologists from Cluj and Bratislava, ethnographers from Szeklerland and Slovakia, or mathematicians from Vojvodina and Cluj can meet, conduct debates and encourage each another. In addition to strengthening the Hungarian identity and national connectedness of youth in Slovakia, Subcarpathia (Zakarpattia Oblast in Ukraine), Transylvania in Romania and Vojvodina in Serbia, the Collegium Talentum support programme also broadens the Hungarian scientific and social elite by encouraging them to stay in their home countries. It is already evident that young teachers and researchers who have done their doctorates with help from Collegium Talentum are present in all higher education institutions of the neighbouring countries. Selye János University, also supported by the Hungarian state, Sapientia EMTE, the Rákóczi Ferenc II Hungarian College of Subcarpathia at Beregovo and the College of Subotica are not the only examples. Babeş-Bolyai University, the Medical and Pharmaceutical University of Târgu Mureş, the Constantine the Philosopher University of Nitra, the Comenius University of Bratislava, the National University of Uzhgorod, and the Novi Sad University all have teachers who were or have been supported by Collegium Talentum.

In the period between 2011 and 2015, 152 students, primarily PhD candidates, were granted Collegium Talentum support at various tertiary institutions in the Carpathian Basin, and we continue to have close and live relationships with them today, as they remain active Collegium members, many of them as members of the increasing Alumni network. Fifty four of the 152 members admitted to the Collegium have completed the full three-year cycle, and 74 students can be considered as active Collegium members. Twenty two members left the Collegium early, for professional or personal (health or family-related) reasons. One-third of the graduated Collegium members have already been admitted to the Hungarian Academy of Sciences as external members.

Collegium Membership

Collegium Talentum may have a maximum of 90 persons at a time (in three classes, 30 persons per class), plus one tutor per Collegium member. The talent management programme offers support to the members admitted to the Collegium for six terms. No postponement is allowed. During this period, the Collegium member is paid monthly stipends and is earmarked other financial support, while the tutor is paid personal support and participates in three-day training courses once a quarter.

A tutor is a recognised teacher of the institution in the academic field the student is engaged in, supervising the Collegium member in the first year of the grant pro-

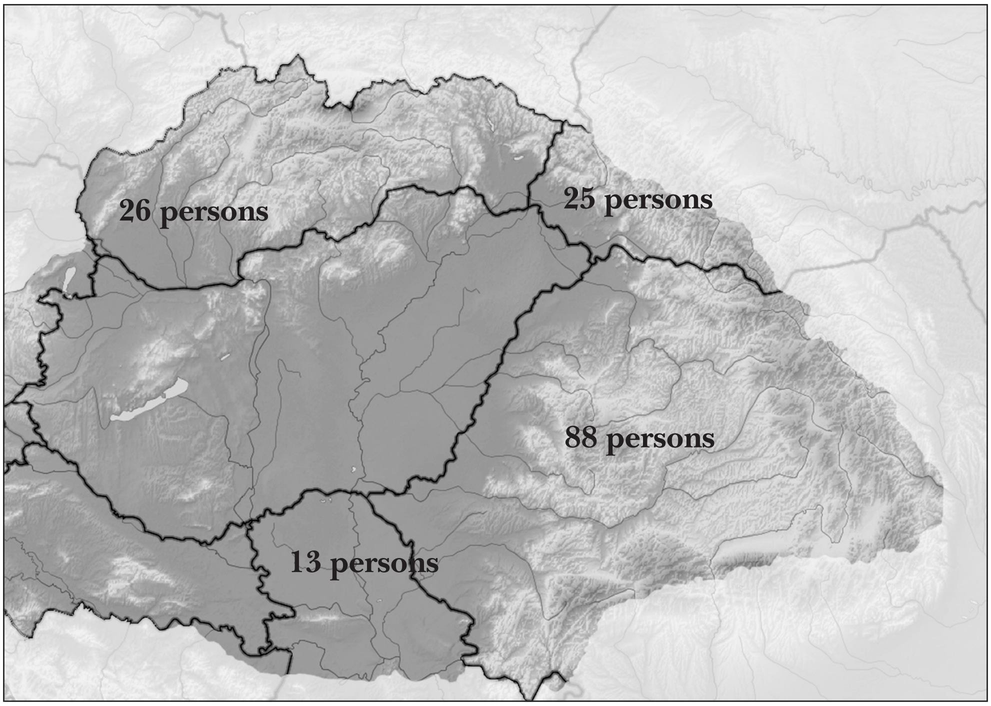
PSZ 2017. angol.szam_beliv_v16.indd 283 2017. 04. 06. 7:29:11

gramme, although in the second year, a different professional advisor, or tutor, must be selected from another institution. Both the first tutor and the Collegium management provide help in the selection. Tutors may be replaced only once in the three subsidised years. One tutor can supervise no more than two Collegium members at a time.

Work is performed, and the stipend is paid, on the basis of a grant agreement concluded with the Collegium member and the tutor for a term and setting out the tutor's obligations and rights. On re-contracting, once per term, the Collegium member must declare that he or she is not paid any other state grant from Hungary. If the Collegium member's legal relationship with his or her university is terminated (for reasons of graduation or dropout), the Collegium membership is also terminated. Thus, despite the fact that a new class of 30 students is started every year, the planned headcount of 90 is not usually filled, with the average headcount being between 70 and 80 students.

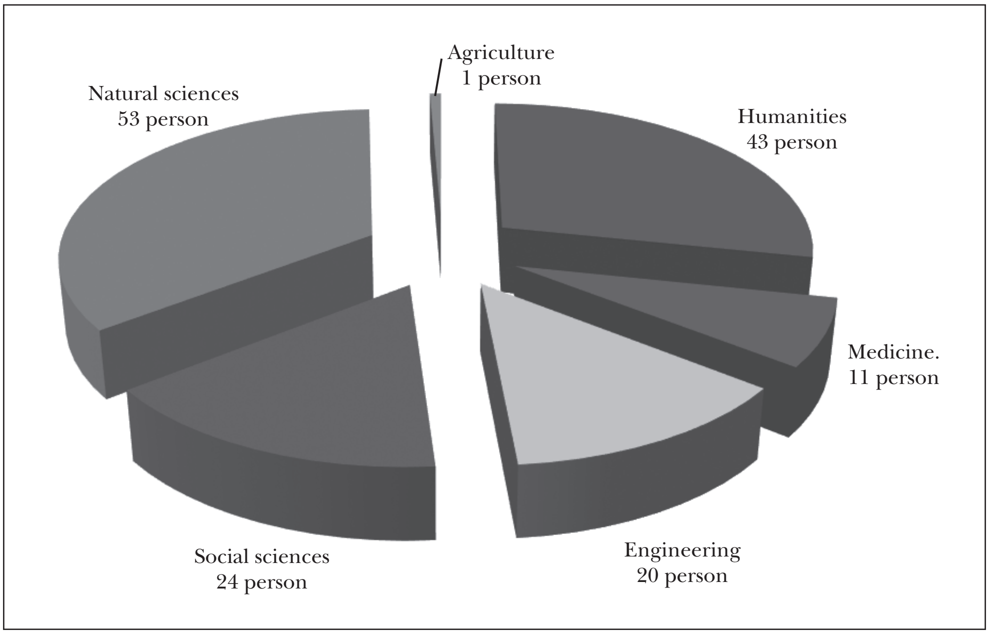
Regional rates approximately correspond to the ratio of Hungarians, with the exception of Subcarpathia. This is, however, understandable, as the latter region offers the lowest number of opportunities for learning, and especially for doing one's doctoral studies, in Hungarian. At the same time, this region has recently been the special target of various kinds of support to keep people in their homeland. Unfortunately, the unrealistically low and unsuitable ratio of natural sciences is due to the decade-long general decline of interest in natural sciences in the reviewed areas.

Figure 1: Distribution of Collegium Talentum members by region, 2011–2015



Source: Annual reports of Collegium Talentum

Figure 2: Distribution of Collegium Talentum members by academic discipline, 2011–2015



Source: Annual reports of the Collegium Talentum

If students' personal tutors are also taken into account, in five years altogether total of 304 persons have established long-term contact with this form of talent management, which also serves specific national policy goals, organized by Collegium Talentum and through the Bethlen Gábor Foundation. To this number can be added more than two hundred lecturers, trainers and professional supervisors who have met the organisation at training courses and various programmes. Thus, the scope of Collegium Talentum already covers more than five hundred Hungarian intellectuals in the Carpathian Basin.

Collegium Talentum grants

Stipend

A Collegium member is paid HUF 72,000 per month for 10 months in per academic school (within the framework of two semester-long contracts), which may only be received personally, in cash, during the mandatory quarterly training courses. (Personal payment in cash is required to guarantee the Collegium members' participation in the mandatory training courses). In return for the stipend, the Collegium member is expected to finance his or her travels to mandatory training courses held in Hungary, and purchase the research and experimental materials and smaller equipment and books required for his or her research.

PSZ 2017. angol.szam_beliv_v16.indd 285 2017. 04. 06. 7:29:11

The tutor is also paid a stipend of HUF 50,000 per month for 10 months per year within the framework of semester-long contracts. Tutors receive the stipend by bank transfer.

Professional tutorial help

The most effective help to a Collegium member in his or her professional progress is given by a tutor. The tutorial system includes customised activities that supplement the scholarship student's regular studies. The Collegium member undertakes to prove their aptitude through their learning outcomes and academic progress.

The tutor undertakes to direct the student and call them to account for the work done and progress made during the semester according to the criteria determined by the management of Collegium Talentum and the work schedule developed jointly with the Collegium member. It is especially important for the tutor to support the Collegium member's publications and professional integration. For this purpose, the tutor calls the Collegium member's attention to conferences held in Hungary and abroad and encourages them to participate. The tutor must pay special attention to the drafting of the student's publications, proofread them and actively promote their publication. The tutor must carry out personal tutoring at least twice a month. Tutoring can also be performed electronically, in which case the email messages must be archived.

A tutor must have an academic specialisation, must be a recognised representative of their academic field, and be a full-time employee or retired former employee of a research institution or educational institution in Hungary or abroad.

At the end of each semester, the tutor must make a written report of the grantee's performance and progress (tutor's report), giving an opinion on further support for the grantee. In relation to this, the tutor is entitled to seek information at any time about the Collegium member's work as defined in the relevant work schedule. If the Collegium member fails to properly cooperate or make appropriate progress, the tutor must inform the Collegium Talentum management of this fact.

Sponsored conference participation

Collegium Talentum encourages its members' participation in conferences held in Hungary or abroad. If the Collegium member delivers a lecture or presents a poster at an international conference that they have registered for, and thus increases the number of their documented publications, they may be granted financial support from Collegium Talentum within the limits set and based on a previous written application.

Encouragement to learn foreign languages

Collegium members are expected to make continuous progress in two different foreign languages (other than the official language of their home country) during the period of the grant. The Collegium member must document their continuous lin-

PSZ 2017. angol.szam_beliv_v16.indd 286 2017. 04. 06. 7:29:11

guistic progress once per semester in a report, and must advance to the next level within two semesters, providing evidence with a language examination certificate. Collegium Talentum reimburses the costs of a successful language examination in cash against an invoice. If the Collegium member fails to make progress in language examination levels within two semesters, only a reduced stipend will be paid to them until they produces the appropriate language examination certificate. Following the production of the language examination certificate, the member is again entitled to a full stipend, and has two semesters to fulfil the next level of language examination.

Obligation to compile a work plan and a report

Collegium members must submit a self-development and research plan for each contracted semester, and at the end of each semester they must make a progress report following the criteria specified by the management of Collegium Talentum. The semester work plan must include the expected results in specific terms, whether in written or oral form. In their work plan for the semester, the Collegium member must undertake to appear at a minimum two specialist public events and provide demonstrable results, with proof in a progress report.

The progress report may include more or other achievements than those in the work plan, but a measurably reduced outcome is unacceptable. In this case, the Collegium member is first warned and their stipend reduced for the next semester, and if it occurs a second time then the Collegium member's legal entitlement to a grant is terminated. Every semester the professional management of Collegium Talentum evaluates the Collegium member's performance on the basis of the progress report for the semester and the written tutorial report, and takes it into account for the next semester's contract.

Mandatory quarterly training

Collegium Talentum's activities and operations are intended to continue Hungary's tutorial tradition, which is exceptionally rich even by European standards. In this tradition, a "collegium", or board, is an independent intellectual workshop, an institution that passes on the most modern intellectual achievements, and artistic and educational values. Training courses held quarterly forge Collegium members into a strong community by strengthening their national identity and solidarity. In order to achieve this, a feature of the talent and elite training programme of Collegium Talentum is that Collegium members must take part in a three-day training programme. In order to encourage and enforce personal participation, regular financial support, conference participation fees and language examination support are paid, and personal discussions and evaluations based on individual work plans and reports are also held on these occasions.

In the course of attending to the complex duty of talent management, we endeavour to develop outstanding professional skills and creative thinking and a commitment to and motivation towards the selected academic field and community. For this

PSZ 2017. angol.szam_beliv_v16.indd 287 2017. 04. 06. 7:29:11

reason, we provide an environment at mandatory training courses where the participants can feel at home professionally, personally and as Hungarians.

Collegium members cover many different academic areas, and they learn the process of thinking collectively. It is an advantage that these young people come from the most varied institutions of higher education and have different social backgrounds, and for this reason our concept includes encounters and familiarisation with many different opinions, the acquisition of a culture of debate, and the education of intellectuals sensitive to one another and to social problems. We endeavour to make our members the primary beneficiaries and realisers of an interdisciplinary approach.

It is seen as a fundamental value in our educational concept that during six semesters spent in the tutorial scheme, our members acquire positive behavioural patterns, in addition to high standards of professionalism, which help them achieve success in the institutions of their home country, and make them leaders and active public figures capable of responsibly influencing decisions. During the compilation of the training content, an additional objective is to familiarise them with the discourses that academia is most interested in and with the most recent competitive areas, to provide them with access to and the opportunity to work in these areas, if possible, during the period of their membership. In addition to ensuring personal academic performance, which is guaranteed by the relationship between the tutor and the tutored member, an emphasis is placed on cooperative skills and personal development.

The following topics are of particular importance; they determine the content framework of the courses, which always organized on an individual basis with specialist trainers some of whom are constant but most of whom are frequently changed:

– Coaching, development of communication skills, self-understanding, and community building;

– Hungarian national policy, national memory, national holidays, Hungarian culture, and famous Hungarian role models;

– Local values and tourist sights, new exhibitions, and Hungarian customs;

– Learning policy, the history of knowledge, Hungarian scholarship abroad, and academic communication;

– Pedagogy, the history of education, and educational methodology and techniques.

Collegium Talentum provides lecturers, trainers and the technical conditions for training (accommodation, catering, tickets to and participation fees for certain programmes, and the costs of travel to programmes). Collegium members must pay the costs of their travel to and from the training site. At the end of the training, Collegium member students evaluate the programme. The Collegium Talentum management takes their experiences into consideration during the organisation of subsequent programmes.

Supported Collegium members must participate in the collective training courses announced, at the latest, at the beginning of Collegium semesters. Unless justified on health grounds by a doctor, failure to fulfil the above entails termination of the stipend, in terms of the per capita costs of training. The stipend is not paid in the case of absence without leave, and this amount may not be received subsequently or through a proxy. The management takes absence without leave or early leave into account in the semester performance evaluation.

Winter Academy

The Winter Academy, which is usually held in the first calendar quarter, brings together the members of all three years. This is a 4- to 6-day excursion in which about half the active Collegium members participate by registering beforehand. Destinations include the memorable sites and university towns of Hungarian history. As the participants spend several days together in a more informal programme, relationships become closer, and at each location the Collegium members are familiarised with the different social, educational and living conditions of their fellow Hungarians, as well as the beauties of nature and the old Hungarian cities and towns of the Carpathian Basin. (So far, locations have included: Novi Sad, Senta, Subotica, Miercurea Ciuc, Cluj Napoca, Oradea, Bratislava, Banská Štiavnica, Trnava, Szeged, Pécs and Győr). At these locations, the programme is enhanced by sightseeing, university visits, the presentation of research sites and personal meetings with local tutors. The full travel and accommodation costs of the Winter Academy, all tickets, admission and guide fees, and the costs of organized meals are borne by Collegium Talentum.

Achievements during the five years of operation

Publications

The most important measure of academic progress (in general agreement with the requirements of doctoral schools) is the number and quality of publications. A publication may be printed (reference book, a chapter in a book, an article, a review, a published study or abstract, or a poster presented at a conference) or an oral publication (at an international specialist conference, a conference in one's home country, during a workshop debate, or a public lecture at an event, including participation in a programme of the Students' Scientific Association corresponding to the Collegium member's level). As the Collegium trains and manages elite and talented individuals, the expected level of achievement must be higher than the general research and publication requirements of a doctoral school. The expected date and place of the publication must be specified in the statement, and the delivered or printed publication must be specified in the progress report according to the official rules for journalistic references.

Over the past five years, Collegium members have delivered 427 lectures at academic conferences, 34 of them at significant international conferences. These were published in the programmes and in the publications of the relevant conferences, and increased the lists of the lecturing students' scientific achievements. Every year several Collegium members participate in the International Students' Associations

PSZ 2017. angol.szam_beliv_v16.indd 289 2017. 04. 06. 7:29:11

Conferences organized by the universities of the individual regions and at tests specifically organized for doctoral candidates.

The number of reference books, chapters in reference books and publications in specialist journals has been 535. These have been published in large numbers in noted journals devoted to various academic fields, but some of them are complete reference books, chapters or educational materials. Half of the publications were in a foreign language, for the most part in English. The aggregated impact factor of the articles published by our Collegium members in scientific journals exceeds thirty.

Role in science communication

Each Collegium member is obliged to take part in conferences, workshop discussions and other events organized by Collegium Talentum where they must deliver a lecture, make a report or lead a discussion, and are required to compile the publication requested by the Collegium management for the publicity of the organization's results.

Conferences on the occasion of the Celebration of Hungarian Science

One of the autumn training courses is held during the Month of Hungarian Science in November. In the framework of the training, Collegium Talentum organizes public conferences to introduce first year members, and also invites the tutors along[1]. Lectures are followed by professional questions in the framework of a public conference, and lecturing and presentation techniques are discussed at the subsequent workshop.

Novel Science Communication Projects

Every academic year, Collegium Talentum organises publication opportunities for senior student members of the Collegium to present the findings of research conducted during the period of the grant. This is an opportunity for the students to obtain experience in the creation and use of innovative academic communication instruments. Thus, posters or science slams may be presented with the knowledge of the Collegium members' academic groups and topics. Competition improves the programme. The management announces in advance the conditions and method of judging science communication and the awards.

Poster exhibition and competition

In 2013, for the first time in the history of Collegium Talentum, a poster exhibition and competition was organized. The posters of 46 senior Collegium members were exhibited in the House of Hungarians. This was the very first occasion in the life of the Collegium that the professional results that have been achieved were presented to scientific circles and the wider public in the form of a major event. The other ob-

PSZ 2017. angol.szam_beliv_v16.indd 290 2017. 04. 06. 7:29:11

jective of the poster exhibition and competition was to encourage the students newly admitted to the Collegium and to give them an example of scientific communication to be used in their research career[2]. From the moment the idea of a poster competition arose, we gave information on the competition and the process and techniques for creating posters, and provided consultation opportunities for the Collegium members. They were required to place professional material that had been proofread by their tutors into a predetermined printer's frame. The posters were printed for the exhibition, but an A4-size flyer was also made of every poster with the Collegium member's biography on its reverse side. This also served as the press material for the event, and was used for wider awareness raising.[3]

Science Slam

The real homes of science slams are the stages in theatres, clubs and entertainment halls, where new scientists can explain the meaning and application of their research to non-specialists. The first Science Slam competition was organized in 2008 in Darmstadt. It has been so successful in Germany that it now has a central organizational centre and seats must be reserved for the biggest competitions. The first European Science Slam was organized in Copenhagen in June 2014.

In the – for the time being more moderate – Hungarian version young biologists, historians, men of letters, linguists, psychologists, architects, mathematics teachers, philosophers and geographers spoke to the general public about their amateur achievements, in creative stories filmed using modern IT tools. These short films were shown on 20 November 2015, during the Celebration of Hungarian Science, at the Edutus College.

Workshop Discussions

In recent years two scientific workshop discussions were held with the *Intellectual and Infrastructure Conditions of Hungarian-language Scientific Research in Other Countries*. The first one was organized in Cluj jointly with the Babes-Bolyai University and the Cluj Academic Committee, and the second one in Beregovo, in cooperation with the Rákóczi Ferenc II Hungarian College of Subcarpathia. Collegium Talentum introduced itself and gave information at the BB University of Cluj, Sapientia EM University of Targu Mures, the Constantine the Philosopher University of Nitra in Slovakia, and at the Selye János University, and participated in the Summer Open University held at Bálványos.

Smart net

For graduates – in general to close the six-semester support programme – Collegium Talentum compiles books of reviewed specialized articles about Collegium members' research topics or any one of their results, and presents them during the degree ceremony. The academic János Péntek, then Chairman of the Cluj Academic Committee made a review of the first volume published in 2014: "Undoubtedly, Collegium Talentum can

PSZ 2017. angol.szam_beliv_v16.indd 291 2017. 04. 06. 7:29:11

have a significant role in mitigating two major problems of Hungarian science beyond the borders. One of them is the generational shortage that started in the three or four decades preceding 1990. A new generation of teachers and researchers has grown up and has found relevant positions in the past two and a half decades. Now CT members can ensure its continuity and natural order, and can make up for the still significant gaps that exist. And, as seen on the basis of the book, this is what they are doing. The other problem, which is more difficult to solve, is the closed and clannish attitude of staff, as a result of previous isolation, unregulated operation due to the lack of government control, sub-critical research headcounts and lack of institutions. This entails insufficient respect for professionalism and competence, and due to a lack of a constant dialogue and criticism, the genuine order of values cannot be set up. This makes young people's integration more difficult. CT's "net" works against this, representing major progress in developing common training and research in the Carpathian Basin. This is the elimination of borders the Academy also endeavours to achieve using its grant scheme, system of relationships and prestige" (Péntek, 2015). Additional volumes were published in 2015 and 2016, and were distributed to university libraries all over the Carpathian Basin.

New and retired collegium members

Admission procedure

Following the negotiations and contract conclusions that guarantee annual financing, which take place generally in spring, Collegium Talentum requests applications for admission and support. The invitation is published on posters placed in higher education institutions in neighbouring countries and in student, youth and professional organisations, online in the social media, and through personal communication in the form of roadshows.

The chairman and the educational director of Collegium Talentum evaluate the materials submitted in writing, with the involvement of external experts if necessary. Approximately half of the applicants are invited for an interview with an academic committee of five, according to the groups of academic disciplines announced in the tenders. In early October, Collegium Talentum enters into a grant contract with the thirty persons accepted, providing that they can prove their current student status and submit their first semester plan by the deadline.

Degree ceremony

One day during the June training programmes, a degree ceremony is held for the graduating members of Collegium to conclude the grant period. On this occasion, those who have obtained their doctoral degrees and fulfilled their professional obligations are also granted a certificate even if they have not been paid support for six semester. This event also includes the awarding of the Prima Prize, founded by Collegium Talentum for the young person coming from a neighbouring country who excels in knowledge and humility as a researcher, and also represents the mission objective of Collegium Talentum, which is to realise the noble task of staying in one's home country to build and strengthen Hungarian communities abroad.

Alumni system

A Collegium member who has concluded the grant period becomes a member of the Alumni organization if, in alignment with the mission of Collegium Talentum, they perform professional work in their home country. By signing the letter to join the Alumni organization, former Collegium members agree to abide by the rules of engagement (e.g. assume assignments to popularize Collegium Talentum), and may participate in Collegium Talentum's Alumni grant programmes and benefits (events, Collegium programmes, partial support for lectures at international conferences etc.).

Feedback

The feedback received from Collegium members, whether spontaneous or, occasionally, requested by the management in relation to an event or a programme, provides an impression of the outcome and benefits of the three-year talent management. The stipend paid by the Collegium, usually directly to its student members, has enabled them not to have to take employment just to satisfy their material needs, or to secure the required supplementary income through less time-consuming jobs. Thus, they have been able to devote the majority of their time and energy to research. The majority of Collegium members assign great importance to the Collegium's role in developing the mind and in community building, highlight the opportunities and achievements, and have good memories of the programmes aimed at strengthening Hungarian identity and national solidarity.

In early 2016, we were informed that the Office of the Minister of State for National Policy was planning to suspend and reform the current operational form of the five-year-old Collegium Talentum. As currently, in the autumn of 2016, we still do not have new information in any form whatsoever on the programme's operation, we were unable to convey encouraging news on 21–23 October to the thirty-two former Collegium members who gathered in Budapest for the Alumni programme.

At the end of 2016 the Sapientia Hungariae Foundation was nominated by the Office of the Minister of State for National as the new organizer of the Collegium Talentum. On the 13th March 2017 the Board of Trustees decided the first steps of the continuation of the support system Collegium Talentum still in the first half of 2017.

Notes

1 The following are a few illustrative examples of the topics discussed in the past few years. In 2012: Beáta Grabovac, University of Novi Sad: *Emotional Contexts of Monolingualism and Bilingualism in Vojvodina;* Sándor Bulcsú, BBTE: *Symmetry in Inverted Stock Exchange Statistics;* in 2013: Vas Krisztina, MOGYE: *Resistance*

PSZ 2017. angol.szam_beliv_v16.indd 293 2017. 04. 06. 7:29:12

Problems in the Case of Staphylococcus Aureus Strain; Áron Tőtös, University of Oradea: *Political Evaluation of Prostitution in Hungary in the Second Half of the 19th Century;* László Gogolák, University of Novi Sad: *Application of Wireless Sensor Networks Among Industrial Conditions;* In 2014: Júlia Makkai, BBTE: *Young Ladies in Transylvania – The Pink Fable of Transylvania in a Regional Reading;* Jolán Turóci, National University of Uzhgorod: *From Atoms to Quarks.*

[2] Besides major national radio and television channels (MTVA, MR1-Kossuth Radio, Echo TV, Lánchíd Radio), internet forums (the National Talent Promoting Committee of MTA, tehetseg.hu) were also interested in the research topics shown on the posters, and several newspapers reported on them in Hungary and abroad.

[3] The posters can be viewed on the website of Collegium Talentum. www.collegiumtalentum.com/index.php/rendezvenyeink/poszter-konferencia/95-a-collegium-talentum-poszterverseny-eredmenyei

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PSZ 2017. angol.szam_beliv_v16.indd 294 2017. 04. 06. 7:29:12

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Ethnic and Demographic Changes in Hungary's (More Than) 1100 Years Long History

Summary
This paper will follow the ethnic and demographic changes of Hungary across the changing aspects of Hungarian history. It will discuss the issues of war, devastating sicknesses, migration and emigration.

Keywords: Holy Crown, assimilation, Habsburg Empire, sovereignty, integration

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Thinking, attitudes to life, faith, way of life, family, social and other circumstances and the concepts describing and defining them are subject to constant change. Spoken and written words have changed and meant different things over time. Projecting back our current notions to the distant past can lead to misunderstandings and misinterpretation. Assuming this the author will try to be faithful to the period, to be clear, and to simplify complicated events, knowing for sure that this is not completely possible. Since the demographic and ethnic situation is determined most of all by history, wars, devastating diseases, migration and emigration, among the possible approaches these events form the basis of and framework for this study.

Hungary, or the Hungarian state, has existed for more than 1100 years. If we used the notion of the 'state' in the sense conceived by historians of law, historians, sociologists, social and cultural anthropologists, then Hungarian statehood was founded in the middle of the 9th century by King Stephen I's ancestor Álmos, when he was

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PSZ 2017. angol.szam_beliv_v16.indd 295 2017. 04. 06. 7:29:12

elected to be the reigning prince in Etelköz, the land where the Magyars (ancient Hungarians) stayed before their conquest of the Carpathian Basin. The state is an institutional supreme authority, independent from external powers, and enforced on the population of a specific geographic area. To the extent that the state functions in order to achieve the supreme common good as defined by Aristotle, it might be considered the political expression of the will of the community. Beside all this, it is also characterised by the acceptance of the governing power, integrity and a spiritual sense of interdependence.

The common will of the Magyars living in Etelköz was directed towards the conquest of the Carpathian Basin, which was successfully accomplished in the second half of the 9th century, and therefore the statehood of the Hungarians in Central Europe has more than 1100 years of history (Szabados, 2011). The adoption of Western European norms, of course, commenced with the re-establishment of the state on a Christian basis by Saint Stephen (King Stephen I), building on the foundations of Grand Prince Géza (Veszprémy, 2002). There are elements of these norms still operating today, such as codified legislation, literacy based on the Latin alphabet, public administration organised on a territorial basis, and the first Hungarian work on the theory of the state – the *Admonitions* (De institutione morum) written for Prince Emeric – by Stephen I. (Havas, 2005).

The other community organising principle was ethnicity. In the Hungarian language this is reflected in the meaning of the word 'nép' (people), which is not identical to population. While population is a neutral term for all inhabitants within a given geographic area, ethnic community, an ethnicity is a community of traditions and common origin where the people have their own name and system of symbols. It is a fact, however, that these concepts are barely present in such a clear form during the eventful centuries of the Migration Period in Central Europe.

Hungarians are the living example that, beyond these notions, real communities are continuously changing and stirring.

The Hungarians own myth of origin (the legend of the Miraculous Stag) and the associated ethnic names Hun, Turk, Onoğur, Avar, Bashkir etc. indicate that the Magyar conquerors were originally from a steppe culture (Anonymus–Kézai, 2004). However, the evolution of the Hungarians did not come to a standstill with the settlement of the Carpathian Basin. 'Hungarians' is the umbrella term for the communities that arrived in waves and settled down in the Carpathian Basin. They were ethnically Magyars, local Avars and Slavs, Pechenegs, Oghuz Turks, Cumans, Jász, Franks, Italians, and newcomer Slavic and German groups. They believed in the gods, or in Christ from a Byzantine, Roman or Reformed perspective, or practised the Muslim or Jewish religion. The adopted ethnic groups brought with them their languages, traditions, customs, warfare and culture. Although the relative proportions of these populations were different at specific points in time, they increasingly became homogenised and assimilated over the centuries, thus enriching the multi-rooted Hungarian nation. The people, stratified in different ways in social terms, were called the regnicola (inhabitants of the country). They formed society and the state (regnum, archiregnum),

PSZ 2017. angol.szam_beliv_v16.indd 296 2017. 04. 06. 7:29:12

which provided a liveable framework for the inhabitants based on the force of law – despite the storms of history – until the peace agreement of the Treaty of Trianon. The organic development of Hungarian law was interrupted in the period of the 20th century dictatorships and took an entirely different course.

The reasons why the Carpathian Basin was conquered are not known for sure. The numerous theories centre around two marked but not proven opinions. According to one, seven 'Magyar' tribes of similar origin quit the Khazar alliance, and were joined by three related Kabar tribes. The wave of migrations that began in the surroundings of the Caspian Sea pushed the Oghuz Turks westward, who defeated the Pechenegs, and who in turn destroyed the Hungarian homeland. Thus fleeing Hungarians were forced to conquer the Carpathian Basin. The logical weakness of this theory is that it is based on an ancient Greek trope (Szabados, 2010). According to this, attacks from the east defeat and disperse towards the west to their neighbours who, in turn, albeit weakened, conquer their western neighbours at their strongest. At the end of the domino effect, in 895 the dispersed Hungarians conquer the vast expanses to the east and north of the Danube, and by 900 they occupy the entire Carpathian Basin. They abolish the supremacy of Arnulf, the King of East Francia and, moreover, in 899 they defeat the greatly superior army of Berengar, the King of Italy, near the river Brenta. On top of all that, the Hungarian empire was solidified by the Battle of Pressburg in 907, which ended with the humiliating and total defeat of the Frankish army marching to take back the former Frankish territories (Veszprémy, 2008).

The other opinion is the conviction of dynasty. Based on the surviving native and foreign chronicles, history books and folk traditions, it was unanimously accepted until the 1850s that the Magyars' sacred grand princes, the descendants of Attila (the Turul peoples) were empowered with a heavenly mission to invade the central Danube basin.

Even though the Attila tradition of the Árpáds can be accepted as an authentic belief (Dümmerth, 1996) it in itself does not answer the question of the conquest of the Carpathian basin. The cause was, on one hand, the establishment of the Magyar steppe state as a new power factor emerging in Etelköz under the leadership of Álmos and, on the other hand, the attractive natural geographic conditions and political division of the Carpathian Basin. In the light of more recent observations, the conquest itself could have been a long, deliberately planned process that started in the mid-9th century and lasted until around 895; it started with Grand Prince Álmos and was fully realised during the rule of his son, Árpád.

Since the decline of the Avar Khaganate in the early 800s did not result in genocide, the various ethnic groups – Avars (among them the Onogur proto-Hungarians and the Szeklers?) and Slavs – inhabited this area, accompanied by Frank and Bavarian settlers in Carolingian Pannonia. Álmos' and Árpád's people came to know these relationships and with this knowledge they successfully carried out the state-political integration of the Carpathian Basin under Magyar leadership. The process of the deliberate Magyar conquest did not result in any demographic shock for the Carpathian Basin.

PSZ 2017. angol.szam_beliv_v16.indd 297 2017. 04. 06. 7:29:12

The number of the conquerors is estimated by the author at around 250-300,000. The size of the population in the Carpathian Basin in the decades before its conquest is estimated to be 300-400,000. Their composition and location are summarised in Table 1 based on historical and archaeological data. It should be emphasised, however, that this is to be regarded as only a historical reconstructive possibility.

Table 1: The population of the Carpathian Basin before its conquest (9–10th century)

Vassal nations of the Carolingian boundary culture (from the Istrian peninsula to the Czech Basin)	Avars (40-45%) Franks (40-45%) Byzantine fragments (typical finds) Slavic fragments (atypical finds)
Transdanubia	Avars Franks
Upper Hungary (Slovakia)	Slavs (from Košice to the Plain of Szatmár and to the Transcarpathian Oblast) Finds of unidentified origin
Transylvania	Avars (south of the Arieș River, along the Mureș River and scattered) Bulgarians (Lower Danube and scattered) Slavs (Northern and Eastern Transylvania) Szekler (Northern Transylvania, northern areas of Bihor County and the Partium)
Hungarian Great Plain	Avars (across the Great Plain) Bulgarians (scattered around the Tisza region) Magyars (Transcarpathian Oblast, Upper Tisza region, Bodrogköz)

Source: The author's compilation

During the 100-year reign of the grand princes, the Magyar medium-sized power was wedged between the Byzantine Empire, and the Eastern Frankish Holy Roman Empire. During this time, while always being part of an alliance, the Magyars prevented and delayed the strengthening of their two powerful neighbors with "plundering raids" and preventive campaigns to the west and to the south. Nothing could happen in Europe between 907 and 955 against the will of the grand princes. The army of a few thousand horsemen, however efficient, was not suitable for leading marauding campaigns – ships and chariots would have been needed for those – but during their expeditions, which were sometimes thousands of kilometers in length, they could plunder precious metals, prisoners and animals. The ethnic and religious situation was further complicated by voluntary migrants and those seeking asylum, in addition to the captives. The Battle of Lechfeld in 955 and the Battle of Arcadiopolis in 970 concluded the period of the preventive campaigns to the west and to Constantinople, respectively. Human losses in these wars were negligible, since they were fought by armies of only few thousands troops. Despite the defeats – in the absence of a dominant position – between the years 907 and 1030 (the imperial army of Conrad II, the Holy

PSZ 2017. angol.szam_beliv_v16.indd 298 2017. 04. 06. 7:29:12

Roman Emperor) the country was not attacked from the outside. Byzantine and Roman missionaries could evangelise freely and build monasteries, the numbers of their followers grew and their servants were allowed to settle down, while trade was secured to all points of the compass. Three years into his reign, in 1000, Grand Prince Vajk (husband of Gisela of Bavaria, the sister of Holy Roman Emperor, Henry II) decided to officially convert to Christianity. Pope Sylvester II sent a crown, acknowledging the sovereignty of the Kingdom of Hungary (independent from the Empire) Hungarian Kingdom and the church organisation and proselytising of the king, who was canonised as Saint Stephen in 1083 ("I am Apostolic, while he is rightly the Apostle of Christ, if Christ converted so many people through him" – stated the Pope when sending the crown, according to the hagiography written by Bisop Hartvik). Gisela was accompanied by many German and Italian knights and their household servants. A considerable number of missionaries came from Rome, although Byzantine monasteries were still operating at the time of the Mongol invasion (1241–1242) – despite of the schism of 1054.

Settlers and refugees (Pechenegs and Bulgarians) increased the population more than did the emerging trade connecting the four points of the compass, and the traders and craftsmen who were making Hungary their home. The *Admonitions* of Saint Stephen, written for the benefit of his son Emeric, determined for a period of a thousand years that refugees and settlers should be accommodated without discrimination: "…as the guests arrive from different parts and provinces of the world, they bring with them different languages and customs, and a variety of teachings and weapons. They do honor to every kingdom and make the court magnificent, deterring foreigners who act provocatively. The kingdom which is built on a single language and based upon only one custom is, therefore, weak and vulnerable." The quote, written in contemporary Latin, signifies the accommodation of those foreigners who are worthy, have value and are willing to take a stand against attacks from the outside. It is not about the wandering masses, but about the voluntarily naturalized people, who are of quality. Even though Stephen I established a Carolingian state, his kingdom was not a feudal state in the Western European sense, since lands were granted for individual merits, and possession of land did not entail enforced service. This circumstance made settlement of foreigners desirable, and greatly strengthened royal authority. Thus the Christian Hungarian state was not established as a faithful copy of the Western model, but the Latin and German, or 'Roman', innovations were combined with the steppe legacy in a synthesis. The Kingdom of Hungary exhibited a strong and centralized sovereign power, in which there was no place for feudal lords who devastated and sacked each other's lands and people (Györffy, 2000).

Stephen I won every one of his military campaigns. Neither the armed clashes (within the dynasty) that preceded and followed his ascension to the throne, nor the defeat of the Bulgarians in alliance with Byzantine Emperor Basil II, nor the destruction of the attacking imperial army of the Holy Roman Emperor Conrad II caused any significant casualties. The same applies to the 11th century after 1038, although uprisings and fights for the throne followed after Saint Stephen's death. The spontaneous

PSZ 2017. angol.szam_beliv_v16.indd 299 2017. 04. 06. 7:29:12

fusion and proliferation of society was ongoing. Since both Saint Stephen and all of his offspring married the children of foreign dynasties (dynastic marriages with the two empires are particularly evident), the ethnic mix of the ruling class was influenced by the settlement of the royal entourages. The ruling class from the conquest merged with local leaders, the elites invited in by the Árpád dynasty from surrounding countries and empires, including Germans, Slavs, Franks, Spaniards, Italians, and, during the reign of Sigismund and the Habsburgs, mainly Germans and Czechs. A significant proportion of Hungarian aristocracy originated from the Croatian ethnic group at a continuously growing rate from the time of Ladislaus I onwards. In the 19th century a substantial number of families of Jewish origin entered the Hungarian nobility.

The favourable demographic tendencies of the 11th century were not influenced by its four civil wars (in which the Holy Roman Emperor had intervened), or the defeat of the following: the German Imperial army seven times, of the Oghuz Turks and Cumans three times, the Bulgarians twice and the Polish once. The greatest military leader of the epoch, the first knight-king, Saint Ladislaus (King Ladislaus I) was alone victorious in eleven wars. As his sister's husband, Zvonimir of Croatia, died without an heir, the majority of the Croatian and Slavonian leaders invited Ladislaus to the throne. In the years 1090 and 1091 he occupied Slavonia peacefully and invaded Croatia and Dalmatia at the expense of small military conflicts. First he made his younger nephew, Prince Álmos, the Croatian king (Table 2), but when his elder nephew, Coloman the Learned, who had been King of Hungary since 1095, had himself crowned King of Croatia in 1102, a personal union was created between Croatia and Hungary. The personal union lasted 800 years without an armed conflict and to the mutual benefit of both nations, until the Treaty of Trianon. A substantial part of the Croatian nobility intermarried with Hungarians and the mixed marriages mutually enriched both nations.

Table 2: Population growth up to the death of Ladislaus I (11th century)

Growing population	Natural Queens' entourages (Russian, Polish, Norman, German, Byzantine, Serbian) Remnants of the defeated Black Cumans (Oghuz Turks) (Eastern part of Transylvania)
Growth of territory and population (personal-royal union)	Slavonia (today Croatia today) Croatia (today Dalmatia) Dalmatia (Adriatic shore and islands)
Defeats	Seven German Imperial attacks (1030–1107) Four civil wars in several stages Three Cuman invasions

Source: The author's compilation

The first and the second half of the 12th century and the first half of the 13th century were characterised mainly by indecisive clashes with Byzantium and (up to the Mongol invasion) by the successful establishment of a series of vassal states around

PSZ 2017. angol.szam_beliv_v16.indd 300 2017. 04. 06. 7:29:12

Hungary (Table 3). The losses arising from the short biennial military campaigns were not significant. Many crusades marched through the country and the fifth crusade was even led, in 1217, by Andrew II to the birthplace of his mother (Agnes of Antioch). It was of great significance that Andrew II granted the Teutonic Order settlement in southern Transylvania in order to evangelise and civilise the Pechenegs and Cumans, who had fled from the Mongols and settled down in Wallachia, and the Vlachs (Romanians) who were seeping into the Carpathian Mountains, and to protect the country. Moreover, he granted settlement to many Saxon hospites to serve the order of chivalry and to introduce various economic activities that were unknown in the country at the time. Yet Andrew II expelled the Order to Pomerania (Hóman–Szekfű, 1936) – because of its efforts to gain independence – while the hospites, who had multiplied to several hundred thousands, retained their privileges until 1848, having become one of the Transylvanian nations, the Universitas Saxonum. (Their cities and villages were transferred to Romania after the Treaty of Trianon, and were abandoned in the Ceauşescu period, when the 'Genius of the Carpathians' started to demolish Hungarian villages, while letting the Saxons go to Western Germany for a couple of thousand German Marks a person). Being a shepherd folk tending their herds in the Carpathians, the Vlachs barely suffered any losses for centuries, and increased their numbers rapidly. The nobles forced Andrew II to sign the *Golden Bull* in 1222 – the second in Europe, just a few years after the *Magna Carta* – which limited the previously very strong royal powers, although they were still strong afterwards, and included the right to armed resistance if the king were to violate the law. This is the legal foundation of later Hungarian wars of independence (Corpus Juris Hungarici).

Table 3: Trends in demography from Ladislaus I to Andrew II, 12th century and the first half of 13th century

Growing population	Natural Queens' entourages Settlement of the Teutonic Order and the Saxon hospites Admission of Jewish refugees Penetration of Vlachs (Romanians) Pecheneg refugees
Losses	Byzantine wars Expansive wars (establishing vassal states in the south and east) Minor raids of passing crusades Expulsion of the Teutonic Order
Growth of territories and population (vassal states)	Bosnia Northern Serbia Banate of Severin Ungaro-Valachia, then Wallachia and Moldova Galicia and Lodomeria

Source: The author's compilation

PSZ 2017. angol.szam_beliv_v16.indd 301 2017. 04. 06. 7:29:12

The crown of Saint Stephen was becoming gradually more and more sacred and the concept – unique in Europe – that was being built around it at that time, the so called Doctrine of the Holy Crown, relates to what is mentioned above. According to the doctrine the Holy Crown took over the power of the "Holy Kings" and their role in forming and unifying the nation. The crown is holy, because it was delivered by the angels from Heaven, and the pope sent it to Saint Stephen who, before his death, offered Hungary to the Virgin Mary, and therefore the Holy Crown is the crown of the Queen of the World, who is the heavenly patroness of Hungary. It connects Hungary to God, the heavenly power to the earthly power. Consequently, the Holy Crown is not an object, but an idea, an independent personality, the depository of the sovereignty and integrity of the nation, the possessor of complete authority that cannot be possessed by any man or group of people. The Doctrine of the Holy Crown has changed through the age. It was understood as the King from the very beginning up to the early 13th century, however because *Admonitions* is in favour of the pious exercise of power and is strongly against oppression, therefore the Doctrine of the Holy Crown excludes any form of dictatorial or despotic methods of governance from the beginning. Even in this early, personal era the Crown symbolizes statehood. The regnum is the country and the object of governance. From the 13th century onwards, the concept of the crown also included the subjects, thus it was not the Holy Crown symbolising the state that changed, but the state that it symbolised. When Władysław III ascended the Hungarian throne in 1440, he had no dynastic ties to his predecessor, but became king exclusively through an election. This demonstrates the non-perishing progressive power of the Doctrine of the Holy Crown. At the same time, the principle of election dates back to the Blood Oath in Etelköz, before the time of the kingdom. Although this knowledge survived in a Gesta which portrays the election of Álmos as a monarch through the notions of knighthood, but the blood oath itself was an ancient steppe custom as Herodotus also recorded it from the time of the Scythians. Therefore, the principle of the limitation of powers dates back to the time before the Kingdom of Hungary, however discussing this poorly attested issue would exceed the framework of this present study. The pertinent point now is the separation of powers under the aegis of the Holy Crown, which meant that the king's power was shared with the people (the political nation) – uniquely in Europe – not with the king involving the people in power, but the people electing the reigning monarch. This can be traced back to the 13th century, but it probably dates back longer, as the coronation is performed with the Holy Crown by the Archbishop of Strigonium (Esztergom) at Alba Regia (Székesfehérvár). All of these three conditions have to be met for the coronation to be considered legitimate. The king also involves the entire (political) nation in power but – and this is also unique in Europe – people do not serve the king (and, through him, the Holy Crown) because of an oath of fealty in exchange for authority (feudal hierarchy), but because they have previously earned it. The Doctrine of the Holy Crown therefore achieved, on one hand, the maintenance of a strong and efficient central power since there was no vassalage and, on the other hand, that every person in the Hungarian world was restricted in their power. (Using our current set of

PSZ 2017. angol.szam_beliv_v16.indd 302 2017. 04. 06. 7:29:12

concepts, the expression 'democratic feudalism' could jokingly be used for this situation.) The doctrine was not influenced by oligarchs or by the periodic weakening or strengthening of royal power.

The Holy Crown ensures an eternal divine set of values and eternal values (fundamental principles of natural law) which are not to be questioned but are to be followed (good and bad, truth and injustice etc.). In the course of the development of the Hungarian legal system, this does not relativize, even after the Renaissance.

At the time of Andrew II, the Holy Crown, as the supreme authority, is the sole proprietor of the country based on tradition as well as law, therefore its wealth, land, mines, goods and chattels could never be sold, bargained or pawned, since the king and the people who form the nation i.e. the nobility (the members of the Holy Crown) are merely leaseholders and managers of the inalienable assets of the supreme power until the family line ends (entailment, which is abolished only in 1848) or until they become unworthy of the land gifted to them.

Because supreme authority is divided, measures must be taken to ensure balance between the powers of the nation and of the king (e.g. free election of kings, the coronation oath, the right of armed resistance against the king, the county system with local and later representative governments established by Stephen I, without the consent of which the king could not enact or enforce laws). When the king, the nation or any external force violates such rights, they are bound – even at the expense of armed conflict – to restore them. Its rights, being of heavenly origin, never cease to exist, but may only be temporarily suspended (Tóth, 2007).

The Doctrine of the Holy Crown also carries an enormous spiritual depth, because Saint Stephen is not only apostolic, like the Pope, but is an apostle, equal to the other apostles, and an evangelist of nations, in other words he and his descendants have a universal mission. Additionally, the country is the kingdom of the Virgin Mary, and hence any Hungarian king after Andrew II is also a king of Jerusalem. In the 14th century, the Kingdom of Hungary is the sole 'archiregnum' (the first, holy, ancient power that is capable of making the world work) in Europe.

During the reigning of Béla III (1172–1196) and his sons, Hungary again became one of the major powers (in Europe). The revenue of the country equalled that of the French and English kings, and by 1241 the population – 90-95 per cent ethnically Hungarian – was close to two million (Table 3). It was in this situation that the Mongols invaded Hungary. The Mongols defeated the combined armies of the Kievan Rus, the Cumans and other associated, smaller nations near the Kalka River in 1223, and resolved to attack Western Europe; they invaded Kiev in 1240 and conquered the steppe. The fleeing Cumans asked for asylum. King Béla IV took measures to protect the country – the nobles, however, viewed the Cumans as the advance party of the Mongols and chased them out of the country. According to some sources Batu Khan made an offer to Béla IV to attack the Western empires together. Such a force could not have been resisted by anybody up to the Atlantic Ocean. The 'kindred of the holy kings' could not accept this offer but, as always throughout its history and even against overwhelming odds, defended Christian Hungary and Christian Europe, the 'Schengen borders' of

PSZ 2017. angol.szam_beliv_v16.indd 303 2017. 04. 06. 7:29:12

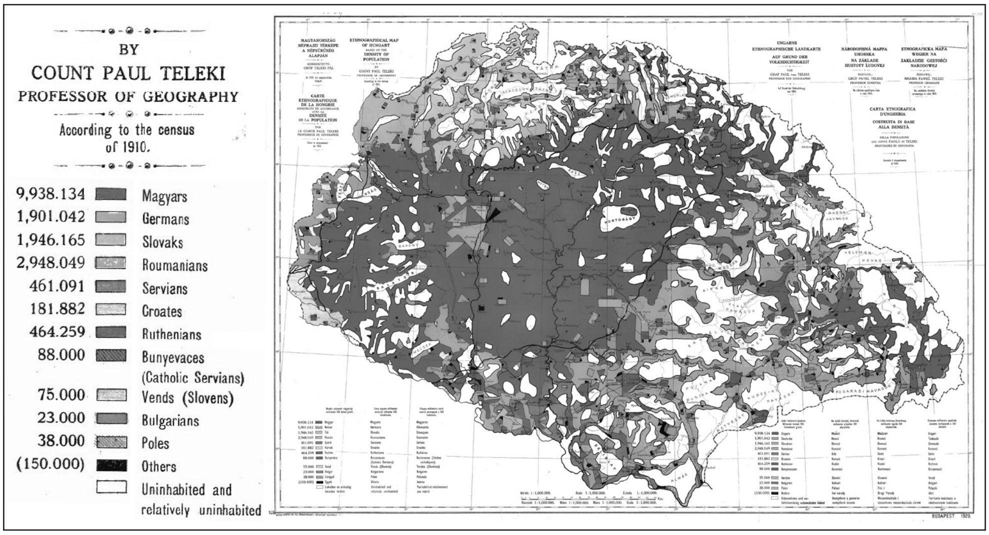
the time. The Mongols invaded from three directions. In the north, they overran the minor Russian principalities, the Polish and Silesia. The southern army troops broke through Bulgaria and Wallachia while the main army swarmed into the country across the passes of the eastern Carpathians. The royal army was lured into a trap and ambushed at the Battle of Muhi in March 1241, the occupied territories were devastated, and the inhabitants massacred. Béla IV did not receive assistance from either the Pope or the Emperor (who were at war with one another) or from any other Western ruler. The available military forces could maintain the line of the Danube until the winter of 1241. After the river froze, the Mongols crossed it and tore along Transdanubia, Slavonia and Croatia as far as Dalmatian Trau (today Trogir), chasing the king, but – most probably due to the election of the Great Khan – they then left the country.

The Mongol invasion was the first demographic catastrophe in the Hungarian history. According to an estimate the kingdom lost 30–50 per cent of its inhabitants. Today we think this is an exaggeration (Kovacsics, 1997). The destruction wrought havoc mainly on the rich plains to the east and north of the Danube, although the marshland of the Great Hungarian Plain and the forests of Transylvania and the Upper Hungary (Slovakia) hid away many inhabitants. Fortunately, the winter was very harsh and thus – even through plague broke out – it resulted in a significantly smaller epidemic than in western Europe. By 1242, Béla IV had already driven out Frederick II, Duke of Austria, from the Western counties occupied by him during the Mongol invasion, and Austria was divided up between 1242 and 1246 together with Ottokar II of Bohemia. During the rest of the century there were offensive military operations, the most significant ones being the victory at the Battle on the Marchfield (1278) and the elimination of the second Mongol invasion (1285). In order to recover some of the losses, the king granted settlement to numerous hospites and the Knights Hospitaller, and provided them with significant privileges. The king also granted refuge – after they had embraced Christianity – to 40 thousand Cuman families and to others fleeing the Mongols (Bulgarians, Russians, Pechenegs, Polish etc.) as well as to Jews, who were persecuted and harassed in the West. Vlachs were also seeping into the country at a growing rate. Among the settlers, the assimilation of the nomadic Cumans was difficult, eventually leading to armed conflict. However, at the Battle on the Marchfeld – won by Rudolph I of Habsburg, in alliance with Ladislaus IV, against Ottokar II, who was part of the Árpád dynasty on the female line – the Cuman advance parties have fought with cries of "Jesus! Jesus!". The Kingdom of Hungary remained a major player in Central Europe after the Mongol invasion, but its position as a major power was, however, only reestablished by Charles Robert of Anjou (the grandson of Charles II the Lame of Anjou and Mary, the daughter of Stephen V) – who emerged victoriously from the dynasty struggles between the three dynasties on the female line of the House of Árpád [the Wittelsbach, the Přemyslid and the Anjou dynasties] after the "Kindred of the Holy Kings" ended on the male line – and his son, Louis I (Louis the Great). After dealing with the coastal situation (Adriatic Sea), Charles Robert strengthened the southern and eastern defensive lines of the country, the banates and vassal principalities. He also wanted to secure the country towards Bohemia and

PSZ 2017. angol.szam_beliv_v16.indd 304 2017. 04. 06. 7:29:12

Poland in order to reclaim his rightful inheritance, the Kingdoms of Naples and Sicily. In 1335 he organised the famous Congress of Visegrád (from which the cooperation of the Visegrád Four arose upon the initiative of József Antall), attended by the Bavarian, Polish, Bohemian and Hungarian monarchs. The kings agreed on the spheres of interest and alliances in Central Europe. The key consequence of the meeting was that Habsburg endeavours were concluded in the region for two centuries, peaceful decades followed and after the death of Casimir III the Great, Louis inherited the Polish throne. His successor on the Polish throne was his younger daughter, Hedwig, who married the Grand Duke of Lithuania, Władysław II Jagiełło – who, in turn, converted to Christianity – therefore unifying the two empires (Dümmerth, 1982).

Figure 1: Demographic map of Hungary based on population density



The Kingdom of Hungary reached the peak of its power in terms of political influence as well as militarily, geographically, and economically, during the reign of Louis I. During this time the population grew substantially, while no major ethnic changes occurred. No substantial casualties occurred in the struggles for the throne and in the various military campaigns, because a large number of foreign mercenaries fought in the major expeditions outside the boundaries of the kingdom. The Black Death, the plague epidemic that exterminated 30–50 per cent of the European population, was introduced by the soldiers who took part in the Neapolitan campaigns. Based on the public administration records and contemporary chronicles it is most probable that mortality did not approach the European rate in Hungary. Leprosy was also only encountered sporadically (Ember, 2007).

During the reign of Sigismund of Luxemburg, the successor through the Anjou line, and the following "mixed house kings" (of the Jagiellonian, Hunyadi and Habsburg dynasties), the Ottoman Turks gained a foothold in the Balkan and pushed

PSZ 2017. angol.szam_beliv_v16.indd 305 2017. 04. 06. 7:29:13

northward. Throughout his long reign Sigismund, in the capacity of King of Hungary (1387–1437), King of Bohemia (1417) and Holy Roman Emperor (1433) changed the way and style of governance. He mainly pursued an imperialist policy; in the first period of his reign, he expanded to the west by relying on Hungarian resources, settled church matters at the Councils of Constance, Basel, Florence and others, deposed the antipopes, sentenced Jan Hus to be burned at the stake, and fought with his Hussite followers. He also interfered with the attempt to establish an independent French church. Sigismund was a European monarch of broad vision, who tried to establish an empire. Though his role model was Ladislaus I – Sigismund was buried next to him and his first wife, the daughter of Louis the Great – he planned to rule over his empire from Buda. His travels in Europe, diplomatic activities and the struggle for the thrones and those against the Hussites occupied all of his attention. Even through Louis the Great disbanded the Ottomans in the vassal states (the first line of defence), during the reign of Sigismund the Turks broke through it. They defeated the Serbian vassal state at the Battle of Kosovo (1389), and Sigismund lost a major battle in these territories (Nicopolis, 1396) with his international army due to the poor discipline of the French-Burgundian troops. He could not prevent the increasingly frequent Ottoman incursion and attacks on the border fortresses in the second line of defence, centred on Belgrade (C. Tóth, 2009). It can be assumed that Sigismund – like Matthias – wanted peace in the west so that he could turn the united Christian forces against the Ottomans. The Serbian despot, the Voivode of Wallachia and Moldova – depending on the balance of power – was, in turn, the vassal of the Hungarian king and the Ottoman Sultan. Minor military operations occurred every second year. Only the unrivalled military genius of John Hunyadi (c. 1407–1456) transferred the conflict to the Balkans again. While being constantly attacked, Hunyadi defeated the Ottomans in 14 military campaigns over a period of 17 years. He was victorious in six additional minor battles, and even his defeat at Battle of Varna (1444) set the Ottomans back to a great extent. After the sensational victory at Belgrade in 1456, the Sultan made only a few faint attempts against the Hungarian border until 1521 (however, he occupied several major islands in the Mediterranean and the northern states of Africa) (Pálosfalvi, 2005).

As the Ottomans attacked more and more frequently and with greater armies – while the war with the Hussites was still ongoing – the Hungarian armies fighting were also becoming larger (during Hunyadi's 'Long Campaign' his army consisted of c. 30-35,000 men). Despite Polish assistance, the auxiliaries of the vassal states and the employment of mercenaries, the casualties were also growing. These losses however, were amply compensated by the Bosnians and the Serbians, who were streaming into the country in flight from the Ottomans, and the migration of the Romanians from Wallachia and Moldavia, who were fleeing from the cruelties of the Ottomans and their own Voivodes (the vendettas of the Dănești and the Drăculești families, the origin of the Dracula story). With the increasing number of the inhabitants the ethnic proportions changed, aided by the fact that refugees were allowed to retain their faiths. Immigration continued during the reign of his son, the excellent military lead-

PSZ 2017. angol.szam_beliv_v16.indd 306 2017. 04. 06. 7:29:13

er, supreme diplomat and Renaissance ruler, Matthias Corvinus (1458–1490) – the strategist, diplomat and all-round Renaissance sovereign – who was able to maintain the sovereignty and integrity of the nation through his substantial and permanent armies, including a force of 6-8,000 mercenaries. The country could raise an army of some 160,000 strong, and its fleet consisted of 364 vessels (including 16 large galleons), equipped with the necessary manpower and weapons. He trained dozens of the finest vice-captains of Hungarian history. The number of war wagon carts was around 3,000. Only the emerging Ottoman Empire could raise an army that was comparable both in numbers and weaponry. Because of constant attacks from the west, Matthias decided to make peace in the west and in the north by the force of arms, so that he could rely on new resources to launch a later counterattack on the Ottomans. During the 32 years of his reign, he led 29 military campaigns. (In 1485, he became the second Hungarian king after Stephen I to conquer Vienna.)

Up to the death of Matthias, the sporadic outbreaks of plague – the result of the permanent state of war – and the cholera outbreak (1439) caused by contamination of drinking waters, in which King Albert and most of the army marching to release Smederevo died, had caused fewer casualties than wars and the captives taken by the Ottoman armies breaking into the country. For example one Ottoman army crossed the Danube into Transylvania in 1438 and destroyed Orăștie, Sighișoara, Mediaș and Brașov and then crossed the Carpathians with 70,000 captives. Massacres carried out by the akinjis and the vassals from the Balkans, who accompanied the main Ottoman army, were frequent and common.

In spite of all this, the population of Hungary kept on growing until the Battle of Mohács (1526), equalling the number of inhabitants of England, i.e. 4–4.5 million, 80–85 per cent of them ethnically Hungarian. The Romanians in Southern Transylvania, the Slavic fugitives from the Balkans in the Délvidék ("southern lands"), and the Czech Hussites remaining in Upper Hungary (Slovakia) changed the ethnic balance. The peasants' revolt led by György Dózsa in 1514 did not cause any demographically measurable damage either.

In 1520, the greatest emperor of the Ottoman history, Suleiman the Magnificent ascended the throne. He took Belgrade, Zemun, Šabac and other important southern castles in 1521 (thus causing the collapse of the secondary defensive line) and the remaining lesser fortresses of the southern defence system in 1526. Having conquered Northern Africa and Rhodes, the Ottomans launched an attack against Hungary in 1526.

Even though Louis II could only raise and send into battle half of the army, he undertook to engage the enemy at Mohács. After initial successes in the battle, he suffered a catastrophic defeat, losing 26,000 men against the greatly superior enemy. The King himself fell in the battle, so the troops that had been gathering at three different locations dispersed and a decisive battle could not be fought near Buda. The Ottoman army scorched both sides of the Danube (in the hills between Esztergom and Buda alone, more people were killed than in the Battle of Mohács), and left the country with an endless number of captivess. This was the end of the first half of the 300-years

PSZ 2017. angol.szam_beliv_v16.indd 307 2017. 04. 06. 7:29:13

long Ottoman–Hungarian war, during which, between 1372 and 1526, Hungary was able to preserve with great effort its sovereignty and integrity, its religion, its status as a medium-sized power, and its ancient folk and European (Roman, Gothic and Renaissance) culture, while the population grew in numbers and wealth. This could be seen as a miracle, since by the beginning of the 1500s the territory and population of the Ottoman Empire was five times and its revenues at least ten or fifteen times bigger than those of the Hungarian king. But then reality caught up when, step by step, the Ottomans captured Buda (1541) and one third of the country's territory to the west, east and south of it. That two kings were elected facilitated the conquest because the eastern provinces expected the most powerful baron of Transylvania, John Zápolya (with his wife was Isabella Jagiellon) to drive out the Ottomans, while in Western Transdanubia Ferdinand (the brother of Emperor and King of Spain, Charles V) was expected to accomplish the same. However, neither of the two parties was able to restore the rights of the Holy Crown. Zápolya tried to reach an agreement with the Ottomans, as did Ferdinand, while he waited in vain for assistance from the Empire, as Charles V was absorbed by the war against the French and the numerous problems in the huge empire, including the claims of the German Electors who had converted to the Protestant faith. The legal continuity of the Kingdom of Hungary (which had actually lost two thirds of its territory) was declared in the Treaty of Speyer (1570), and a relatively independent state, Principality of Transylvania, was established, representing the idea of the Holy Crown, and became the alternative to the unification of the nation, ensuring the development and culture of the three constituent nations, the Hungarians, the Szekler and the Saxon, and the other ethnic groups as well (R. Várkonyi, 1999). The leaders and soldiers of the 'Ottoman territory' in the middle were mainly southern Slavs, mostly Bosnians supplemented by Albanians. The Turkish ethnic groups marched across the country during the major campaigns, feeding the army by robbery, killing off the inhabitants and taking prisoners, although the Ottomans did not want to exterminate the population but impose taxes and plunder them. There were constant fights along the line of the border fortresses until the end of the Ottoman occupation, and smaller groups moving to and fro also fought each other. Owing to the conflict over the course of 150 years, south Slavic peoples became the dominant population in the southern territory (the area between the rivers Sava and Drava), while Zápolya granted the right to settle to Cserny Yovan ('the Black Tsar') in the Bačka and Temesköz (Banat plains) regions. Incoming Serbs killed off the great part of the remaining Hungarian inhabitants until Zápolya destroyed the marauders (1527). The indigenous Hungarian population of the Banat could never fully recover from this. The second demographic disaster was caused not by the above events but by the so-called Fifteen Years War (1593–1606), when substantial mercenary armies (20 to 40,000 in number) under Austrian command liberated some Ottoman castles in Trandanubia, devastated the area and crossed the Danube to march against the Sultan who was approaching the Great Plain with an army of 150,000 troops. Both armies caused extreme devastation during the military operations, exterminating a significant portion of the population. The fights also spread to the southern territo-

PSZ 2017. angol.szam_beliv_v16.indd 308 2017. 04. 06. 7:29:13

ries and to Transylvania. The situation was consolidated by Bocskai, while Gábor Bethlen (1613–1629) fought against Ferdinand II, the Holy Roman Emperor in two wars (1619–1621, 1623–1626), while the economy, industry and culture of Transylvania prospered. The campaigns of the Habsburgs and the Ottomans and occasional attacks by Tartars reduced the number of Hungarians, mainly those living in the river valleys. The Tartar campaign after 1657 and the Ottoman campaign of 1660 were especially devastating. Romanians settled from the mountains to replace the exterminated inhabitants. During the rule of Gábor Bethlen, approximately 80 per cent of the one million inhabitants of Transylvania were still either Hungarian or Szekler (Székely), the rest being Romanians and Saxons. By the time the Ottoman were expelled, only half of the inhabitants in south and central Transylvania were ethnic Hungarians. In the 1600s, for example, in 46 of the 106 villages in Szilágy (Sălaj) County, the Romanians became a majority, while ethnic Hungarians were displaced in 55 communities of 112 in Kolozs (Cluj) County.

The expulsion of the Ottomans began with the siege of Vienna in 1683. After winning the Battle of Kahlenberg (for which Sobieski, King of Poland, deserves credit) the allied troops of the Holy League, led by an Imperial Commander and enjoying substantial Hungarian participation, had liberated the entire territory of Hungary from the Ottoman rule by 1689, and then made deep inroads into the Balkans. At that point Louis XIV of France, in order to relieve the Ottoman Empire which was regarded as a 'friend', terminated the armistice that had been concluded for a period of 20 years and, therefore, substantial military forces and excellent military leaders had to be reassigned to the French border. The resulting Ottoman counter attack reconquered the Balkans but the last large assault by the Sultan after a few years of static war was smashed by Prince Savoy in 1697 at Zenta. Only the Banat plains were left in Ottoman hands up to 1716–1718. The last 15 years of the 300 year long war restored the integrity of Hungary, but at the cost of yet another demographic disaster.

Between 1526 and 1697 the population of the country was reduced from 4.5 million to 3.5-4 million. The losses were increased by periodic outbreaks of plague and typhus (described by Cardano as morbus hungaricus), introduced by the Ottoman army in 1542 when it marched from the Balkans to Buda. The number of Hungarian fatalities was up to 30,000. In 1544, the Christian army that set off to recapture Buda also lost 30,000 thousand people without having fired a single shot (Szakály, 1986). Therefore it was in this period – in the two Fifteen Years' Wars (1591–1606, 1683–1699) – that the ethnic composition of Hungary changed substantially. Significant loss of lives was caused by the fights and campaigns in the Ottoman-occupied Great Plain and its border areas, by the Habsburg campaigns in Northeast Hungary, and by the incursions of the Tartars and Turks in Transylvania.

The expulsion of the Ottomans was not accompanied by enthusiasm and was not preserved in the memory as would be justified by its significance. The war that dragged on for 15 years, then the movements of the Imperial army of some 50-60,000 thousand people wintering in and fed by the country, was accompanied by extreme deprivation. Special taxes were levied, the Neoacquistica Commissio demanded presentation

PSZ 2017. angol.szam_beliv_v16.indd 309 2017. 04. 06. 7:29:13

of the original title deeds – after 150 years of plundering, arson and flight – and if the estate was restored successfully then 10 per cent was confiscated as war contribution. The looting of the country was accompanied by the deprivation of rights. The Diet waived its right of free election of the King (1687), Transylvania was subject to separate governance by the Hungarian king (and Holy Roman Emperor), although it remained part of Holy Crown (Diploma Leopoldinum), the rights of the estates were impaired as well the freedom of religion guaranteed by the Diet of Torda (1568). The expulsion of the Ottomans was accompanied by deep despair in all layers of society. The above reasons triggered the Kuruc movement, which gave rise to Rákóczi's War of Independence (1703–1711) ("cum Deo pro patria et libertate").

The 18th century was determined by three peace treaties. The Treaty of Karlowitz (1699) restored the integrity of the country, while impairing sovereignty and ancestral rights, the Treaty of Szatmár (1711) settled the constitutional and other relations of Hungary, while the Treaty of Utrecht (1713) defined the place of the Habsburg Empire in Europe (the Empire was pushed back to the areas along the Danube, and so the value of Hungary within the Empire was raised).

Rákóczi's War of Independence resulted in a military situation that varied for years, the fight affected all parts of the country several times and the military campaigns consumed whatever was left after the expulsion of the Ottomans (Tamás, 2003). Hungarians also fought in the Imperial Army, and so the conflict also had the characteristics of a civil war and, in addition, the large number of Serbs living in the southern territories also rebelled in an effort to support the Emperor and decimated the natives communities, Hungarian and Croatian alike. This was the second episode of genocide in the southern territories. The Kuruc uprisings against the Austrians (1687–1699 and 1701) and the War of Independence caused around 30,000 fatalities. The eruption of plague took the lives of ten times as many people (approximately 300,000). These events caused another demographic disaster. The total population dropped to approximately 3.5 million with the ratio of ethnic Hungarians falling to around 35 per cent. The Treaty of Szatmár that ended the war was reasonable and as a result, a cultural consolidation could begin in accordance with the constitutional, political and social character of the country. The reformation movement significant in the previous century, was followed by a peaceful counter-reformation. While armed wars of religion and retribution have taken place in almost all Western countries, this has never happened in the 1100 year history of Hungary. Destroyed populations were spontaneously replaced in the middle of the country, in the plains and in river valleys by settlers coming from the peripheries, the Carpathians, and beyond. This is how Slovaks settled in the south of the Great Plain, and the Romanians of Moldova and Transylvania in the east and north of the Great Plain, and in the Transylvanian basin, with the exception of the Szeklerland. The Croatians moved towards the north on the western border, as did the Serbs on both sides of the Danube. The remaining Ottoman soldiers, mainly south Slavs and Albanians, integrated quickly and unnoticed, and the 200,000 Serbian refugees did so partially. Ethnic diversity was further enhanced by the fugitive Armenians and Roma. A great number of foreigners were

PSZ 2017. angol.szam_beliv_v16.indd 310 2017. 04. 06. 7:29:13

settled by the ruling houses and a few major barons, mainly Catholic groups of German origin, granted them substantial privileges in the southern territory, in Upper Hungary (Slovakia), Southern Transdanubia, and in the areas where Transylvania and the Great Plain meet. Spontaneous and organized migration consisted of populations that were ethnically different, but culturally similar, practicing one of the rituals of Christianity, who accepted the supreme power and the laws, and who mostly adapted to the habits of the tolerant host country.

After the Treaty of Utrecht the Danube Monarchy was outlined, the provinces of which were governed by the ruler as the Holy Emperor while the Kingdom of Hungary and its provinces were governed by him as the King of Hungary. It remained a characteristic feature throughout this century that the Emperor or Empress acted as a paternal (Charles III and Maria Theresa) and then as an absolute (Joseph II, 1780–1790) but enlightened despot, promoting the interests of the Empire by trying to reduce the rights of the Hungarian estates, while the estates successfully resisted these efforts by referring to the ancestral Constitution (the Doctrine of the Holy Crown) and to the oath of the king. Both the king and the estates tried to expand their powers. They could do so because the Empire would not have won its wars without the Hungarian military forces, raw materials and agriculture, and neither could it have maintained its rule, which extended to the female line after 1740 (Habsburg–Lothringen dynasty), and its status as a great power ("Vitam et sanguinem") (Marczali, 1997).

Industry developed mainly in the Austrian, Bohemian and Moravian provinces, while agriculture dominated the territory of the Kingdom of Hungary and in Transylvania, and was also promoted by the disputed 'dual customs system'. As a result of spontaneous migration and the arranged settlements that occurred under Charles III and, especially, under Maria Theresa, the population of the country grew fast, especially the Romanians, who were driven across the Carpathians by the miserable situation in the principalities of Moldavia and Wallachia. The numbers of several hundred thousand Serbian refugees, who arrived in Hungary during the Ottoman wars and even after 1690, grew similarly. Romanian and Serbian peasants and shepherds settled down in blocks, while the German (Swabian, Walloon, Saxon etc.) settlers were scattered around, mainly in major towns (most of them were artisans and traders). By 1785 – according to census figures – about 38 per cent of the approximately 8 million inhabitants were Hungarians. This is the first time that the ratio of the Romanians exceeded 50 per cent in Transylvania. The growth of the population was hardly affected during the century by the three wars against the Turks (during the reigns of Charles III and Joseph II) and the two Western wars (under Maria Theresa). However, it was affected by the peasant revolt led by Horea–Cloşca–Crişan (the 'Vlach Emperor'), which resulted in the deaths of 60,000 ethnic Hungarians, mainly in and around the Metaliferi Mountains of Transylvania.

In the last half of the 18th century and the first half of the 19th century decades-long disputes began in the circles of the Hungarian nobility on the necessity, contents and method of the bourgeois transformation, which would take place constitutionally and peacefully within the Habsburg Empire, based on the sovereignty and integrity

PSZ 2017. angol.szam_beliv_v16.indd 311 2017. 04. 06. 7:29:13

of the country. This process involved the alignment of the ideas of the Age of Reason with the ancestral constitution. The brutality of the French revolution and the terror of the Napoleonic wars went against the Hungarian traditions and mind set, so radical solutions were disregarded. However, national feelings were strengthened, in the sense of patriotism as opposed to nationalism. The latter was characteristic not so much of the Croatians, but rather of the Romanians, the Serbs and later the Slovak elite, with a few decades of delay and relying on historical precedents that did not exist.

While in the 18th century the royal and imperial family made efforts – giving priority to the interests of the Empire – to extend the rights of the lower social classes and to promote wealth accumulation by them, in the first half of the 19th century the Hungarian nobility initiated bourgeois transformation with increasing determination. Count István Széchenyi ("the greatest Hungarian") mainly promoted economic reforms, while Kossuth focused on social reforms Hermann–Závodszky, 1999).

The wave of revolutions in March 1848 (Paris, Italy, Vienna etc.) accelerated the events. The Lower and Upper Houses of the Diet of the Estates voted elaborate and well prepared bills into law on 13 March, and after a lengthy dispute, the king (Ferdinand V) signed them on 11 April. These laws provided the fullest guarantees for the civic and social transformation, and the nobility surrendered their privileges voluntarily and peacefully, which was unique. The dynasty deposed Emperor Ferdinand V (Hungarian law does not recognise the abdication of the king), and Franz Joseph I was appointed to be emperor. However, he could not become Hungarian king because the previous king was still living, he did not take the oath on the ancestral Hungarian Constitution and several conditions necessary for the inauguration of the Hungarian king were not met. He cancelled and rejected the 1848 laws in his capacity as Emperor of Austria (which he was not entitled to do), incited rebellion among the Serbs and part of the Romanians and the Saxons of Transylvania and mobilised his armies. Despite the lack of international assistance, the first Hungarian Prime Minister, Count Lajos Batthyány organised the state administration and war industry, issued new money, organised an army which defeated the Imperial Army led by Jelačić at Pákozd at the end of September and pushed it back to the Austrian border. Initially, the imperial counter attack during the winter was successful, but in the 'spring campaign' the Hungarian troops – featuring excellent commanders and superior fighting morale – routed the demoralised remains of the Imperial Army in a series of victorious battles, pushing them back to Vienna, while General Bem achieved substantial successes in Transylvania. Emperor Franz Joseph appeared before the Russian Czar in Warsaw and kissed his hand, resorting to entreaties for his intervention. In accordance with the Holy Alliance, the Czar ordered Prince Pashkievich to attack Hungary with an army 200,000 strong. The Hungarian troops, attacked from three different directions, were concentrated around Oradea and Timișoara, but Arthur Görgey (one of the most ingenious military commanders of the century) realised that the still intact Hungarian army of 30-35,000 troops could not possibly defeat two armies of 100,000 men each and surrendered to the Russians in the middle of August 1849

PSZ 2017. angol.szam_beliv_v16.indd 312 2017. 04. 06. 7:29:13

(Hermann, 2001). The surrender was followed by brutal retribution and disenfranchisement which was illegitimate under Hungarian law and can only be compared to that made by Kádár after 1956. (Lord Palmerston wrote to the English Ambassador in Vienna, "The Austrians are the biggest brutes among those who ever usurped the name of civilised people, their cruelty […] in Hungary and Transylvania can only be compared to the acts of negroes in Africa and Haiti.") The Emperor ruled the country administratively by decrees, to which the nation responded with passive resistance. Franz Joseph participated in the anti-Russian coalition of the Crimean war (he bit the hand that he had kissed in 1849), tried to prevent with force of arms the creation of two large nation states, Italy and Germany, but was defeated in every war (the loss of Lombardy and Venice, the little Germany solution under Prussian leadership). After defeat at the Battle of Königgrätz, the dynasty realised that they needed to compromise with Hungary. A large number of ideas were discussed during negotiations that lasted several years. Ferenc Deák ("the Wise Man of the Nation") found the solution which complied with the ancestral Hungarian legal system derived from the Doctrine of the Holy Crown, the agreement between the dynasty and the estates (Pragmatica Sanctio), the laws of 1848, the interests of the contracting parties and the need to settle the common affairs (military, financial and foreign). After the Compromise ('settlement') Emperor Franz Joseph took the ancestral royal oath, and was crowned with the Holy Crown by the Prince Primate (the Archbishop of Esztergom) as King of Hungary, Croatia, Dalmatia, Rama, Halitch, Lodomeria, Jerusalem, etc. This was followed by the Hungarian–Croatian compromise of 1868. The elected parliament guaranteed personal freedom rights, civil rights and cultural autonomy for its citizens, and one of the first laws allowed unlimited and unconditional immigration into the country (Gergely, 2005).

The country experienced breath-taking development in the fields of economy, culture, health care and education. The GDP grew fifteen-fold and the railway and road network tenfold. Growth in other areas of the economy was similar to that. Hungary produced one of the highest rates of development in Europe. One issue, however, could not be solved: the matter of the nationalities. A part of the religious and political leaders of the various ethnic groups recognised their ethnic identity in the 19th century. Their Hungarian identity was gradually supplemented with or partly replaced by an affinity with the neighbouring populations of the same origin that still partly lived under Ottoman rule. A number of myths were created and elevated to become 'scientific facts': the Slovaks referred to Greater Moravia, the Romanians to the Daco-Roman theory, the southern and northern Slavs to the ideal of Pan-Slavism, and the Czechs to their state within the Holy Roman Empire before 1620. Several proposals were put forward, some of them extreme, both by the Dualist state and the nationalities. They were either unfeasible or contradictory (e.g, the Slavic capital should be Prague, Zagreb or Belgrade in the case of a trialist state) (Zeidler, 2008).

Significant changes took place in Europe over the centuries. New political and economic powers emerged while others weakened. Emerging interests, occasional alliances and the wars that followed created two major systems of alliances in Europe:

PSZ 2017. angol.szam_beliv_v16.indd 313 2017. 04. 06. 7:29:13

the Central Powers and the Entente cordiale. The population of the Kingdom of Hungary was about 10 million by 1848, with a 40 per cent ratio of ethnic Hungarians. In 1869 the native population was 13.6 million, 6.2 million of them ethnic Hungarian. According to the last authentic census made in 1910, 54 per cent of the 18 million citizens (9.9 million) were ethnic Hungarians (Figure 2). The population was reduced by the wars in the 19th century, permanent emigration to America totalling up to one and a half million by the time of World War I, and by epidemics. French prisoners of war captured in the Battle of Raab (Győr) during the Napoleonic Wars caused a typhus epidemic in Pécs. In 1831 a cholera epidemic swept across the country, taking victims mainly in Upper Hungary (Slovakia). Half a million people fell ill in the epidemic, and the loss in population was approximately 200,000. In the spring of 1848 cholera once again flared up in Croatia, then it spread to Transdanubia. This caused difficulties in recruiting soldiers for the Hungarian army, but it also prevented the Imperial Army of Jelačić from enlisting more men. The disease was brought in from Poland by the 200,000-strong Russian army led by Pashkievich, with approximately 80,000 soldiers falling ill and 10,000 dying. The most deadly epidemic was the diphtheria outbreak that started at the end of the 19th century, beginning around 1870 in France, killing 30,000 children each year. Plague disappeared at the end of the 17th century, smallpox was eliminated in the 19th century (thanks to vaccination), and epidemic typhus at the end of that century. On the other hand, tuberculosis (morbus hungaricus) appeared in the country, killing masses of people up until the 1930s, and could only be eliminated entirely by the 1940s and 1950s.

The ratio of natural growth within the Hungarian population increased constantly through the spontaneous assimilation of the nationalities and the significant integration and assimilation of Jews fleeing from prosecution in the Czar's Empire. Jews were allowed to flee to Hungary without restriction, since the Hungarian Parliament – the first in Europe – granted free immigration and full emancipation by law. The ratio of ethnic Hungarians despite the fact that in 1848–1849 Serbian insurgents organized themselves into marauding gangs and massacred masses of Hungarians, killing tens of thousands of people, and so did the Romanians in Transylvania, even though the laws of 1848 granted full rights to each inhabitant of the country, without exception. (The entire Hungarian population was killed in the small Transylvanian town of Nagyenyed/Auid and a pyramid consisting of several thousand skulls was erected in front of the Roman Catholic church. The same happened at Fehértemplom/Bela Crkva in the southern territory.) Major areas, towns and villages became depopulated. Horea's peasant uprising and the carnage of the southern Slavs fleeing the Ottomans in 1526 and after 1690 also had some ethnic characteristics, but at that time the aim was to acquire the land and wealth of the richer and more civilised natives. On the other hand, the mass murders of 1848–1849 were primarily ethnically motivated. However, a significant portion of the nationalities and numerous foreigners supported the war of independence, even in 1849, when the revolutions had been suppressed all over Europe.

In the Congress of Berlin of 1878, Bismarck and Count Gyula Andrássy (the common minister of foreign affairs) enabled independence for the Romanian principali-

PSZ 2017. angol.szam_beliv_v16.indd 314 2017. 04. 06. 7:29:13

ties, then the Monarchy annexed Bosnia and Herzegovina, referring to the imperial of the kings of the House of Árpád – just as they did in the partition of Poland – but the Hungarian leading elite prevented annexation into the Kingdom of Hungary, owing to the deterioration of ethnic proportions.

The Ottoman Empire continued to lose its power in the two Balkan Wars, then after a temporary strengthening of Bulgaria, the always Russophile Serbia became more valuable. The outbreak of the Great War was not unavoidable after the assassination of Franz Ferdinand, heir presumptive to the throne, and the ultimatum of the Monarchy addressed to Serbia was at first accepted, with the exception, among others, that the police force of the Monarchy should be involved in the investigation. (Now, in an era of Interpol and cooperation between the various intelligence services, this rejection is not understandable, as it was not understood at the time, either). The causes of the World War I, the driving force behind the failure of several attempts to make peace, the development of the conditions of peace, and then the historical events that have lasted up until our time are not known even today, or they are misinterpreted, distorted or, as the interests of the great powers were kept secret, these issues are subject to constant discussion. It was a fact, however, that the Hungarian Prime Minister Count István Tisza opposed the war, taking a stance against the German and Austrian commanders-in-chief, the political elite and the two Emperors. When he could no longer maintain his position, he demanded that the Monarchy declared that it had no aim of territorial expansion. The war broke out seemingly for prestige, degenerated finally into an ideological kind of war, and then peace was made based on the interests of the great powers. Two members of the Central Powers announced their neutrality, which was breached by Italy once (when she entered the war against her former allies), while Romania attacked the Monarchy in 1916 without a declaration of war, but the Central Powers destroyed the Romanian army with a small military force and marched into Bucharest. At the beginning of 1918 Romania signed a separate peace treaty, but before the peace negotiations it was again an ally of the Entente. Until 1916 it had been mostly the Central Powers that had won victories, but the entry of the USA into the war in 1917 resulted in a decisive material superiority for the Entente. The 14 points of U.S. President Wilson promised the opportunity of creating a fair agreement of equal parties, including the right of the nations for self-determination. But in reality, secret pacts were concluded. These secret pacts were enforced when the peace treaties were signed. After the halt of the German offensive of 1918 in the West and the breakthrough by the Monarchy at the river Piave, the Central Powers did not surrender but concluded an armistice, relying on the 14 points of Wilson. At the very beginning of October, Poland was reborn, joined by Galicia in the beginning of November, the Czechs became independent once more, the South Slavs were planning to set up their own state and the Romanians declared their secession. On 31 October Count Károlyi became the Prime Minister and the Republic was proclaimed. According to the cease-fire signed on 3 November 1918, until the peace talks each belligerent party would remain in its currently held positions. The Hungarian armies were stationed beyond the 1000-year-old border in every direction. The soldiers start-

PSZ 2017. angol.szam_beliv_v16.indd 315 2017. 04. 06. 7:29:13

ed going home en masse, 40 per cent of the army in perfect order and with their weapons. At that point Minister of War Linder stated that he "did not want to see any more soldiers." Parallel with the demobilization of the armies, and mainly with the assistance of the French, the Romanian army, which had formerly been disbanded, and Czech and Serbian forces marched into Hungary, modifying the armistice line arbitrarily. After the terms of the Vix Note of March 1919 became known, the radical left made pro-Entente Károlyi resign. For a period of 133 days power was captured by the communists, the social democrats allied with them and the radical liberals, turning internal relations deadly and the maintenance of foreign relations impossible. The soldiers of the Red Army defended their country and defeated and drove back the Czechs who marched into Slovakia. The Szekler Division, a military unit of a few thousand people, that was set up despite the prohibition, slowed down the Romanian army for several months. At the request of the Entente Powers the Bolshevik regime withdrew the troops from Slovakia, while the Szekler Division fell apart after heroic battles. Most of the territory of the country was under occupation. A national army was set up in the city of Szeged and marched into Budapest. The temporary and then the elected Parliament inherited a hopeless situation.

At the same time, peace talks were in progress around Versailles. In the case of Hungary even the Americans gave up the 14 points of Wilson and enforced secret pacts made with leaders of the nationalities. The Hungarian delegation was not invited to the talks and so the accused party was not allowed to participate in the retribution trial and could not tell its arguments or defend itself. After the conclusion they were of the trial allowed to make a final statement before the "execution" (signing). At the same time, each of the demands of the neighbouring states on the Kingdom of Hungary was accepted, sometimes involving brazen lies (e.g. the claim that the river Ipoly, only a few meters wide, is a navigable waterway etc.). It is symptomatic that there were no references to the right of self-determination of nations or ethnic principles, but rather to falsified historical and economic interests. Considered a model liberal state until the Franco–Russian treaty of 1907, Hungary was portrayed by the successor states as the home of feudalism and suppression, a prison of nations. As Francesco Nitti, the Italian foreign affairs minister at the time stated, they wanted to execute Hungary and to bring it into an unmanageable situation. They almost succeeded (M. Kiss–Raffay–Salamon, 2011). Exactly two-thirds of the area of the country was torn away by a dictated peace, including 70-80 per cent of its industry, most of its railways and public road network, natural resources and best lands, and 95 per cent of its forests. Of the estimated 18.3 million inhabitants, including Croatia, 7.6 million remained. 10.6 million people were reassigned to the new countries, including 3 million ethnic Hungarians, 30.2 per cent of the detached population, who lived in blocks on the far side of the newly enforced borders (Table 4). It was at that time that the phrase "Hungary borders on Hungary" was created. A multiethnic, thousand-year-old constitutional state was terminated, carved up into seven parts, and such states were created in which the ratio of nationalities was higher than in the thousand-year-old Kingdom of Hungary (Figure 2). Each of the successor states has disintegrated, the first between

1940 and 1945. One nation state has remained intact in the region: Hungary. One thousand years of history, the principles of geo-economics (the Carpathian basin is a perfect geographic and economic unit), the ethnic principle and the rights of nations to self-determination were all ignored. The population of the detached areas were not even allowed to decide their fate by referendum. In the town of Sopron the volunteers of the 'ragged guards' drove away the Austrian gendarmerie, then the citizens of this small town, most of them German-speaking people, decided to remain part of Hungary by a referendum won by a two-thirds majority. Similar results could have been expected elsewhere as well, since the intentions of the leaders of the nationalities and the opinion of the people often differed (the legal, economic and cultural situation of nationalities was much more favourable in Hungary than the situation of their fellow nationals outside the country).

*Table 4: Share of the successor states of the Austrian Hungarian Monarchy of the territory and population of historical Hungary **

Country	**Area (km^2)**	**Population (persons)**	**Of which ethnic Hungarian (%)***
Czechoslovakia	61,633	3,517,568	30.3
Romania	103,093	5,257,467	31.6
Kingdom of Serbs, Croats and Slovenes	20,551	1,509,295	30.3
Austria	4,020	291,618	8.9
Italy	21	49,806	13.0
Poland	589	23,662	1.0
Total loss	189,907	10,649,416	30.2
Hungary after Trianon	92,963	7,615,117	88.3
Historical Hungary	282,870	18,264,533	54.4

** Figures excluding Croatia-Slavonia; based on the figures of the 1910 census on mother tongue*
Source: Ember, 2007

The occupying armies plundered the country (the Romanian army alone, which also occupied Budapest, robbed some 20-30,000 railway wagon's worth of goods, ranging from typewriters and furniture all the way to the entire machine stock of factories, and herds of horses and cattle); the armies took everything they could lay their hands on (Bandholtz, 1993).

In the restored Kingdom of Hungary the Habsburg dynasty was dethroned and, after Hunyadi and Kossuth, Horthy was elected to be the third governor of Hungary. He developed an autocratic political system that showed signs of both democracy and dictatorship, mainly under the leadership of Transylvanian aristocracy. Although recovery seemed impossible, state administration was organized, finances were consolidated, the economy was developed, the system of education was developed from primary schools all the way to universities, the complete political and economic blockade of the Little Entente was broken up, and the ethnic Hungarian communities in the

PSZ 2017. angol.szam_beliv_v16.indd 317 2017. 04. 06. 7:29:13

'successor states' received support. The country operated one of the best healthcare systems in Europe, primarily on the basis of solidarity. Every branch of Hungarian culture flourished (e.g. music: Bartók, Kodály and Dohnányi), almost all of Hungary's 15 Nobel Prize winners completed their school education between the two world wars, Hungary was one of the first countries to develop cinematic art (some of the Hungarians involved in filming, e.g. George Czukor, created Hollywood), and the sportsmen who won two silver medals in the Hungarian national football team (1938, 1954) and those who came third in the Olympics of Berlin (1936) and Helsinki (1952) grew up at that time. The ethnic Hungarians of the successor states suffered from several kinds of discrimination, with the victors violating the Treaty of Trianon in several ways. However, the national unity of Hungary was strengthened substantially. Every Hungarian party and organisation in the home country and in the successor states concurred that Trianon was unjust and could not be justified by any means, and that the thousand-year-old integrity of the country must be restored, either with ethnic boundaries or wholly. Trianon allowed for peaceful revision, though no active support could be expected from England and France (they declared themselves uninterested in the first and second Vienna Awards, but were not opposed to them, leaving the decisions to the Germans and Italians). The events of the World War II are well known, of these I would like to highlight that Austria was united with Germany with extreme enthusiasm, approving the unification in referendum with a majority of 97 per cent. All the rest of the successor states disintegrated, and in Munich the four great European powers accepted the partitioning of Czechoslovakia. Czech manufacturing industry supported the Wehrmacht at full capacity, and the Slovak leader Tiso immediately formed a close alliance with Hitler.

Romania was partially dissolved and the Kingdom of Yugoslavia disintegrated to its constituent part in the course of a brutal civil war. Between 1938 and 1940 Hungary peacefully regained part of Slovakia, Subcarpathia and northern Transylvania.

In 1941 Hungarian troops marched into the other territory 12 days after the Kingdom of Yugoslavia was terminated by the secession of Croatia; Serbia, the only country in the region that defied the Nazis, was defeated by the Germans. The population welcomed the revision without almost any resistance, with great enthusiasm in every detached area. Hungary did not want to participate in the war, but did so after the Romanians, Slovaks and Croatians and, furthermore, because the geopolitical location of the country made neutrality impossible; after an act of provocation it entered the war, which it tried to leave after 1943, but without success (Püski, 2010).

The country was occupied by the Germans on 19th March 1944, and lost its independence, which was only restored in 1990. Prosecution of persons with patriotic rightist and leftist views began, several hundred thousand Jews were deported to Germany until the middle of the summer of 1944, then after the coup d'état of the Arrow Cross party (15 October 1944), this was increased further. The country became a battleground, it was devastated and plundered by the Germans, then by the Soviets. The communist regime was forcibly introduced by arms, terror, propaganda and the application of other Bolshevik means, overcoming significant resistance. Apart from

PSZ 2017. angol.szam_beliv_v16.indd 318 2017. 04. 06. 7:29:13

some groups of the narrow elite echelons of the Bolshevik party, every group in society was injured legally, socially and economically. This became the cause of the revolution and fight for independence of 1956, in which a country of ten million took up arms to fight for freedom against a superpower. As in most cases during its history, Hungary did not receive assistance from any party, including the UN; no armed assistance came despite some uncertain promises, and so the Soviet Union successfully suppressed the fight for freedom.

After the retribution, in the Kádár era the communist system did not essentially change, but fearing a repeat of the revolution the leadership tried to establish more beneficial social conditions ("Goulash Communism"). While the great powers followed the apparently coordinated strategy of non-intervention, Hungary let the East German refugees across the border and into Austria in 1989. This tipped the first domino of the socialist countries, which in turn tipped all the others within a few months. The Treaty of Trianon once again proved unviable. The Soviet Union was terminated, and independent states with large Russian minorities declared their secession from it. Czechoslovakia split in two, and Yugoslavia fell apart in an extremely brutal war, with its nationalities acquiring independence. Hungarian minorities continued living in Slovakia, Ukraine, Slovenia, Serbia and Croatia, countries that previously did not exist before, and in Romania. The states of the region joined NATO and became or will become members of the EU.

From the outbreak of the World War I to this day, Hungary has lived through at least nine different and contradictory political and ideological regimes. After the kingdom, the Republic was established on 31 October 1918, followed by the Hungarian Soviet Republic. After its downfall the new regime that lasted until 19 March 1944 was a national – conservative – Christian state hallmarked with the name of Horthy, which was terminated by the German occupation and the Arrow Cross coup d'état after 15 October 1944. This was followed by the Soviet occupation after 4 April 1945, the regime of coalition governments under illegally expanding Bolshevik supervision until 1947, then came the Stalinist Rákosi dictatorship until 1956, the revolution and freedom fight between 23 October and 4 November 1956, followed by the Kádár regime, and from 1990 the parliamentary democracy established by parties that won free elections. The ruling nations of the successor states also had to undergo a significant part of these painful changes, and the difficult conditions of the Hungarian minorities living in these countries were compounded by the enforced policy of assimilation, and the legal, spiritual and material discrimination that came with second-rate citizenship.

In the cataclysm of the 20th century, after Trianon we lost 10.6 million fellow countrymen, 30 per cent of whom were native speakers of Hungarian. 7.6 million people remained in the rump state, the ratio of ethnic Hungarians was 88 per cent (the only ethically unified state in the region). As a result of natural growth, their number once again approached 10 million. By peaceful territorial revision the area of the country increased from 93,000 km^2 to 172,000, and the population rose to 15 million, which was lost after the Peace Treaty of Paris (1947). The birth ratio had been 34-35 per

PSZ 2017. angol.szam_beliv_v16.indd 319 2017. 04. 06. 7:29:13

thousand until 1914, which had been steadily decreasing since the Treaty of Trianon (5.28), and it has been a negative figure since 1981; in recent years the fertility rate has been 1.34 children, lower than the mortality rate. Since then the population of the country has steadily decreased. Since the World War I, 300-500,000 people have fled from the successor states to the rump. Acting on the Beneš decrees enacted after the World War II, 60,000 ethnic Hungarians were relocated from Slovakia. The number of Slovaks who chose repatriation was lower. Several tens of thousands of Hungarians of German extraction, most of them assimilated, were deported, and Szekler refugees from Romania took their place. Tens of thousands of ethnic Hungarians in Transylvania returned to the mother country first illegally, then legally. The number of ethnic Hungarians living in the successor states (3 million) had decreased to 2.4 million by 2001 (Table 4). This trend continues. Since in 1939 Horthy did not permit the Wehrmacht to march across Hungary despite the most emphatic request of Hitler, hundreds of thousands of Jews and Poles who found themselves in Nazi and Bolshevik pincers fled to Hungary across the common border. Prosecuted Jews also fled from other European countries, mainly after the accession of Austria to Germany.

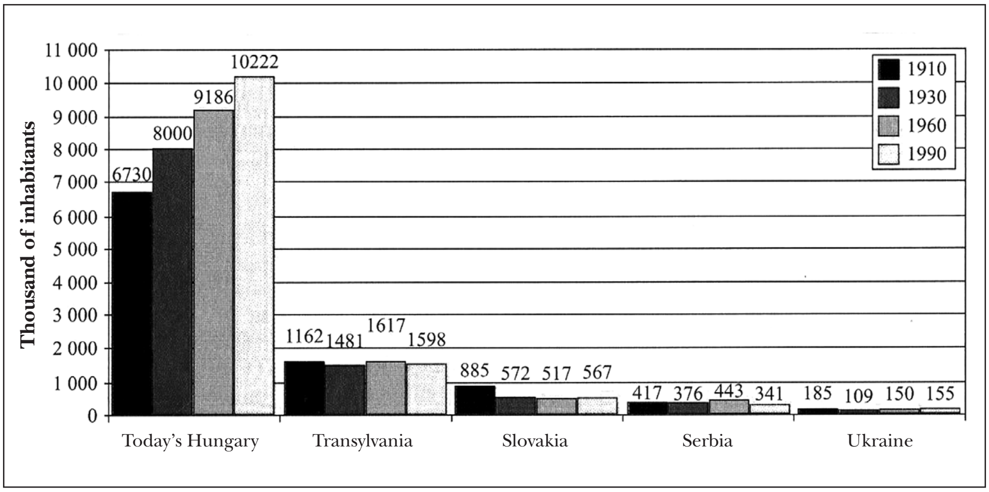
The military losses of the World War I and II were 1 million persons each. These figures included two genocides. During the Holocaust several hundred thousand fellow Hungarians were deported to extermination camps, in addition to the Jews, members of the resistance movement (including the son of the Governor) and a few thousand Roma. In the Novi Sad raid of 1942 Hungarian combatants executed about 3500 people, while at the end of 1944 and the beginning of 1945 the partisans of Tito massacred about 35-40,000 Hungarian civilians. The fascists of Slovakia and the Maniu Guard in Romania killed a few thousand people, but the number of ethnic Hungarians who emigrated from the hinterlands is unknown. We lost about 200,000 ethnic Hungarians in Soviet war captivity for various causes. The purges after 1945 took the lives of about 30,000 people, but the number of people who fell in the freedom fight of 1956 and in the retaliation is lower than that. For the last one hundred years emigration has exceeded immigration. After the era of the Hungarian Soviet Republic only a few hundred Bolsheviks fled the country, and a few thousand persons left owing to the spread of fascism and the strengthening of the Nazis before and during the World War II. Between 1945 and 1948 several hundred thousand people emigrated from Hungary, and after 1956 over 200,000 people left the country. The most educated, cultured and wealthy groups in society fled the country (including 3000 university lecturers).

At the end of the 19th century (antisepsis – Ignác Semmelweis, asepsis – Lister, vaccines) and in the first half of the 20th century (discovery of bacteria, increasingly efficient medications) epidemics caused by bacteria were terminated, but epidemics caused by viruses were not. The Spanish flu swept over Europe in three large waves and substantially affected Hungary as well. The virus infections of recent decades (AIDS, West Nile fever, Ebola etc.) and the danger of already terminated epidemics flaring up again can be associated with global tourism, migration towards Europe and "sexual liberation."

PSZ 2017. angol.szam_beliv_v16.indd 320 2017. 04. 06. 7:29:13

The ethnic Hungarian communities of the successor states were also inflicted by enforced assimilation. One million ethnic Hungarians disappeared because they rejected their ethnic identity. The destination of emigration caused by discrimination was mainly Hungary at first, then in the last decade the countries of Western Europe (Figure 2).

Figure 2: Changes in the number of ethnic Hungarians between 1910 and 1990, according to census figures



Source: Ember–Molnár–Varga, 2009

At the end of the World War II the prohibition on abortion was suspended because the Soviet Army raped several hundred thousand women, from teenagers to old women. The aggressive syphilis epidemics of the Middle Ages avoided the country – in the 19th and 20th centuries it was sporadic and mainly affected bohemian circles –, but in 1945 480,000 doses of Salvarsan handed out. In order to create more cannon fodder for the next world war, the communists introduced an extremely stringent prohibition on abortion. In the era named after Bolshevik minister Anna Ratkó, natural growth increased significantly and, furthermore, the children and grandchildren of the children born in that era also increase the number of births while they are of child-bearing age. After the laws on abortion were slightly liberalized in the Soviet Union in 1955, all restrictions were totally lifted in Hungary, which is unique in the entire world. As a result, to this day 6 million abortions have been performed, thereby causing one of the worst demographic disasters of the Hungarian nation. If it had not been so, there would be over 20 million ethnic Hungarians in total (Für, 2001).

Summary: having been spontaneously formed from populations of various ethnicities, the Hungarian nation created a special legal system and state organization, society and culture over a period of 600 years, as a sovereign and complete medium-sized power, acknowledging the sacredness of the kings of the Árpád House, then the traditions and cohesive power of the Doctrine of the Holy Crown. This natural development

PSZ 2017. angol.szam_beliv_v16.indd 321 2017. 04. 06. 7:29:14

was arrested for half a century by the Mongolian invasion, the attack of a world power that was alien in every respect and to which the Kingdom of Hungary offered armed resistance, which resulted in the extermination of about 30 per cent of the population, while the ethnic composition of the country did not change. In the 300 year-long war against another foreign world power, the Ottoman Empire, the national was bled dry, its sovereignty and integrity were impaired, and the number of ethnic Hungarian inhabitants fell from 4 million to one-third of this figure. After the Ottomans had been driven out, the fact that the Habsburg emperor was the King of Hungary ensured the territorial integrity of the country, the constitutionality of it being separate from the rest of the empire, and its sovereignty tied to the interests of the empire; the violation of this sovereignty was restored after two wars of independence (1703–1711, 1848–1849), first by a peace treaty, and then by conciliation. The two-thirds of the population lost during the wars against the Ottomans was replaced by refugees and immigrants who came of their own accord and often received support, but the ethnic ratios did not reach their original level, although they did improve. After the end of the Austro-Hungarian Monarchy, Hungary was torn up into seven parts and two-thirds of the area of the country was taken away under the terms of the Treaty of Trianon, which could not be justified by any set of arguments. Over half of the inhabitants of the country, 54 per cent of them ethnic Hungarians, were forced to become citizens of foreign countries; this covered 30 per cent of the entire community of ethnic Hungarians.

For 1000 years Hungary defended Europe (the "Schengen borders") based on systems of ideals through the changing historical eras. Owing to its laws, traditions and ideals, it welcomed all refugees and immigrants without any kind of discrimination, most of whom were integrated into Hungarian conditions. The majority of these people assimilated spontaneously and fully (Pechenegs, Cumans, Jász, Italians, Poles, Bunjevci, Swabians, Saxons, Armenians and minor ethnic groups), while others only assimilated only partially (Serbs, Slovaks, Jews, Wends). Some of them referred to themselves as Hungarians (Ruthenians and Roma).

Integration was voluntary, and assimilation took place spontaneously. Practically there were no efforts at forced assimilation. Some of those refugees and immigrants who lived in blocks and accepted the Hungarian state regime developed a parallel national identity owing to nationalism emerging in the 19th century, and different religious affiliations under the influence of religious and secular leaders; they did not assimilate and provided an excuse and argument for splitting up the one-thousand-year old country, whether or not the majority approved of that. They were assigned to artificially-created or enlarged states that did not prove viable. Having been forced into the successor states, the ethnic Hungarians could not even exercise the rights sanctioned by the Treaty of Trianon. They did not assimilate, despite many kinds of powerful violence and coercion. The community of Hungarian immigrants in the West was partially assimilated, and partially it has a dual identity, maintaining the awareness of its origins, sometimes for several generations.

Despite wars, waves of emigration and the liberal abortion law, during 1100 years the community of ethnic Hungarians has multiplied: from a people of a few hundred

PSZ 2017. angol.szam_beliv_v16.indd 322 2017. 04. 06. 7:29:14

thousand it turned into a nation of fifteen million. Despite the coercions after the Treaty of Trianon, it has grown by fifty per cent – across seven countries – over the last one hundred years, and still remains the largest population in the Carpathian basin, a perfect geo-economic and political unit (13-15 million), with immigrant communities in the Americas, in Western Europe and in Australia totalling millions.

This is why we are optimists.

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Béla Kolozsi

About the Hungarian Autonomous Territoriality of Szeklerland

The Autonomous Enclave Within Romania: A Second Territorial Entity Where the Hungarian Ethnic Group Is Concentrated

Summary
The fact that after World War II, during a historical period internationally considered as fully legitimate, a Hungarian autonomous entity was established in Transylvania that has not been possible to be eliminated by any fair and legal means, should be the focus of an ongoing fight for Hungarian territorial autonomy in Romania. This autonomous entity is able to provide the necessary structural, administrative and political framework for the Hungarian ethnic group and can also ensure security in the region. The structural build-up of Szeklerland as an autonomy is an important priority task. The option of depriving the Szekler region of its national and ethnic autonomy must be rejected and the boundaries of the entity should be modified and finalized in agreement with the Romanian nation.

Keywords: Szeklerland, territorial autonomy, Trianon

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PSZ 2017. angol.szam_beliv_v16.indd 326 2017. 04. 06. 7:29:14

Not more than five years after the Paris Peace Treaty of 1947 which confirmed that Szeklerland[1] would remain attached to Romania with borders similar to those before 1940, an autonomous area named Hungarian Autonomous Province (HAP) was established within the borders of the Romanian state. The Hungarian Autonomous Province was established in accordance with the political statutes in effect in the region at the time, in a legalised manner not contested internationally. In 1960, however, a unilateral Romanian 'amendment' was introduced concerning the territorial scope of the HAP, and then Ceauşescu took it all away in 1968. This action was not legitimate to any extent. For this reason, the current demand for the territorial autonomy of Szeklerland is not some sort of new-fangled pure 'endeavour', but rather the re-securing and release from blockade of a state of legitimate territorial autonomy which cannot be unilaterally revoked, but has, nevertheless, been *de facto* 'revoked'.[2]

After World War I, Szeklerland was taken from Hungary; not only by the agreement of the international community, but also in the Hungarian constitutional law. The secession did not take place at the time the documents were signed at the conference table in the Grand Trianon Palace, but rather when – after the legislative bodies of other states affected by the treaty had done so – the Hungarian legislative body also ratified it and made it into a constitutional Hungarian legal act in the summer of 1921. Little bit more than four years after the region had been re-attached to Hungary in 1940, the re-attachment was invalidated on 15 October 1944, upon the proclamation of Hungary's governor, and the region legally became Romanian territory again in line with Moscow's conditions of truce.

The ratification of the treaty in 1921 and the peace treaty of 1947 were essentially inequitable, but lawful as to their form and the international law. The unilateral 1968 annexation and purloining of the subsequent Hungarian autonomy covering Szeklerland, on the other hand, was not sufficiently legitimate even in terms of form.[3] Similar to the sovereignty of a state, the granting of ethnic and national territorial autonomy is not some sort of a loan or "temporary deposit" which the 'grantor' may take back arbitrarily, with or without some false excuse. For this reason it is this annexation and seizing of autonomy, executed by Ceauşescu, which must first of all be countermanded and corrected today; and the lawfulness of the Hungarian demand for such correction must be understood and made understood. Szeklerland, as well as Hungary as the 'parent country' of the Hungarian minority, and even Romania at the time of the fall of Communism and ever since, should have put and kept on the agenda the reversal of the unlawful annexation of autonomy, fabricated by the dictator in 1968. One of the criteria for the change of regime in Romania to have been accepted as meaningful would have been – and still is – a universal *ex post* refusal of the seizure of autonomy in 1968, which would have become possible with the fall of Communism. The failure to raise this issue after the fall of Communism was a case of gross negligence.

Naturally, the granting of territorial autonomy of a national nature is *not the same* as granting independence (as was done in the case of other states in post-colonial times). It is still *similar*, however, and the granting of autonomy could even be construed as a kind of in-between status in that direction. The relationship arising between the gran-

PSZ 2017. angol.szam_beliv_v16.indd 327 2017. 04. 06. 7:29:14

tor and the grantee on account of the granting of ethnic and territorial autonomy is one between nations rather than one between states; therefore the nexus between the grantor and the grantee includes components of international law and politics relevant between nations and not between states. Any change thereto – and especially its abolishment – cannot therefore be interpreted and executed as an issue purely within a state or a nation state. Szeklerland, with its Hungarian majority; but also South Tirol and the Åland Islands, each was granted autonomy lawfully by a power of decisive might in the respective region. The so-called 'revocation' of only one of them – the Hungarian autonomy of Szeklerland – violated and still violates the international law, and indirectly possibly even the legal principles underlying the autonomy of South Tirol and Åland, as the autonomy of these latter two was raised and granted to a major extent by external great powers. What is more, 'changing' the territorial autonomy of Szeklerland to 'Mureş Hungarian Autonomous Province' in 1960, and changing its territory, was – and still is – in itself unlawful on account of being unilateral.

In the case of the autonomy of South Tirol, Austria, where the area belonged until 1919, acts as a protective power. As pointed out above, the autonomy of South Tirol (a kind of internal quasi state within Italy, which is, of course, more than just a 'stripped-down state') was established against the same background: motivation, and the approval of a great power – of a Western one here and of an Eastern one there – as the Hungarian Autonomous Province in Szeklerland. The HAP has links to Hungary in the same way that South Tirol has links to Austria. More recent reports indicate that the picture of South Tirol as a model for autonomy is fading as they "want to belong to Vienna again" – which shows that even the affluence they enjoy does not make the differences in language and culture disappear. Mayors in South Tirol in the north of Italy are asking for their self-determination rights to be reinstated. The Hungarian autonomous entity, on the other hand, does not pursue any kind of reunification – which can be linked to the absence of territorial continuity and due to the geographical separation of the two blocks of Hungarian population.

Naturally, the Romanian governmental elite does not deny that Romanians are a minority in Szeklerland (they make up one fourth of the population). Romania might argue, however, that national majorities are local minorities in many places and minorities often constitute a majority locally, as is the case with Romanians in the Hungarian village of Méhkerék or with Russians in East Ukraine, and therefore there is nothing extraordinary about this fact.

A notion of relevance to our topic is that "one's awareness of national identity is often associated, not only with people, but with various forms of living and physical reality. To landscapes; geography; the countryside and to the abstractions of the countryside, such as maps and drawings of the country […] Analyses of the Hungarian national identity mention that for some Hungarians with strong emotional attachment to the drawing of historical Hungary, the beauty of this map of the country is strongly associated with the drawing. We might add: also, perhaps, the image of a well-baked Hungarian loaf of bread: the top curvature and arch of that image. Bread, then, is the symbol of life; the fresh hotness of which is associated with 'home'. To be satisfied, the

PSZ 2017. angol.szam_beliv_v16.indd 328 2017. 04. 06. 7:29:14

soul somehow needs all of this together: a home, the warmth, the flavour, the homeland with its wooded hills that is shaped like an arched loaf of bread. Still, in addition to being all of the things listed above, one's homeland is primarily a community of people. […] The territory of the Roman state is shaped like some sort of a disc, an irregular circle. The pre-Trianon Romania was not so; today's Romania is. Between the two world wars, with its borders at the River Dniester and the wider Dobruja region, it was even more so; and 'Romania of myths', possessing also Transnistria and stretching to the River Tisza, is probably the most so. Did the Romanian people settle in a country-sized homeland universe shaped like a circle, a disc? Not quite, of course. Rather, it was a relatively wide circular strip, a ring. Szeklerland, small in comparison, is located at the centre of this ring. While it is located in the middle of this ring, the 'country of the Szeklers' is not part of the ethnic 'Romanian globe' where Romanians dwell – as evidenced in the drawing of Romania fifty years ago, when Romania still officially included the Hungarian Autonomous Region, and has since never been fully abrogated. Should Romanian patriotism disregard such 'central but still outside' location as immaterial? Should it be uninterested in the actual location of the Romanian nation? With some pathos: should it be uninterested in its national inclination as manifest in the movement of the people and in the patterns of settlement? One can hardly say Yes to that question… […] When a European nation attempts to assimilate culturally another European nation or even only a portion; or by destabilising its self-governance and autonomy, then it is somehow treading a path that is neither noble nor acceptable. If a large nation is doing this to a small fraction, then – let it be said – it is also petty, and such pettiness can make it pitiable and fallible" (Kolozsi, 2010).

The affairs of the Hungarians living in Szeklerland, and the territory itself, are not regarded by Romanian official entities to be of a scale that is unmanageable within the current political and administrative framework and necessitating the establishment of territorial autonomy. Therefore if autonomy does, indeed, have to be created right now, the Romanian official entities could defend and represent this view better than if they had to defend the seizure of territorial autonomy that once used to exist, including defending it from the criticism of annexation.

Going back in time, it should be pointed out that the peace treaty signed in 1947 in the Luxembourg Palace in Paris was, similar to its predecessor in Trianon, lawful under international law. According to Hungarian misinterpreters, the process has only one step leading up to the current situation which is not certain to be fully legitimate internationally. People who think this way tacitly accept the unilateral elimination of the Hungarian Autonomous Region by Romania, as what they condemn is the existence of the one-time autonomous area, having been, they say, "created by Stalin and a foreign great power". Why, wasn't Trianon brought on by the great powers, and then Paris by Stalin? All this was decided by the great powers, not only the autonomy granted to Szeklerland in 1952 – and of course, this was done the way everything else was done in the area at the time. The unilateral revocation of the territorial provisions by Romania was, however, the worst of all of these. The Hungarian side should keep protesting that the subsequent revocation by Romania was unlawful, as something once granted cannot then be unilaterally withdrawn. Say, for example, the independence of Algeria could not have been revoked by France by saying later that as it had been granted by France, why could France not revoke it if it saw fit to do so? We should not be begging for autonomy for Szeklerland as the demand is legitimate for the same reason: its revocation was unlawful.

In the Trianon Palace, in Vienna Belvedere, in Paris; then finally in Moscow and ultimately at the Communist Party headquarters in Bucharest when the revocation was decided; areas were passed back and forth between Hungary and Romania, between the Hungarian and Romanian nations, truly without any kind of international participation. Apart from the states of Hungary and Romania, Moscow was the last place where issues were actually decided. There, the designation of status took place between the nations, although not between the states. There we were given something, as some kind of a compromise, which in terms of territory was more than we currently have.

By the way, the stability of the territory of states is of important international value and interest which should be safeguarded, even by the winner of a war.

When Hungary was still a winner of the war in the fourth year of World War I, it did not attempt to annex Csángóföld (Ceangăii) in the peace treaty of Bucharest of spring 1918, through which Hungary emerged as a winner, even though that area was contiguous with Szeklerland and was populated by Hungarians. In the spring of 1918, Romania was "forced to sign the peace treaty of Bucharest with its head bowed. Hungary, which was one of the winners, was magnanimous, unlike Bucharest a little while later, when it coasted in alongside the then winning Allies. Yes, coasted, as Romania's separate peace agreement caused it to lose favours with the Allies, Romania was no longer party to the Entente, nor a combatant in any meaningful sense. Two years later in the Trianon Palace, Romania secured for itself not only the areas along its former borders, which were populated by Romanians but – as we know – also plenty of regions with a Hungarian population. Hungary, however, at the time of its victory, which later proved fleeting, refrained not only from trying to appropriate areas with Romanian population in the peace treaty of spring 1918, but did not even claim for itself the areas directly outside its borders at the time, which were populated by Hungarians. Even though there were such areas: namely, as mentioned earlier, the Csángóföld (Ceangăii), which directly adjoined the Hungarian Szeklerland in Hungary. The Hungarian border could have been moved easily (and not at all unfairly) in terms of ethnicity, not excluding from the Hungarian state the directly adjoining areas which supported Hungarian populations. The leaders of the Hungarian government, however, considered historical traditions and long-term stability more important. Was such Hungarian restraint born of a nobility of spirit? In the context of the end of the Great War, one should not only remember Trianon, but also this peace treaty and the fact that Hungary did not, even when winning, grab the Csángó lands with its Hungarian population makes it evident how unfair the panicky, mean-spirited, chauvinistic Romanian politics is when it pants for the removal of Hungarians from Csángóföld, claiming danger" (Kolozsi, 2011).

PSZ 2017. angol.szam_beliv_v16.indd 330 2017. 04. 06. 7:29:14

The granting of independence as well as of autonomy is a non-symmetric act, a non-revocable action. Once granted, independent status – or in the case of autonomy, greater independence – may not be withdrawn by applying the same logic as when it was granted, only in reverse. If the Hungarian party were to accept the seizure of its territorial autonomy, it would make any future struggle for autonomy meaningless from the outset, as even the winning of such internal self-determination would intimate, as "part of the package", that it might be revoked at a later time. This is why we *must* not accept with indifference and in an implicit and self-destructive manner the expropriation of our autonomy that took place in the previous century in a stealthy manner (under the pretext of transformation of the public administration system).

It is obviously unacceptable for an entity with territorial self-determination to lose its identity or its right to exist just because – similarly to its immediate international environment – it used to have a bad dictatorial political structure forced upon it during a previous political regime. It is easy to see that if anyone wanted a fully sovereign state to cease to exist due to a former unacceptable political structure, it would not only be outrageous but anarchistic or downright comical. Nothing like this has ever happened. Would it then be acceptable to seize even a part of the territory of a country or an autonomous entity because, in the era of 'ugly regimes', it, too, had an 'ugly regime' forced upon it, similar to its neighbours? Just as a state will not lose its sovereign territories due to its former political fallacies, an autonomous entity must not lose its territory for such reasons either. National territorial autonomy, which is derived from nations' right to self-determination, can obviously not lose its existence rooted in the same right.

Territorial autonomy promotes good relations between nations formerly engaged in territorial conflicts. In this respect the relationship between Germany and France is often interpreted as a model of some kind. In the context of the improvement of the relationship between Germany and France, let us not have illusions with respect to the relationship between Hungary and Romania: we must take note of the differences, both permanent and temporary. Such differences are manifold. Hereunder, let us address only two of them. One difference concerns the ratio of the minority group living in the autonomous territory to the total population, and the magnitude of the land that changed hands in the course of history along the River Rhine and in Romania. The other concerns the attitude of the ethnic groups involved towards compromise, which can be considered historical even though it only goes back a few decades.

After the end of World War II, the Saarland, located along the French border of Germany and in the French sphere of interest, could not join Germany right away as peace came – its status was kept uncertain for years. Alsace and part of Lorraine were permanently joined to France, but France authorised referendums to be held on joining the adjacent Saar to Germany on 23 October 1954 and on 23 October 1955. The voters chose Germany, and this province has been a stable part of Germany and one of the German 'Lands' ever since. Shouldn't something have occurred just like

PSZ 2017. angol.szam_beliv_v16.indd 331 2017. 04. 06. 7:29:14

this in the second half of the 20th century between Romania and Hungary? Nothing of the sort did. Some form of minimal compromise, which was later made to 'evaporate', also came into being here in the same decade as the plebiscite on the Saar was held: namely, the establishment of the Hungarian Autonomous Province in Szeklerland. A region with deep-rooted traditions of autonomy and supporting a largely Hungarian population of the same magnitude as that in the Saar. Its establishment was stipulated in the Romanian constitution. Although a relatively small area and with only partial 'sovereignty', this still was proclaimed as a Hungarian autonomous area, and an act like this – the granting of sovereignty elsewhere or the proclamation of autonomy here – is not reversible simply by the will of the 'grantor'. As stated above: after autonomy is granted, its perpetuance or ultimate dissolution is subject to the very same autonomy.

Due to the peculiar, enclave-like geographical position of Szeklerland, an option similar to that of the Saar, i.e. its joining to the nation state, was not and is not feasible for the region. On account of its enclosed geographical position and relative self-sufficiency within the state, Szeklerland should have remained de facto autonomous; naturally after undergoing a democratisation process as the majority nation, the entire country and the whole region. Szeklerland could and should be functioning in that way in that era of "shared sovereignties" of Europe.

The social and political structures changed around 1990 along with the political regime, but rule of law – being more subtle than institutionalisation –, legality, legitimacy and real self-governance is only now starting to take root among the principles defining the region. That is for this reason that a genuine, deep and organic reconciliation of the German-French type has remained here a task requiring great efforts, a "Herculean" task, one might say. But it must be achieved, however, together with a functioning territorial autonomy (Kolozsi, 2009a).

It is worth bringing up an international example of 'rights are retained despite annexation'. For approximately five decades, since 1967 to be precise, territories occupied by a very significant power in the Middle East, the State of Israel, have been subject to a very peculiar international interpretation and treatment. Over these five decades, it has not been possible to legalise or find legitimacy for any kind of removal of these areas from the lawful status that these areas legitimately held 50 years ago and still held today. No such legitimacy has been pursued by any party, either. In 1967 the Hungarian autonomous region of Szeklerland was still in existence in the "territorial sense" of the word, according to the political and administrative framework of autonomy in line with the political conditions at the time. As in the Middle East, de facto territorial changes were made here as well one year later. Bucharest quasi annexed the autonomous status of the area; but doing so could not have changed the legitimate conditions here either – nor could it have done so ever since, similar to the situation in the Middle East. With respect to the territories occupied by the State of Israel, the United States of America and the great European powers have recently declared – being pressured by the Palestinians and other stakeholders as well, naturally – that the legitimate conditions have not changed. This principle should also be

PSZ 2017. angol.szam_beliv_v16.indd 332 2017. 04. 06. 7:29:14

asserted in a more determined manner with respect to Szeklerland, as the two situations are similar and have existed for the same length of time.

To really argue for the comparability and similarity of the territories occupied by the State of Israel that are recognised to have maintained their status with the annexation of the Hungarian autonomy; Hungary and Szeklerland must sufficiently convince themselves as well as others that the Hungarian autonomy for Szeklerland is still lawfully valid today and that it is the revocation of such autonomy and the implicit tolerance of such revocation that are invalid. Quite a few have been bamboozling the Hungarian audience by saying that the territorial autonomy was decreed under communist rule, making self-destructive statements to the effect of "Hungarians don't want this territorial autonomy, because it is a bad communist autonomy!" This is nothing but a bluff. Territorial autonomy has not been declared and implemented only within communist countries; but only in a communist country has it ever been ended by the stroke of a pen.

A concern is sometimes raised that territorial autonomy might be harmful to Hungarians living outside such an autonomy as they could become some sort of second-rate Hungarians, even in their more immediate world, on account of being excluded from areas with partial self-determination. One should not fear that Hungarians outside the autonomy would be disadvantaged, as the existence of Hungary itself is obviously not harmful to them, even though it does not share their existence and pain as a minority. Quite the contrary, the existence of the mother country offers them benefits, support and strength. In addition to Hungary, the Autonomous Territorial Entity of Szeklerland could assume the role of a partial mother country and offer more effective support to the Hungarian population living elsewhere, often sporadically, in the historical region of Transylvania.

When Széchenyi[4] and Wesselényi[5] talked about "our two homelands" and the double identification of all Hungarians, they meant Hungary and Transylvania; the latter being detached then as well. Today, by two homelands, we should mean two disjointed territorial entities: a country (Hungary) and an autonomy (Szeklerland), both of which are incomplete when compared to the historical country – but we should mean no less than that! This is also the heritage of the two classical patriots mentioned, and of the notion of two homelands.[6] Hungary, or more accurately, the area covered by predominantly Hungarian settlements belongs not only to the major continental region of Central Europe, but in many respects also to Southeast Europe. For some years now, all Southeast European nations that live scattered like Hungarians (Serbians, Croatians, Romanians, Albanians, Bulgarians, the Turkish, the Greek) have been living in two entities – all except Hungarians, as the second Hungarian entity has been annexed by Romania, the state providing the framework for its autonomy (Kolozsi, 2009b).

The possibility of continued divestiture from national and ethnic autonomous territoriality must be resolutely refused. Optimally, once the blockade on Hungarian autonomous territoriality, in place for nearly five decades, is lifted, the borders of the new entity may be finalised by common agreement.

PSZ 2017. angol.szam_beliv_v16.indd 333 2017. 04. 06. 7:29:14

Notes

1 In our interpretation, after territorial autonomy is restored to Szeklerland, another alternative name such as (East) Transylvanian Hungarian Autonomous Region is also possible.

2 The analysis aims at interpreting the issue of autonomous second Hungarian identity not solely from the aspect of Szeklerland but also as a pan-Hungarian issue.

3 Indeed, neither international law nor the standards of international relations are a unified, wholly codified law – they could be the paradigm and theory of just a few participants and interested parties. It should be treated accordingly and considered an argument in a dispute rather than absolute truth. International law is not clearly deducible or applicable to all parties anyway, but is rather a multitude of proposals in negotiation and dispute. All of internal law is not clear, either – if it were, we would not need judges and courts to deliberate on and decide between different interpretations. This "disputational law" is what we find on the topic of autonomy. As a rule of thumb, something that used to work once, something that already existed – such as the reference to the Hungarian Autonomous Region, which used to exist with a specific territorial scope and was then appropriated – is better than something we might "come up with, find out just now".

4 István Széchenyi (21 September 1791 – 8 April 1860) was a Hungarian politician, theorist and writer, honored with the epithet "the Greatest Hungarian".

5 Miklós Wesselényi (20 December 1796 – 2 April 1850), was a Hungarian statesman, leader of the upper house of the Diet, member of the Board of Academy of Sciences.

6 Perhaps we should avoid calling the smaller entity a province. The term province carries some kind of "feudalistic", paternalistic, subservient notion, as if it was "provided" by the centre, the greater power, just like the process of the great antique empire that used the equivalent of this word involved some sort of lack of emancipation, and as does the Hungarian designation of the Austrian patrimonial lands, as well as the (incorrect) Hungarian term used for the member countries (Land) making up today's state of Germany. Neither is the term acceptable to denote autonomy in Transylvania, in Szeklerland; rather, the term autonomy or entity should be used to refer to a constituent area, a "member country" within a fully sovereign state.

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PSZ 2017. angol.szam_beliv_v16.indd 334 2017. 04. 06. 7:29:14

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The Educational Policy of the Soviet Dictatorship in Hungary

Summary
In a dictatorship of the kind built by the Soviets, power was exercised in every sector in the form of brutal, blatant and uncontrolled governance. The ideology termed, in most places, Marxism–Leninism was imposed on the people as a kind of a "state religion". From nurseries to universities, from adult education to the media, the official doctrines were hammered into people's heads and claimed to give answers to just about any question. The Communist Party wished to use schools to create obedient citizens. The 1950 curriculum set the objective of "teaching pupils to become conscious, disciplined citizens of the People's Republic, who are loyal to the working class and build Socialism."

Keywords: ideological education, Moscow, communism, Marxism–Leninism

The concept of Soviet-type dictatorship

Soviet-type dictatorship is a stand-alone, legally definitive public law-based regime rather than a state of emergency which, under the provisions of the constitution, is only installed in case of war or some other emergency, and as soon as such an emergency ceases to exist, constitutional order is restored (Búza, 1936). Soviet-type dictatorship was, therefore, a new, independent category of public law which, during its 70-year and 40-year rule in the Soviet Union and Hungary respectively, allowed no inherent trends to evolve that were aimed at radical change of the regime.[1] Totalitar-

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PSZ 2017. angol.szam_beliv_v16.indd 335 2017. 04. 06. 7:29:14

ian dictatorship is a closed system unyielding to any reform, a fact that is sufficiently attested to by failed attempts to carry out such reform (Vajda, 1989:15). A consistent rejection of reforms was not a political mistake but, rather, it followed precisely from the logic of the regime.[2]

A narrow political elite was able to establish totalitarian dictatorship by applying a modern 20th century administrative technique. A type of social regime evolved that resisted all kinds of restrictions as it intended to rule and assume control over all aspects of life.[3] The exercise of power manifested itself in the form of brutal, blatant and uncontrolled authoritarian rule in all spheres of the political system. This exclusivity led to the elimination of any political leeway in society through a simplified technique of exercising political power. A hierarchically structured, extremely centralised one-party state evolved which refused to observe the principle of separation of powers, and which, therefore, centralised legislative, executive and judicial powers. As a result, state and party functions became inextricably interwoven.

The state wanted to rule all aspects of life, even those that were not formerly even remotely related to politics.[4] Headed by a "secretary-general", a dictator with unlimited power, a narrow elite decided on all political, economic, social and cultural issues.[5] The post of secretary-general was not even put to vote at the 17th Congress of the Soviet Communist Party (16 January – 10 February 1934).[6]

The Bolshevik party became an organisation that functioned as a means of safeguarding the concentration of power and totalitarianism. The party, as a body above the law imposed by the state, ruled and exercised control over the entire system of the state and all spheres of society. The secret police used methods of terror to exercise total control over society, the state and even the party, and executed, in addition to enemies proper, potential rivals selected arbitrarily. Politics was criminalised and anybody (even the highest ranking officials) could be held accountable for anything at any time and even sentenced to death.[7]

The ruling elite managed nearly all aspects of the economy including the production and distribution of goods. There has been no other regime in history that has employed such a broad array of financial rewards and sanctions. The ruling elite enjoyed a monopoly on news and information and had a hold over mass communication and party propaganda.

The ideology mostly referred to as Marxism–Leninism, which functioned as a kind of a quasi-state religion, was imposed on the population.[8] This ideology claimed that the Communist Party was the vanguard of the proletariat, and that the communist (socialist) régime would build a perfect society in accordance with the tenets of Marx and Lenin where the principle "from each according to ability to each according to need" prevailed. In fact, it was not the proletariat, but the party elite that exercised power. Even if one believed that party leaders governed in the interest of the proletariat, it could only have taken the same mythological form as "God ruled France through Louis XIV".

The totalitarian dictatorship not only terrorised society, it also tried to transform it according to its own needs. It militarised and atomised the population[9] and sought to crush civil society and the bottom-up self-organisation and independence of society,

PSZ 2017. angol.szam_beliv_v16.indd 336 2017. 04. 06. 7:29:14

weaken the family, traditions and old customs, sever attachment to the homeland and suppress national sentiment. It attempted to eliminate the churches and religion; it banned political parties, associations and civil society movements and organisations.

It follows from all of this that Soviet-type dictatorship was unable to create social conditions befitting human dignity during its 70-year existence. Individuals were subjected to all kinds of constraints in the home, at work, at school and even in their private life. Authorities and their "voluntary" helpers kept an eye on them continuously. The opinion of Zbigniew Brzezinski, advisor to the US president, sheds light on the impact that this regime exerted on individual initiatives.[10] According to him, during its 74-year existence, the mighty Soviet Union was unable to come up with one single invention that was competitive in the global market (the only exception being a few instances of innovation in military technology).

Marxism–Leninism as compulsory ideology

The meaning of the word "ideology" in socialist countries differed from what it meant in democracies. Marxism–Leninism, as an official theory and a set of principles of a weltanschauung character mediated by a central will, was used to justify power directly. All other theories were together declared erroneous, harmful to society and hostile to the state. What the leaders of totalitarian states became aware of was that violence alone was unable to create integrated societies. Marxism–Leninism was used as some sort of "replacement for religion" (Aron, 2006:5), which the Jacobins missed so badly during the French revolution. This ideology was expected to win the masses over.[11] Under this theory, Marxism–Leninism was "God", Moscow "the ecclesiastical seat", the revolution the "second coming of Jesus Christ", "Hell" is punishment administered to capitalists, Trotsky was the embodiment of "Evil" and the communist state "the future kingdom of God" (Nisbet, 2003; H. Szilágyi, 2003; Jászi, 1989).

Marxism–Leninism may have looked attractive for those who would otherwise have perceived their fate as hopeless. It mostly played on the animosity of the poor against the rich (Bibó, 1986:181). Its main tenets can be mastered with ease. Nevertheless, Marx's main works, including *Das Kapital,* often proved opaque and intricate, and the wording was usually ambiguous. A separate department of ideologists was established to analyse long and complicated works. The opinions thus formulated were irrefutable. Sentences lending themselves to multiple interpretations gave reviewers a headache. The man in the street opted for simple ideas and did not bother to decipher intricate details. The dissemination of the tenets of Marxism–Leninism was facilitated by the fact that socialist countries were closed societies exposed to no influences other than the official ideology. Furthermore, elaborated linguistic clichés also helped to simplify reality and depict all "bourgeois ideologies" as harmful.

Ideological education started early at the age of 3. A subject called the *Foundations of Our World View* was taught at secondary schools, and *Dialectical Materialism* was a compulsory course at universities and colleges, with a number of institutions even prescribed a final examination in it. Party organisations at work were responsible for

PSZ 2017. angol.szam_beliv_v16.indd 337 2017. 04. 06. 7:29:14

the ideological education of workers. Legions of official ideologists produced teaching materials, party propaganda documents, brochures and catechisms in accordance with daily political expectations. Ideology had to cover all aspects of life including arts, literature, music and linguistics lest there should be aspects of life left where interpretations other than the official one could evolve.

Marxism–Leninism was also incorporated into the Constitution as an official ideology. Pursuant to Section 3 of the amended Constitution of 1972 (Act I of 1972 on the amendment of Act XX of 1949 and the consolidated text of the Constitution of the People`s Republic of Hungary), the leading force of society is the Marxist–Leninist party of the working class. Party leaders could not have been too happy with the results, as the following was reiterated at the 11th Congress of the Hungarian Socialist Workers' Party (17–22 March 1975): more effort must be made to convince the population to accept the ideology of socialism. The fight against ideologies challenging Marxism–Leninism must resume. "Socialist ethics" must prevail (Rákosné Szőke, 1975).

The exclusivity of the interpretation of the doctrine of Marxism–Leninism was a prerogative of the secretary-general. This was how Marxism permeated Stalin's "ground-breaking" linguistic studies (Stalin, 1950a; Fogarasi, 1952) and economic "approaches" (Stalin, 1950b) Nikita Sergeyevich Khrushchev's programme aimed at bringing virgin land under cultivation[12] and Brezhnev's ideological doctrine on "developed socialism"[13] (Brezhnev, 1979). As history reveals, Khrushchev was to condemn Stalin, Brezhnev was to deny Khrushchev, Andropov was to disavow Brezhnev and Gorbachev was to disown all his predecessors. Each ideological change entailed the rewriting or replacement of the now no longer topical textbooks and related literature. No reference was to be made to failed secretaries-general any longer. One of the most typical examples of the above is the case of István Dolmányos, one of the most disciplined advocates of Soviet-type dictatorship. His book entitled *The History of the Soviet Union* was banned because Khrushchev was removed after the book had been finished. After Dolmányos had submitted the manuscript, he could no longer update his story in accordance with the daily unfolding of political events.[14] Soviet secretaries-general passed down their various theories as feudal rights to their local stewards for "national adaptation". This is how Marxism translated into the methodical destruction of villages in Romania and Castro's rather idiosyncratic dictatorship in Cuba.

Following the Stalinist pattern, Mátyás Rákosi used extensive ideological propaganda not so much to convince, but rather to mobilise society in a repressive way. Events organised daily for propaganda purposes, including the so-called 30-minute Szabad Nép sessions etc., were meant to wear down potential opposition and its resistance at work, at school, at the cinema, at the theatre and at party rallies. Whenever Rákos's or Stalin's name was spoken, enthusiastic applause had to follow. This broke down even passive resistance immediately, because only very few dared to remain seated and not to applaud (Pokol, 1989:416–417).

The Kádár régime used a manipulative rather than a confrontative form of ideological persuasion. It became obvious that the leaders themselves had lost faith in

PSZ 2017. angol.szam_beliv_v16.indd 338 2017. 04. 06. 7:29:14

the official ideology, and Marxism–Leninism was relegated to being a mere means of exercising power. György Aczél[15] judged Kádár thus: "One of his characteristics is that he despises ideologies. Although he chaired meetings about the importance of ideologies and he himself stressed their significance, deep inside he did not think much of them and, in fact, he thought they were harmful... Ideologies were more like decorations that had to be worn, but hundreds of his notes attest to the fact that he despised them." He also despised Marxist teachers "and thought of them as persons who are paid without their doing anything worth mentioning."[16]

The theories of Karl Marx and Friedrich Engels served the purposes above because the classics of Marxism, as they were referred to, were intended to formulate definitive opinions at all times about anything that human civilisation and the human mind invented or discovered (H. Szilágyi, 2003).

The issue of "free" schooling

Pursuant to Section 70/F of Act XX of 1949 on the Constitution of the Hungarian People's Republic, the Republic of Hungary guarantees the right of education to its citizens. Pursuant to Sub-section (2), "The Republic of Hungary shall implement this right through the dissemination and general access to culture, through free compulsory primary schooling,[17] through secondary and higher education available to all persons on the basis of their ability, and furthermore through financial support for students."

Economic, social and cultural rights, which also included the right to education and free schooling, are the least interpretable categories of human rights. The acknowledgement of such rights was no more than wishful thinking in most cases, because neither the budgetary funds nor the intention on the part of the government was available (Szamel, 1993:27; Tóth, 1994:54; Menyhárt, 2004:470; Lőrincz 1963:43). Citizens entitled to social rights could not have gone to court to claim those rights as their inalienable rights, because the extent to which such rights were truly granted depended on the state's discretion. Exercising these rights would have imposed a greater burden on the state than would civil or political rights. In order for social rights to be exercised, the state should have worked out a financial and procedural system in relation with these rights, identified the needs of the most vulnerable social groups, established cooperation with civil society organisations, installed early warning systems and checked the exercising of these rights. Soviet-type dictatorship was completely unsuitable for that.

Soviet-type dictatorship brought general poverty. In addition, the state budget could not finance the exercising of the economic, social and cultural rights granted in the Constitution (Sajó, 1986; Andorka, 1989). Civil society was practically banned. Thus, for instance, neither the churches, nor associations, nor private individuals were allowed to support the further education of even the most underprivileged.[18]

Nevertheless, socialist countries gave high priority to these rights, thereby striving to justify the superiority of socialism over capitalism[19] because, for reasons of propa-

PSZ 2017. angol.szam_beliv_v16.indd 339 2017. 04. 06. 7:29:14

ganda, they entered a competition with affluent Western countries that could not be won. They did so despite the fact that not only the absolute but also the relative share of social benefits in expenses was lower than in Western Europe. The same held true for education.

After what is called "the decisive year" (1948) teachers' pay was reduced to 20 per cent of what they earned in 1938 (Balogh–Föglein, 1986). The nationalisation of schools was followed by a shortage of teachers. Often monk teachers had to be replaced with unqualified teachers. Due to low pay such practice persisted for decades (Báthory–Falus, 1997).

The regionalisation of schools was another curse on education and, hence, on the rural population. During the tenure of Gyula Wlassics[20] and Kunó Klebelsberg[21] as ministers of religion and education, 1100 folk schools, 3500 new classrooms and nearly 2000 teachers' flats were built between 1920 and 1930 (Nagy, 1977; 1978). By contrast, of the 7440 primary schools operational in the 1945–1946 academic year, only 3526 survived by the 1988–1989 academic year. The highest number of schools, a total of 1731, were closed between 1968 and 1979. This could not be attributed to demographic reasons, because by the time "Ratkó children" (those born during the baby boom of the Ratkó era)[22] reached school age, their number had risen to a post-war maximum. Although 1,413,512 primary school age children enrolled for the 1965–1966 academic year, 1404 schools were closed down (Kurucz, 1970:15; Miksa, 2009:77–86).

Although institutions that were classified as institutions of secondary education in Western Europe were reclassified in Hungary as institutions of higher education, Hungary (along with Romania and Albania) had the lowest proportion of students in the 1980s (Tomka, 2009:459).

The nationalisation of church schools

Harassment, showcase trials and vast party propaganda campaigns orchestrated by Communist Party leaders paved the way for the nationalisation of church schools. The State Security Department staged house searches and police raids at church schools hiding "conspirators" during which weapons and prohibited materials planted by detectives were "discovered". Arrested students were coerced into give incriminating testimonies (Ugró, 2016). The Press launched into diatribes and demanded strict rules against "the pockets of reactionaries" (Kiszely, 2000:101–103).

In order for church schools to be nationalised,[23] dozens of showcase trials were started, the most notorious of them being the Pócspetri case.

One of the documents attesting to the mounting of party propaganda campaigns is a decision of the Political Committee of Hungary's Communist Party: "A delegation of teachers should meet the prime minister on Saturday. The delegation should be headed by Comrade Béki (secretary-general of the Teachers' Trade Union). However, a priest teacher should be found who will complain about the drawbacks to church schools and demand state employment for teachers and the nationalisation of church schools. In reply, Dinnyés[24] should inform them that there will be a 20 per cent pay rise for

PSZ 2017. angol.szam_beliv_v16.indd 340 2017. 04. 06. 7:29:14

*Table 1: Public spending on education in Europe as a percentage of GNP and total public expenditure, 1985 (*1984 data, **1983 data)*

Country	**Public Spending on Education**	
	% of GNP	**% of total public spending**
Austria	5.8	8.1
Belgium	6.1	15.2
Bulgaria	7.0	15.2
Czechoslovakia	5.1	7.9
Denmark*	6.6	7.9
Finland*	5.5	12.5
France*	5.8	12.5
Greece**	2.4	12.5
Hungary	7.0	8.0
Ireland**	6.7	9.1
Italy	5.7	9.6
Luxembourg**	5.6	14.1
Netherlands*	6.9	12.5
Malta	3.4	7.7
Norway	6.7	13.6
Portugal	4.2	11.5
Romania**	2.3	7.5
Spain	3.3	14.2
Sweden	7.7	12.6
Switzerland	4.9	18.6
United Kingdom*	5.2	11.3
USSR* (excluding Byelorussian and Ukrainian SSRs)	6.6	10.2
West Germany*	4.6	9.2

Source: Tomka, 2009, 459

teachers and that the government will not forget about public servants either. Comrade Mátyás Rákosi should also be present to welcome and address the delegation.[25] There should also be a photographer and a few journalists. Dinnyés's reply should be drawn up by Comrade Horváth[26]" (Pünkösti, 1996:322).

Another order was addressed to the National Assembly on 4 June 1948: "The bill on the nationalisation of Schools will have to be submitted by 15 June on the understanding that the 3-day committee discussion of the bill be waived. The committee shall be convened at 16:00 on the 15th and finish the discussion on the same day. Parliament should start to discuss the bill on the 16th. Teachers' meetings should be organised and a large delegation should meet the leaders of the parties and the government at the Parliament." Even the composition of the delegation was determined.

PSZ 2017. angol.szam_beliv_v16.indd 341 2017. 04. 06. 7:29:15

Likewise, contributors were appointed, and what they were expected to say was also determined. "The debate on the bill will have to be finished by midday on Saturday. Preschools and kindergartens should also be nationalised."

This is how the bill was passed and Act XXXIII of 1948 on the Nationalisation of Schools went into force. The Act ordered the nationalisation of non-state-owned schools (which were, without exception, church schools) and all related students' hostels, pre-schools and kindergartens with the appliances and equipment in them as well as the assets set aside for funding their operation and maintenance. 6505 schools were nationalised. Of them, 5407 were primary and folk schools, 98 teacher's training college and lyceums and 113 grammar schools (Table 2). Close to 18,000 teachers became state-employed. According to the calculations of Pál Sárközy, Deputy Archabbot of Pannonhalma, 2689 priest teachers, women teachers and pre-school/kindergarten teachers became unemployed and lost their income.[27] In addition to schools, hospitals, orphanages, old people's homes, foster homes and even cemeteries were nationalised.

These measures did away with the public role of churches completely. The termination of education at church schools was a blow to the churches and also to national culture with repercussions felt even today. The made evangelisation impossible, and ignored parents' rights to provide religious education for their children by forcing millions of children into atheist schools. Education in nationalised schools had to comply with the tenets of Marxism–Leninism, communism and internationalism.[28]

As regards the selection of prospective teachers, based on a proposal by György Aczél, the Political Committee of the Hungarian Socialist Workers' Party passed a resolution to the effect that prospective college or university students should come from trustworthy anticlerical worker or peasant families.[29] György Aczél added, "No children from religious families should be admitted to the new teacher's training college, because the fundamental issue is teachers themselves."[30]

Table 2: The Nationalisation of Church Schools

Church	Number	Primary Schools	Secondary Schools	Remaining Institutions
Jewish	130,000	26	13	1 grammar school
Evangelic	480,000	342	21	
Protestant	2,010,000	1,184	46	1 grammar school
Roman Catholic	6,500,000	2,885	301	8 grammar school
Other	4,504	381		10 grammar schools

Source: Mészáros, 1994a:71–72

At the time of nationalisation of church schools, the ministry of education and culture promised that compulsory religious education would remain part of the syllabus. Naturally, it failed to honour this promise. Law Decree no. 5 of 1949 made religious education "optional", but only in primary and grammar schools. It was not allowed in other types of schools (vocational and trade schools, etc.) As 50 per cent of the

PSZ 2017. angol.szam_beliv_v16.indd 342 2017. 04. 06. 7:29:15

14–18 year olds went to vocational or trade schools, approximately half of the youths were excluded right from the beginning. Furthermore, no religious education was allowed to be provided for pre-school and kindergarten children, students studying at teacher's training colleges, universities and kindergarten and preschool teacher's colleges. After the enactment of the law, huge efforts were made to dissuade parents from enrolling their children for "optional" religious education.

A decree issued on 15 September 1950 (renewed on 24 March 1957) by József Darvas, minister of religion and public education on the rules of procedure for religious education[31] by itself made religious education incredibly difficult. Under the decree, religious education classes were allowed only at school[32] and only after the last school class. No grade was allowed and failure to visit the classes did not have any disciplinary consequences.

Religious education teachers were employed by county councils or the municipal council of the capital city upon recommendation by the church concerned. Employment could be refused or terminated "if the person in question takes a stand that is hostile to the people's democracy or its provisions. […] Religious education teachers may not be engaged in any other activities (e.g. substitution or supervision at outings or during breaks, etc.) or providing other types of education. Religious education teachers may not attend the meetings of the teaching staff, and may only stay in the building of the school for the purpose of religious education." The work, syllabi and lesson plans of religious education teachers were strictly monitored.

Enrolment for religious education was only possible at a pre-determined time and date once a year (and usually at a time when parents had to be at work) and both parents had to be present. Principals had to notify county councils of the number enrolled for religious education and the list of names had to be sent to the competent religious authority.

The local organisations of the party in cities, towns, villages and at schools and the departments of education at local councils instructed the teachers engaged in the administration of enrolment to dissuade parents from enrolling their children for religious education. Attending religious education classes put students at a disadvantage when they wanted to go on to universities, and it was often the case that some of the teachers mocked them (Valuch, 1988:54). The fact that parents had their children enrolled for religious education was recorded on their personnel sheet at work. Head teachers were under pressure to reduce the number of those intending to enrol for religious education.

Court proceedings were launched against religious education teachers under various false pretexts, for instance, indecency. These proceedings ended with the arrest or the suspension from work of the person concerned. After 1957 religious education was provided only by priests, because the religious teachers who had trained before 1949 were now old, and there was no formalised training for religious education teachers in Hungary until the early 1980s.

For a short period after 1956, religious education was available without restrictions. The numbers enrolled were so high that providing for a corresponding num-

PSZ 2017. angol.szam_beliv_v16.indd 343 2017. 04. 06. 7:29:15

ber of teachers posed a problem. Not long after the revolution had been crushed, government decree no 21/1957. (III. 24.)[33] reintroduced the Rákosi era regulations, which stated rather hypocritically that "Stern measures must be taken against those who seek to influence decisions to participate or not to participate in religious education through force, threat or deception." The government decree had the broadest possible interpretation and even those encouraging enrolment in religious education during sermons were punished.

After long discussions, the State Office for Church Affairs and the Roman Catholic Church agreed in 1974 that, with effect from 1 January 1957, religious education classes could be held in churches, but not at rectories, twice a week. The maximum number of groups allowed was four and the education of one of them should start after the youth mass. The lists of those receiving religious education had to be sent to the local offices of the State Office for Church Affairs. It is hardly surprising that the number of those receiving religious education started to fall consistently. 80%, 43.2%, 26.4% (1.8% in Budapest), 10%, 6–7% and 3.18% of primary school students enrolled for religious education in September 1949, 1951, 1952, 1965, 1975 and 1987 respectively (Mészáros, 1995).

Socialist educational policy

The Communist Party intended to use schools as a means of training docile citizens. One of the objectives of the 1950 curriculum was "to train students to become disciplined, self-confident citizens of the People's Republic, the loyal sons of the working people and the builders of socialism" (Tanterv, 1950). The education system stifled any student initiative and persecuted independent thinking. New syllabi and textbooks were designed to spread atheism and Marxism. As a result, the objectives of the individual subjects at school were intertwined with ideological and political aspects, which were reflected in uniform mandatory textbooks. School inspectors, school head teachers and party secretaries all checked compliance, and students at teacher training colleges and universities were also trained to follow suit (Mészáros, 1994b:36; 1995:72; Donáth, 2000:64; 2008:450).

The decision of the Central Leadership of the Hungarian Workers' Party on public education in 1950 stated that textbooks and curricula "should, as much as practicable, reflect the ideology of Marxism–Leninism". In addition, it urged resistance against "clericalism" and "bourgeois ideologies".[34]

Tankönyvkiadó (Textbook Publishers) was established in 1949 to supply textbooks. Responsibility for regulations governing teaching materials lay with the single party. Old textbooks were scrapped and the teaching materials used at all levels of education were reviewed and revised. The primary objective was to subject both education and sciences to all-pervasive propaganda and manipulation. This is how the teachings of the biologist and agronomist Lysenko became undeniable maxims,[35] and how Engels' dialectical materialism and Marx's tenets on social changes became irrefutable dogmas.

No school subject was left unaffected by ideological propaganda. History served daily politics. For instance, József Révai was enthusiastic about Lajos Kossuth's having ordered the officers collaborating with the enemy to be deported from the capital city. There was no event in history that was not made topical. We can read from a school inspector's report that: "The presentation of Colbert's system offers an excellent opportunity to familiarise students with the reasonableness of a planned economy. […] One of the weakest points of the class was that although the topic discussed (peasant migrations in the 18th century) offered an excellent opportunity to discuss the current issues of clerical reactionaries, the teacher failed to seize this opportunity" (Szebenyi, 1970:176–177).

The same method was applied even to school subjects that were highly unlikely to lend themselves well to direct political brainwashing. A few excerpts from curriculum objectives:

– Physics: "Helping a scientific world view to evolve and by so doing laying down the foundation of a dialectical materialist weltanschauung. Fight against idealistic view of life."[36]

– Biology: "Acquiring basic knowledge needed for socialist agricultural production, large scale plant cultivation and animal breeding to an extent that helps prospective teachers use such knowledge at school" (Tanterv, 1951a).

– Geography: "Teaching the geography of the Soviet Union, people's democracies and countries subject to capitalist exploitation and, through this, presenting the superiority of the socialist regime and economy... Fight against chauvinism and cosmopolitanism. Nurturing the sentiment of proletarian internationalism, and grooming socialist patriotism" (Tanterv, 1951a). ... As a consequence, geography books read like this: "The economies of socialist countries in South-east Europe, whose structure the planned economy has made much more proportionate, grew faster and, more importantly, more consistently" (Földrajz, 1951b:274). "In capitalist societies [...] mass transport was either neglected or missing." "The planned development of socialist cities put neglected urban areas on a par with others" (Földrajz, 1951a:196).

– Arts "Developing a socialist approach to arts" (Tanterv, 1951a).

– Mathematics: Confident familiarity based on practice of primary school arithmetic and geometry" (Tanterv, 1951a:33). This led to the following exercise in mathematics: "A French factory employed 360 workers. The owner dismissed one-third of the workers because, due to the huge imports of manufactured goods from the USA, he was unable to earn profit on his own goods. How many workers became unemployed?" "There were 16,450 soldiers in a British division forced to go and fight in Korea. 1892 surrendered, 827 died and 1245 were wounded in combat against the Korean army and the Chinese army sent to help the Korean army. How many were left in the division?" "A self-employed farmer sowed 95 of rye. The crop having been harvested and thrashed, 1140 kg of rye remained. How many times more kilos of rye did he have? It was 16 times more in the neighbouring co-operative where the quality of the soil was the same. How many hundredweight is that equal to? Why did they harvest a better crop?"[37]

PSZ 2017. angol.szam_beliv_v16.indd 345 2017. 04. 06. 7:29:15

Concurrently, nothing was said about a large number of the great cultural achievements of human kind. Either they were scrapped as waste paper or they were not allowed to be distributed in Hungary. Generations grew up without being able to familiarise themselves with the most prominent representatives of the past and the present of culture, with scholars, philosophers and thinkers.

Pedagogical principles and teaching methods and materials were treated as a pure objective discipline fashioned after Soviet pedagogy (Nagy, 1958:75). *The Theory of Education* edited by Sándor Nagy, Head of the Education Department at the Faculty of Arts of Loránd Eötvös University and his colleague Lajos Horváth shaped teacher's training in Hungary for a long time. The chapter on *Communist Education* reads like this: "Just as social development will enter communism after a socialist stage, so education will be transformed into communist education, the highest quality ever known in history." The objective of education is to groom communists. "The profile of communists is summed up in the programme of the Communist Party of the U.S.S.R. According to this, communists embody mental development, are morally integral and physically perfect" (Nagy et al., 1965). Published in the *Szabad Nép,* an article by Tibor Erdey-Grúz read as follows, "socialism sets the same goal for both parents and schools. The responsibility of communist education is the responsibility of both parents and schools. Communist ethics is inseparable from the love of socialist patriotism and the Soviet Union."[38]

Teacher training also served this goal. Curricula fashioned exclusively on Soviet pedagogy before 1961 stated that the aim of pedagogy was "to raise awareness of the fact that school is an important means of class struggle and a strong weapon of cultural revolution and the building of socialism" (Tanterv, 1951:15). "Nursery and primary teacher training should become workshops of communist pedagogy. A dialectical materialist world view must be established there. Simultaneously, students must be taught how to behave themselves in a manner prescribed by communist ethic and to adopt Bolshevik mentality and characteristics. We need to train teachers who can teach in nurseries, and primary schools in the spirit of our party." "Teachers should stand out with their rock solid communist views and convictions, and steadfast and unbending behaviour becoming of a party member. They should familiarise themselves with and live in accordance with the tenets of Marxism. […] They should be encouraged to have a fair share of participation in the class struggle. Without open and unrelenting combat against religious world views our work is only half done" (Bizó, 1955:457–459; Jóború et al., 1984:383).

Curricula at all levels of education contained instructions and guidance in accordance with topical issues. The contemporaneous official standpoint of the time was explained by Gyula Ortutay, Minister of Religion and Public Education at the time, "...politics sets great store by the issue of schools from primary to higher education, because students are taught, either explicitly or implicitly, at both primary schools and universities how to behave themselves and how to lead the country in the various corridors of power, economics, politics and governance in the interest of power. […] The issue of schools enables state administrators to ensure that various ideas are learned and become habits, as it were" (Ortutay, 1949:191–192).

The chapter entitled *The Objective of Education at Nursery Schools and Related Tasks* of *The Programme of Education at Nursery Schools* published in 1971 stipulates that teachers at nursery schools should strive “to guide children in the direction of a dialectical materialist world view” (Mészáros, 1994b:111).

The 1950 curriculum for primary schools mentioned the concept of “the socialist man”. In 1960, the following goal was set: “The goal of primary education is to create the makings of the communist man. To this end, it should provide consistent modern basic education for students, and seek to help them develop moral characteristics typical of the communist man…” (Miklósvári, 1963). A committee established to develop education reform also added the following guidance: “When compiling curricula, it is important that priority is given mainly to this tenet rather than the science underlying the subjects taught at schools.”[39] A draft on education and training in primary schools published by the Ministry of Education through adopting instruction no. 114/1977 states that “The goal of primary education is to create the makings of the communist man in the context of the unity of knowledge worldview-behaviour. Teachers should cherish Marxism–Leninism as the guiding principle for creating the “human ideal”, and “students should understand the essence and importance of the war of ideas”.

According to the 1950 secondary school curriculum, “secondary schools are responsible for promoting Marxism–Leninism in secondary education and teaching materials, and combating reactionary idealism...”[40] The minister of education issued these procedural rules on 2 June 1955. According to these rules, “students must be taught how to become patriotic socialist persons devotedly serving the interests of the party, the working classes and our working people. Accordingly, general education must be provided in the spirit of Marxism–Leninism. Furthermore, students must acquire technical skills and receive comprehensive training. Students’ communist world view and ethics must be fine-tuned” (Mészáros, 1994a:74).

Marxist subjects (e.g. dialectical materialism, scientific socialism and the history of workers’ movements, etc.) grew in importance in the curricula of universities and colleges. Marxism–Leninism had become a compulsory subject: by 1974, 91 departments taught Marxism–Leninism at 55 universities and colleges. According to an educational programme issued in 1950: “The pivotal role of Marxism–Leninism should be reflected in the fact that it is taught in all years. At universities and colleges students should receive an introduction into Hungary’s political economy, the basics of Marxism–Leninism based on the history of the party, complemented with some information on Hungary, and dialectical and historical materialism.”[41] Textbooks started with a quotation from Marx, Engels, Lenin or Stalin.

The following explanation was offered in a book entitled *Ideological Education Within the Framework of Teaching Internal Medicine*: “The goal of this book is ... to more efficiently train young intellectuals to become specialists with a communist ideological background.” (Világnézeti nevelés, 1973). This goal was referred to in one of János Kádár’s speeches: “A few months ago I went to the medical school in Budapest and met the professors and a few other people working there. We discussed a few issues

PSZ 2017. angol.szam_beliv_v16.indd 347 2017. 04. 06. 7:29:15

pertaining to the medical profession, including our request that they should train professionals in the communist spirit. Although only a few of the students and professors are communist, that is still feasible. There is no contradiction. I did my best to explain the difference between the present and the past. The state can cooperate with the medical profession despite the fact that some are communists, some are supporters, others are politically neutral, and still others are reactionaries. We can get on with them if they are good at what they do and abide by the laws of the People's Republic of Hungary. However, it will not suffice in 30 years' time and one must bear that in mind. Imagine the situation, Comrades, I told them, where a doctor checks a patient's tongue and chest, writes a prescription and musingly says, 'You know, after all, Otto von Habsburg is an intelligent man.' And how does the patient respond? He leaves and that is that. However, in 10 years' time this society will be a developed socialist society, which we must bear in mind when the education of future generations is at stake. For instance, the now 18–19 year-old students sitting in the auditorium will be working as doctors in 40 years' time. Now it's 1961. In 40 years' time it is 2001. What political regime will there be in Hungary then? A communist one. There will be communism. In 40 years' time a patient comes along. The doctor checks his chest, writes a prescription and finally says, 'You know, after all, Otto von Habsburg was not a stupid man.' What will happen then? It is not the doctor, but the patient who will call the ambulance."[42]

Scientific research followed a Soviet pattern. The Hungarian Academy of Sciences was designated as the supreme institution. It established its own institutional system. Former research institutions were merged into the Academy system. It was these institutions where research was done. Activities at universities were confined to teaching officially-prescribed teaching materials. Kádár provided the following explanation for the curbing and strict control of research: "Hungarian scientists rush to learn the West's scientific achievements, their Western counterparts rush to learn the Soviet Union's. The most recent scientific results have been achieved in the Soviet Union, not in the West. We receive documents in huge numbers. They have not been processed yet. Why do we have to discover or invent something at huge cost that has been in use in the Soviet Union since last year? We draw the attention of the academia in Hungary that the new type of cooperation, i.e. socialist cooperation offers these opportunities. And it is our duty and obligation to seize these opportunities for the benefit of the Hungarian People's Republic and the entire camp."[43]

Admission to university

The aim of introducing a system of entrance examinations was to educate and train loyal cadres. It was government decree no 7.870/1948 that declared that the educational monopoly of the former ruling classes must be broken. Accordingly, candidates from working class or peasant families should be prioritised (Szávai, 1950:2). At the meeting of the directors general of the school districts in the spring of 1950, József Darvas, Minister of Religion and Public Education set a task for head teachers. They

PSZ 2017. angol.szam_beliv_v16.indd 348 2017. 04. 06. 7:29:15

were to convene the implementation committees of their respective schools, which were responsible for vetting prospective candidates and preparing the further studies of young people from working class or peasant families.[44] Admission boards at universities comprised not only the representatives of the faculty concerned, but also those of the single party, the trade union and the Association of Working Youth.

From the 1949–1950 academic year the single party was responsible for laying down the rules of and implementing entrance examinations. Citizens were discriminated on grounds of origin and trustworthiness. It was mainly the pre-war (1938) employment and social status of the parents that were checked in the admission process. First, there were eleven categories. From 1952, candidates fell into one of the following categories: worker, peasant, intellectual, other, or class enemy. The children of those included in the last category (category X), members of the former ruling class ("exploiters"), kulaks, army officers, etc. stood no chance of admission even if they excelled at school. A central regulation prescribed the proportion of students of worker or peasant origin: 1952–1953: 60–65 per cent, Spring 1956: 58–60 per cent, 1957: 50 per cent. As a result, nearly all the candidates with the right cadre pedigree were admitted. By contrast, there were five times more of those with parents belonging to the professional classes than there were places. This is why 44.2 per cent of those who passed their secondary school leaving examination with excellent grades in the 1956/57 academic year could not secure a place at a university or college.[45] The cadres who were admitted despite their poorer performance were not to be flunked at examinations. The lecturers who defied and set requirements for them were accused of "overburdening" them (Kardos, 2003:74–75; Kovács, 1952:493).

Further restrictions were introduced after the fall of the 1956 Revolution. Kádár ordered that the Soviet patterns be followed more closely when class categories were applied. He also recommended that the rules governing the award of stipends be changed: "If it were up to me, I wouldn't award stipends to students other than those of worker or peasant origin. If people in other categories want to send their children to school, let them make sacrifices. But I'd give more stipends to children of worker origin than children of peasant origin. What makes me say this is class consideration" (Baráth–Ripp, 1994:69).

Order no. 25/1957 of the ME stipulated that applications for further education be reviewed first by class teachers and head teachers, with the applications of those whose parents participated in the 1956 revolution or behaved in a politically reprehensible manner being rejected. In keeping with the party's instructions, and based on a proposal by József Szigeti[46], it was decided that the 1938 categories be applied to parents. The children of party and state functionaries "…must be treated as the children of parents who have achieved outstanding results in building and protecting socialism…" (Baráth–Ripp, 1994:57).

It must be ensured that 50 per cent of those admitted are of worker or peasant origin. György Aczél also recommended that, similarly to Czechoslovakia, candidates should be from demonstrably anti-clerical families.[47] Class categories were also applied when stipends were awarded. Only members of the Hungarian Socialist Workers' Party (MSZMP) and the Communist Youth Alliance could be elected to serve on admission boards. The Ministry of Education checked the composition and the operation of these boards (Baráth–Ripp, 1994:70–71).

Open discrimination on grounds of origin was discontinued in 1963, when this type of discrimination also often hit the children of the ruling elite adversely. (Law Decree no 22 of 1962 and Orders nos. 166/1963 and 167/1963. Nevertheless, it was clearly communicated that "However, some of the places will still have to remain reserved for the children of parents in certain categories... furthermore, for the children of workers and peasants."[48] Although B sheets registering "enemies of the ruling classes" were no longer in use, the practice of keeping a cadre record of each student survived. Cadre records were kept in order that the "political loyalty" of students could be checked.

The children of parents included in category F (blue collar workers) continued to receive preferential treatment in education and at entrance examinations even if the former strict categories were no longer in use. Even of those who ranked among the first ten at national study contests only "those with the right attitude" were admitted. The Medal for Hungarian Freedom,[49] the Medal for the Rule of Workers and Peasants[50] and the Medal for the Socialist Homeland[51] came with the privilege that relatives were automatically admitted to university or college irrespective of the results of the entrance examination (Besnyő–Ruda, 1979:28–29, 51–52, 85).

Appointing places of work after graduation was also assigned to an authority. Decree no 137/1961. (VII. 7.) MT (Council of Ministers) was adopted on the scheduled employment of university graduates.

Notes

1 Neither Imre Nagy's cabinet programme in 1953 nor the economic reforms of 1968 ran deep enough to affect the very essence of the regime.

2 This is exactly why the Warsaw Pact invasion of Czechoslovakia was possible in 1968. Brezhnev and his advisors were well aware of the consequences that would follow if freedom of the press were granted.

3 Party member responsibilities also included this principle: "...there should be no space left void in the class struggle. Where socialism fails to gain ground, the powers of capitalism will take control. Failure to execute party decrees opens the door for enemies." See Pató, 1953:165.

4 The Soviet-type dictatorship also made attempts at setting rules even for clothing, hair-styles and fashion.

5 Lenin was cited even on this issue: "The Soviet-type of socialist centralism is not at variance with the principle of one-person dictatorship and rule, because the wish of a class is sometimes fulfilled by a dictator who alone can do more and is needed more." Cited by Heller–Nekrich, 2003:150.

6 A typical manifestation of Stalin's one-man rule and terror is that 98 of the members and substitute members elected at the 17th Congress of the Communist Party of the Soviet Union met violent deaths. Another 1,108 of 1,225 delegates entitled to vote and 711 entitled to participate in discussions also fell victim to Stalin's terror. See Takács, 1992:81.

7 For instance, G.G. Yagoda, N.I. Yezhov and L.P. Beria, successive directors of the secret police of the Soviet Union were all shot. Stalin had nearly the entire party leadership from Bukharin to Zhinovev executed. In Hungary terror hit mainly ministers of the interior. László Rajk was executed, and János Kádár was sentenced to life imprisonment. Sándor Zöld committed suicide as his arrest was a foregone conclusion. Mátyás Rákosi was subjected to internal exile in the Soviet Union.

[8] According to Leszek Kolakowski, "...not a single society can exists without some form of legitimacy. In a totalitarian society, such legitimacy can only be of an ideological character. Totalitarian regimes and totalitarian ideologies presuppose each other." Cited by Schmidt, 2008:12–13.

[9] Stalin would wear boots and a semi-military tunic. Party leaders copied him in even this. Stalin himself compared the party to an army: "Our party, with the structure of its leadership taken into account, comprises 3,000 to 4,000 leaders at the topmost level. They constitute the top echelon of our party. Another 30,000 to 40,000 mid-level leaders constitute the corps comprising the officers of the party. Below them are 100,000 to 150,000 low-ranking officers of the party. In a certain sense they are our non-commissioned officers." See the 27 March 1937 issue of the *Pravda*. It was socialist countries that had the largest armies and military budgets. Military service was compulsory. In addition, they also operated numerous paramilitary organisations and organisations prepping for military service (e.g. the MHK Munkára, harcra kész ("Ready to work and fight") movement, scouts, pioneers, youth guard and workers' militia). Education was also subjected to the militarisation of society (e.g. military education became part of the national curriculum).

[10] Zbigniew Brzezinski (1928–), a Polish-American political scientist and university professor. See Gati, 2014; publications in Hungarian: Brzezinski, 1982.

[11] Sándor Márai voiced his opinion of this as follows: "'New religion, they say. Bolshevism is the new religion.' Maybe. But I only met the priests of this religion. I have hardly met any believers." See Márai, 2008:23.

[12] Bringing the virgin land under cultivation was part of Khrushchev's agricultural campaigns, which turned out to be disastrous. Wind blew soil off the ploughed steppe, which began the desertification of the areas concerned. See Varga, 2013:42.

[13] Secretary-General Brezhnev won Marx Award for his contribution to the further development of Marxism–Leninism.

[14] In the reviewer's opinion: "The author overestimates the importance and the beneficial role of the 22nd Congress of the Communist Party of the Soviet Union and Khrushchev's work. […] In light of the review, it is difficult to understand why Khrushchev was removed. Cited by Standeisky, 2004:322.

[15] György Aczél (1917–1991), communist politician, the chief architect of Hungary's cultural life in the Kádár era. See Révész, 1997.

[16] Quoted Rácz, 2001:19.

[17] Primary schooling is an inalienable right and, at the same time, an obligation of each citizen. Law Decree 15 of 1951, Law Decree 29 of 1959. Act III of 1961.

[18] One of the best-known examples: József Mindszenty, as a parish priest of Zalaegerszeg, provided free accommodation and boarding for 34 poor secondary school students each year. See Közi Horváth, 2002.

[19] This is all the more incomprehensible as not even Lenin expected communist regimes to be left-wing. See Lenin, 1980:262.

[20] Gyula Wlassics (1852–1937) jurist, public writer, member of the Hungarian Academy of Sciences, and Minister of Religion and Education between 1895 and 1903.

[21] Kunó Klebelsberg (1875–1932) jurist, Member of Parliament, politician, Minister of the Interior and Minister of Religion and Education for a short period of time.

[22] Reference to Anna Ratkó's tenure between 1949 and 1953 as the Minister of Welfare and Minister of Health as well as being responsible for population policy in the roughly half a decade between 1950 and 1956. The ban on abortion and taxes for childless adults led to an increase in birth rates.

[23] Ödön Lénárd was arrested in 1948 and later sentenced to imprisonment because he had warned that it was Hitler who last nationalised schools. See Lénárd, 2008:13.

[24] Lajos Dinnyés (1901–1961): politician, member of the Smallholders' Party, and Prime Minister. He was a willing servant of the political ambitions of the Hungarian Communist Party.

[25] Rákosi himself committed this to paper.

[26] Márton Horváth (1906–1987): communist politician, member of the Political Committee, editor-in-chief of the *Szabad Nép*.

[27] Draft letter by Pál Sárközy, Deputy Archabbot, to the mother superiors of the province. EPL 7480/1948. Abstract of the minutes of the bishops' meeting on 27 August 1948. Archives of the Kalocsa Archbishopric – School decisions 3879/1948. Abstract of the minutes of the bishops' meeting on 27 August 1948.

PSZ 2017. angol.szam_beliv_v16.indd 351 2017. 04. 06. 7:29:15

[28] The following was written about this issue in a teacher's journal: "Good teachers are both actors and judges to a certain extent. Good history teachers are very much like politicians. […] We read a passage about Greek religion and then I present mythological beliefs regarding gods and especially the world. Naive ideas bring smiles to faces and often cause loud laughter. This is the very moment that has to be made the most of. […] From then on I never once say that there is no God. On the contrary, I go on to prove that there are many. See how many gods the Greeks have? But not only the Greeks, others too. […] A composition exercise: according to Christian legends, Jesus Christ, the founder of Christianity was born during the reign of Emperor Augustus. Their attention is caught by "according to Christian legends" and "the founder of Christianity". This is something new to them requiring an explanation, which is as follows: only Christian sources mention the birth and miracles of Jesus Christ and they are likely to be biased. Is it not strange, by any chance, that the chroniclers of the age who record even trifles fail to record the miracles of Jesus? […] The following idea may run deep: in the course of history, whenever asked to help to defend Christianity against e.g. the expanding Ottoman Empire, popes only blessed soldiers and weapons or prayed for victory, but they never gave any money (despite the wealth in their treasuries) or send any soldiers. I never fail to mention the Battle of Belgrade, where the only contribution of the pope to victory was his ordering church bells to be tolled at noon. […] Anybody directed by their faith only drifts in the world. They are not convinced of anything because their conviction is hindered by their faith. It strikes one as strange that religions have often hindered meditation and prevented believers from doing research into natural and social sciences. Why? Because they must have realised that science and faith are enemies. Reasonable people only accept what they are convinced of. Well, gods are not something you can be convinced of, they are to be believed in. I have never seen any god depicted in religions. I have no experience related to any god. I cannot imagine what one looks like – in short: I cannot believe their existence." See Győző Torma's study, *Köznevelés,* 10 May 1963, 274.

[29] Minutes of the meeting of the Political Committee of the Hungarian Socialist Workers' Party on 10 June 1958 MOL 288. f. 5. cs. 83. ő. e.

[30] Cited by Mészáros, 1994b.

[31] The text of the decree was published in Magyar Katolikus Almanach II. [Hungarian Roman Catholic Almanac II], 625–627.

[32] Religious education preparing for the First Communion once or twice a week lasted two months and for Confirmation for 1 month. Religious education provided outside the church was strictly monitored and punished. For instance, Father György Bulányi was sentenced to life imprisonment on 9 December 1952 for providing religious education in small groups. See Hetényi Varga, 2002:501.

[33] The text was published in Magyar Katolikus Almanach II. [Hungarian Roman Catholic Almanac II]. 613–635.

[34] A Magyar Dolgozók Pártja Központi Vezetőségének határozata a vallás- és közoktatásügyi minisztériummal kapcsolatos kérdésekről [The decision of the Central Leadership of the Hungarian Workers' Party on the issues related to the Ministry of Religion and Public Education]. *Köznevelés,* no. 8, 1950, 210.

[35] T. D. Lysenko (1898–1976) led the movement and transformed it into an assault on orthodox genetics and claimed that education could change heredity. He also had extreme ideas on vegetative hybridisation. Major works: *A biológiai tudomány állásáról* [The Situation in Biological Science]. Bratsztvo-Jedinsztvo Kiadó, Novi Sad, 1949; *Agrobiológia* [Agrobilogy]. Mezőgazdasági Könyvkiadó, Budapest, 1950; *A hőtényező hatása a növényi fejlődésfázisok időtartamára. Kísérletek a pázsitfűfélékkel és gyapottal* [The Effects of the Thermal Factor on the Duration of the Phases in Development of Plants. Experiments on cereals and cotton]. Mezőgazdasági Kiadó, Budapest, 1951; *Növények szakaszos fejlődése: tanulmányok a mezőgazdasági növények szakaszos fejlődésének és jarovizációjának elmélete köréből.* [The Theory of the Staged Development of Plants: Studies into Theories on the Staged Development and Yarovisation of Agricultural Plants]. Akadémiai Kiadó, Budapest, 1954.

[36] Mihály Farkas's words were to convince fourth graders of the greatness of Prince Ferenc Rákóczi II: "We remember Ferenc Rákóczi as a statesman who led the Hungarian War of Independence. He was the legendary military and political leader of the just war against the Habsburgs." See Vincze et al. 1951:29; Tanterv, 1951a:20.

[37] *Általános iskola 4. osztály.* [Primary School, Year 4]. Tankönyvkiadó, Budapest, 1952.

PSZ 2017. angol.szam_beliv_v16.indd 352 2017. 04. 06. 7:29:15

[38] *Szabad Nép,* 1 September 1955.

[39] Cited by Kovács, 1995:45.

[40] Cited by Mészáros, 1994a:73.

[41] Cited by Köbel, 19.

[42] The speech was published in the 14 May 1960 issue of the *Köznevelés.*

[43] Quoted by Lőcsei, 2008.

[44] *Köznevelés,* no. 9, 1950, 245.

[45] In 1961, the following criteria had to be met: "...in order for the institutions to be able to deliver the (prescribed) social share, 60 per cent of the candidates of worker origin, 62 per cent of those of peasant origin and 43 per cent from the intellectual classes must be admitted." See Statistical Bulletin 1961. Quoted by Sáska, 2007:105.

[46] József Szigeti (1921–2012) communist politician, Marxist philosopher, university lecturer, ordinary member of the Hungarian Academy of Sciences; Deputy Minister of Education between 1957 and 1959, Director of the Institution of Philosophy of the HAS between 1959 and 1968.

[47] MOL M-KS-288. f. 5/83. ő. e.

[48] Quoted by Tyekvicska, 2000:252. Cf. Elekes–Pázmándy, 1981:79. Cf. Takács, 2008.

[49] The award was founded through the enactment of Act VIII of 1946 and was granted to persons who excelled in fighting for freedom and democracy. Act V of 1953 discontinued, subsequently Law Decree no 61 of 1957 reinstated it for those who participated in crushing the 1956 revolution. Privileges concerning entrance examination were guaranteed in Section 17(2) of Order no 3/1968. (V. 26.) of ME and Order no 105/1966. (MK. 2.) of ME.

[50] The Council of Ministers founded it by adopting Decree no 25/1957. (IV. 21.) of CM and awarded it to those participating in the crushing of the 1956 revolution.

[51] The decoration awarded to those who excelled in the consolidation of Soviet-type dictatorship was founded through the passing of Law Decree no 29 of 1966. It was awarded by the Presidential Council of the People's Republic once on 1 May 1967. Cf. Decree no 3/1968. (V. 26.) of ME and Order no 105/1966. (MK 2.) of ME.

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Attila Smuta – Zsuzsa Buzás

Aspects of Kodály's Music Pedagogy

Summary
Zoltán Kodály's principles in music education have had a major international influence across the world. He is universally recognized as one of the greatest figures in music teaching. Zoltán Kodály was a Hungarian composer, folk music researcher, and a pioneer in music education. Zoltán Kodály believed that musical aptitude is a characteristic of every person and that, ideally, a music education should begin as early as possible in a person's life – first at home and later within the school curriculum. Kodály elaborated the structured and sequential system of music education that would make music accessible to all students in Hungary. His concept has gained international interest and remains in use in many countries' music education, not only in Europe, but all over the world. On the basis of his concept we tested students' music reading skills with the aid of the latest computer-based assessment technologies.

Keywords: Kodály concept, music education, literacy, assessment

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PSZ 2017. angol.szam_beliv_v16.indd 357 2017. 04. 06. 7:29:15

Introduction

"There is no complete spiritual life without music, for the human soul has regions which can be illuminated only by music"
(Zoltán Kodály)

Music education in Hungary is based on the well-known Kodály concept. Zoltán Kodály considered it vital that music education should begin at the youngest possible age. Kodály's ideas on how a child should be educated lie in the belief that arts, particularly music, should be at the centre of education. Kodály's pedagogy emphasizes the development of music literacy through the innate music of the culture, beginning with folk songs that he rated alongside the works of classical composers. Zoltán Kodály created reading and singing exercises for practicing from primary to professional levels; he claimed that music reading and writing (like the alphabet) can be learnt by anyone. Kodály wrote numerous articles and essays on his educational concept and gave many speeches at international conferences. He stressed that the goal is not only to teach music, but also to improve teaching techniques (Király, 2012). In all his pedagogical writings, Kodály emphasizes that music should have a central role in education. According to the Kodály concept, musical training should be an integral part of the general curriculum and music should not only be accessible to the elite, but for everyone.

Over the years many thousands have gone to Hungary to study the Kodály concept of music education, which is applied in five continents. Although the application of Kodály's ideas on music education in Hungary is rooted in Hungarian folk music, his concept is easily adaptable to the folk music of any other nation.

Although a great number of music students learn music reading, only a few studies have tried to examine its teaching and there has been no comprehensive examination of this issue. Our assessments were carried out using computer-based musical assessment tools. The purpose of our cross-sectional studies, which were conducted on a national sample, were to measure the success rate and evaluate music reading skills acquired from public and specialised music education based on the Kodály concept.

The historical roots of music education

Music has existed throughout human history and forms an integral part of the cultural heritage of human societies. Music-making is one of the most ancient human activities, and human musical ability has a long evolutionary history (Morley, 2002). Music and language skills enabled the emergence of modern human social and individual cognitive flexibility; both music and language can be regarded as subcomponents of the human communicative toolkit (Cross, 1999). Humans have long been using sound to enhance their communication, and *song* may have been the earliest form of speech (Ulbaek, 1998). This form of communication had both melody and

PSZ 2017. angol.szam_beliv_v16.indd 358 2017. 04. 06. 7:29:15

rhythm. Darwin (1871) argued that musical capacity developed from the tones used in passionate speech and he claimed that music contributed to the development of language. Darwin connected music to strong emotions, as many animals make noises to attract mates, express emotions and communicate with others.

The other important role of music is related to spirituality, where music played a mediating role between individuals exposed to natural forces and supernatural powers. In this particular world, both the rituals and music/music making served the world concept of communities and their fate. Since ancient times, music has been regarded as having a divine origin by many peoples. There are legends in different civilizations about its magical powers. It became one of the most important means to express human emotions. It influenced the life of different societies, and still has an effect on some of them even today.

The relevance of music pedagogy comes from the ideas discussed above. Two major world civilizations which think about music in the same way, despite the apparent differences between them, will be taken as examples. In ancient China, it was thought that perfect music was one of the keys to maintaining order in the empire. Music making based on the *Yellow Bell* and on the system derived from it was of crucial importance. It was assumed that mistuned instruments and imperfect melodies could cause the collapse of the whole empire. Therefore, strict rules were introduced in the field of music. So in China the impact of music on society was its most important aspect.

In his work entitled *Republic*, Plato, one of the most well-known representatives of ancient Greek culture, which is one of the most important roots of European civilization, said: "Musical training is a more potent instrument than any other, because rhythm and harmony find their way into the inward places of the soul, on which they mightily fasten, imparting grace, and making the soul of him who is rightly educated graceful, or of him who is ill-educated ungraceful."

Christian Europe in the Middle Ages considered music of crucial importance, especially Gregorian chant, which was the primary spiritual means of expression during different liturgies. Besides reading, singing was the most important school subject in the Middle Ages.

The musical guidelines of the medieval Hungarian church, the musical training in monastic schools and the teaching of Gregorian chanting in the parishes of villages were the foundations of the culture of everyday singing. According to László Dobszay, a Hungarian peasant in the Middle Ages could sing 150-200 hours of musical material by heart.

The practice of singing was enriched later in the Renaissance, especially in the educational institutions that belonged to bishoprics and archbishoprics founded in the Middle Ages. The period from King Sigismund, through King Matthias and Queen Beatrix, to Louis II of Hungary revived the instrumental and vocal life of the secular music of the country, which gained a reputation all over Europe. The Ottoman occupation of Hungary and the division of Hungary into three areas had a considerable influence on musical life and training; however, music and instrumental education developed further where it was possible, e.g. in schools run by the Evangelists, Protestants, Piarists and Jesuits. Furthermore, music and singing, alongside astronomy and

PSZ 2017. angol.szam_beliv_v16.indd 359 2017. 04. 06. 7:29:15

mathematics, were part of the subject-structure developed by János Apáczai Csere, who worked in Transylvania.

Ratio Educationis, the first school reform introduced during the reign of Maria Theresa in 1777 had an effect on music teaching in Hungary in the 19th century, which took place in the so-called 'national schools'. The increasingly popular music associations and foundations also established many music schools. These institutions became increasingly popular among the emerging middle classes: one of them was the National Music Association of Pest-Buda established in 1840. The milestone of Hungarian music education was the establishment of the Royal National Hungarian Academy of Music founded by Franz Liszt in 1875, and where Béla Bartók and Zoltán Kodály studied.

Towards the turn of the century, many orchestras and singing societies were formed. Foreign musicians or musicians repatriating after having studied abroad also helped to found them and contributed to the growing number of music teachers. Church choirs and singing societies established their first national organization in 1867 and played an important role in laying the foundations of Hungarian choir life in the 20th century. The National Hungarian Singing Society was founded by Ferenc Erkel in Pest in the same year.

In the first decades of the 20th century the contradictions of the Hungarian music life became apparent. Two of them were related to German culture: the first one was the Wagner cult, and the other one was Liedertafel, which hindered the development of high-quality choir music. The third contradiction was the *nóta*, which is a form of 19th century Hungarian popular song. It started to drive out the folk songs not only in small towns but also in villages. Another problem was that the *csárdás* and *verbunkos* (18th century Hungarian dances) began to lose credit after the death of the great romantic composers due to their less talented followers.

Although the Minister of Religion and Education Kuno von Klebelsberg had a positive influence on musical life after the Great War, some of its basic problems remained unsolved.

'Praeceptor Hungariae' – The Educator of his Nation

"We should remain Europeans in Hungary,
and we should be Hungarians in Europe"
(Zoltán Kodály)

Kodály expressed at Eötvös College his aim to become the Educator of his Nation (*praeceptor Hungariae*). Kodály (who was by that time already world famous due to his composition *Psalmus hungaricus*) took his first step on a difficult journey towards becoming a *praeceptor Hungariae* by working for the development of the people and the nation; this was a result of his realising the importance of music education in public schools in 1925. His field activities grew and broadened from this period onwards. A simultaneous multi-front fight in different fields (such as society and politics) and at different levels was required, but all of these can be traced back to a single major,

PSZ 2017. angol.szam_beliv_v16.indd 360 2017. 04. 06. 7:29:15

common aim: the education of the people and the nation. The essence of it was that he was able to merge both 'European existence' and 'the Hungarian world', past and present, music traditions and the new wave of western European musical trends. By doing so, he created a synthesis of East and West not only in music but also more broadly in culture. This kind of synthesis set an example for others to follow. He created a new Hungarian music, and together with it our national self-image from our ancient musical culture's language and soul. Kodály's ideas are still topical. A majority of these might not strictly be connected to music, but they refer to a wider social context. For example, his ideas on school education, general taste and preserving national values and, furthermore, the intention of doing something for the nation such as saving Hungarian language culture from decline. Similar ideas of Kodály's that often reappear are the discussion on how we can get rid of our 'Hungarian illnesses' – such as laziness, envy, disagreement, and hostility – the determination to refuse of any kind of extreme politics, the problems of morality and solidarity, and the necessity to show our European and Hungarian features together.

The Kodály concept

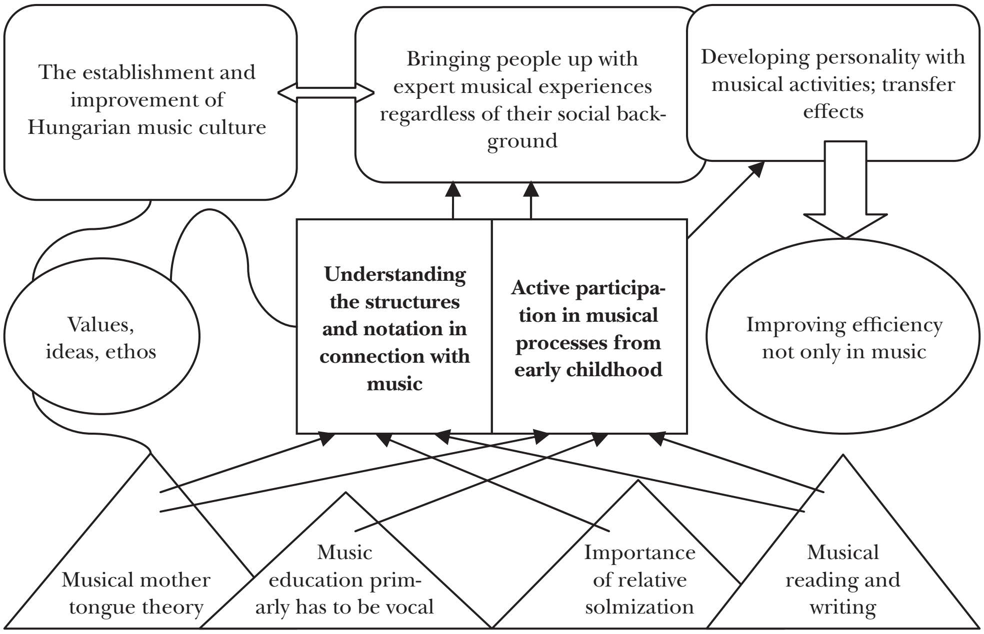
"Music should belong to everyone!"
(Zoltán Kodály)

Gönczy (2009) created the hierarchical illustration of the main elements of Kodály concept following Ittzés, who highlighted four principles (2004) which define the essence of Kodály's ideas: 1) all children should receive music education; 2) the foundations of music education are the human voice and singing; 3) music should be encountered with respect for the principles of value-orientation, and musical mother tongue is the guarantee of this; 4) the prerequisite for educating music experts is the acquisition of musical literacy (music reading and writing) with the use of relative solmization. The application of the relative sol-fa syllables can serve as a memory aid for reading pitch. The principles listed can be interpreted in several categories, and with each other in a hierarchical relationship. Figure 1 presents this model.

The idea of "Music should belong to everyone!" and Kodály's aim to educate the public determined his life's work. His social activities, musical work, pedagogical writing and his compositions (e.g. choral works) all belonged to it. When he first became acquainted with English choirs in 1927, he realized their importance, their balancing role in society and their capability to create a harmonised collective life. We should also mention Jenő Ádám, who helped to put into practice what he called the 'Hungarian method', which is also widely-known as the 'Kodály method'. It was Kodály who wrote the preface to Jenő Ádám's book entitled *Systematic Singing Teaching Based on the Tonic Sol-fa* (written in 1944), which laid the foundations for present day Hungarian singing teaching. In this book it became clear that he – along with Kodály – regarded the Hungarian dramatic folk plays and folk songs as the foundations of his method.

PSZ 2017. angol.szam_beliv_v16.indd 361 2017. 04. 06. 7:29:16

Figure 1: Hierarchical illustration of the main elements of the Kodály concept



Source: Gönczy, 2009

Ádám adopted the most important elements of earlier music pedagogical methods (e.g. the hand signs of John Curwen and the tonic Sol-fa related to Curwen's concept of solmization) and modified some of them (e.g. the rhythm names invented by the Frenchman Émile Chevé) making them simpler and more logical.

The series of music course books for pupils in years 1-8 written by Ádám and Kodály between 1947 and 1948 was withdrawn from public education in 1950 because it did not meet the requirements of the socialist regime. The reason for this was the message of the new national curriculum for music teaching which was introduced in the same year: "the shaping of the socialist character with the help of music teaching".

Unfortunately, the Békés-Tarhos Singing School led by György Gulyás was closed in 1954 although it proved to be a successful initiative at a professional and socio-political level. Kodály stood up in protest against the decision, without success.

The closing of the other singing schools, publishing companies (Magyar Kórus Kiadó), and journals (*Énekszó* and *Magyar Kórus*) and the nationalisation of denominational schools had a negative effect on singing education and the choir culture in Hungary. Despite these difficulties, the works of Kodály and Ádám and their concept and method survived these hard times, even past the end of socialism in Hungary. At the same time, there were contradictions in socialist educational policy. For example, the radio programme Éneklő Ifjúság ('The Singing Youth'), which was aired from 1934, was cancelled, while a new programme *Iskolai énekkarok a Magyar Rádióban*

('School Choirs on the Hungarian Radio') was broadcast from 1946. In addition, a new journal Énektanítás ('Singing Teaching') appeared in 1958 after the closing of all the others.

The role of Kecskemét in music education

Kecskemét had an important role in the music pedagogy of the 20th century, when Hungarian and the Western European musical compositions formed the basis of the music education in the town. The chief labour was undertaken by Pál Bodon, the head teacher of the music school and the choir leader Zoltán Vásárhelyi, who played a crucial role in laying the foundations of the world-famous Hungarian choir culture with his own choir. Their capacity to work capacity can be illustrated by the fact that the *Városi Dalárda* (the local singing society) learned Kodály's three newly composed masterpieces (*Akik mindig elkésnek*, *Öregek* and *Jézus és a kufárok*) within five weeks! Zoltán Kodály asked Vásárhelyi and his choir to conduct the premieres of *Molnár Anna* and *Magyar Nemzet* and he always admired Vásárhelyi's work.

Music and singing teaching were considered of great importance in nursery and primary teacher training in Kecskemét, and they had an important role in the musical life of the town. The 65th birthday of Kodály, when he was awarded honorary citizenship, was a turning point in the life of Kecskemét. He first saw at a gala concert the music kindergarten children of Márta Szentkirályi, the teacher at the Practice School of the Teacher Training College of the Reformed Church.

Following Kodály's advice, the concept of a special music school was developed. This music primary school became a model in Hungarian music teaching and education. Through Kodály's good offices, teaching at this institute started in 1950, and it has acquired an international reputation. The teacher at the practice school of the Teacher Training College became the legendary head teacher of the music school. At the same time, the music kindergarten, which had close ties with the Teacher Training College, also gained in popularity. Furthermore, the world-famous Katalin Forrai was elected honorary professor of the Teacher Training College of Kecskemét after 10 years of harmonious cooperation. The folk music researcher, church musician, composer and chorister Dr Lajos Kálmán also joined the institute and was awarded honorary citizenship of Kecskemét.

The ideas of Kodály, and the success of the Kodály School turned the limelight on Kecskemét. The first Kodály Seminar was organized in the summer of 1970. The Zoltán Kodály Institute for Music Pedagogy was established and teaching started in 1975. In the same year the International Kodály Society was founded. In 2005 the Zoltán Kodály Institute for Music Pedagogy joined with the Franz Liszt Academy of Music. A three-year integrated training course for nursey and primary school teachers started at the Institute for Preschool Teachers in 1983.

The Teacher Training Faculty has offered courses in English for international students since 2005. The Kodály and Contemporary Hungarian Music Education programme contributes to the popularity of Kodály and Hungarian music pedagogy.

PSZ 2017. angol.szam_beliv_v16.indd 363 2017. 04. 06. 7:29:16

The transfer effects of Kodály's musical training

"Music is the manifestation of the human spirit, similar to a language. Its great men have conveyed to humanity things unutterable in any other language"
(Zoltán Kodály)

The relevance of music education and the transfer of musical skills have been proved by numerous studies. Music making (playing an instrument or singing) has a significant effect on other important cognitive, affective and metacognitive domains. Although the social role of music has changed a lot by the 21st century, choral singing and the playing of instruments still have a remarkable positive effect on group cohesion, communication skills, social competence, cooperation, problem solving and emphatic skills (Hagen–Bryant, 2003; Gerry–Unrau–Trainor, 2012). Previous studies also indicated positive transfer effects for musical abilities on mathematics (e. g. Schmithorst–Holland, 2004). Playing or singing from notation requires mathematical thinking-related processes to sub-divide beats and turn rhythmic notation into sound (Hallam, 2010).

The human brain has the potential to reorganize its neural networks. As a result of the effects of musical perception, neural structures are rearranged (Bever–Chiarello, 1974, in Janurik, 2008). These activities involve a much larger brain region than the simpler verbal activities. Music instruction for children at an early age activates abundant and efficient connections, resulting even in increased size of the activated brain areas (Flohr–Hodges, 2002). Altenmüller and Gruhn's (2002) results suggest that musical expertise influences auditory brain activation patterns. They claim that changes in these activation patterns depend on the teaching strategies applied. So the brain structures involved in music processing reflect the personal experiences accumulated over time.

In the 1960s, Zoltán Kodály encouraged a four-year, multi-institutional study launched by Klára Kokas that systematically tracked children who regularly studied music in school. The results showed a better outcome for children involved with music activities in arithmetic, writing, and creative problem solving and in the area of movement in contrast with their peers in normal education (Barkóczi–Pléh, 1982). This exploration of musical education pointed out the transfer effects of the Kodály concept and proved that regular musical activity results in a positive change in other non-designated areas of knowledge (Kokas, 1972). The results imply that music education might have a possible compensatory effect in the development of creativity and the modification of the structure of intelligence. Correlations between creativity and intelligence also increase due to musical education, with regard to the relationships between personality and intellectual performance; the results suggest that high creativity is combined with emotional sensitivity and inner control in children exposed to more music, and they tend to mobilise energy and activity in the convergent tasks requiring more disciplined thought (Barkóczi–Pléh, 1982).

PSZ 2017. angol.szam_beliv_v16.indd 364 2017. 04. 06. 7:29:16

Folk music in the Kodály concept

"Hungary is an integral part of Europe: its tradition has to live. The purpose in the life of a country and a people situated at the point of impact between East and West can only be to belong to both, and to smooth out and blend the contradiction between the two.. We can and must learn from the musical culture of all nations. Isolation and lack cultivation can dry out the national traits as well"
(Zoltán Kodály)

Kodály believed that every nation has a body of suitable folksong material for teaching music, so it should be simple to use folk songs during singing lessons. Hungarian folk music feeds from multiple sources and it was affected by the music of other nationalities. Kodály's children's choruses are based on Hungarian folk songs, like the first one from 1925, when Kodály's interest turned toward music education (*Villő* and *Túrót eszik a cigány / The gypsy is eating cottage cheese*). Kodály's pedagogy emphasizes developing music literacy through the innate music of the culture, beginning with folk songs that he rated alongside the works of classical composers.

Zoltán Kodály composed reading and singing exercises for practicing from primary to professional levels. He claimed that music reading and writing (like the alphabet) can be learnt by anyone. In Hungarian music education, sol-fa lessons are primarily built on the pedagogical compositions of Kodály. These works not only improve music reading and writing, musical memory or intonation, but they also introduce students to joint musical activities such as group or choir singing via valuable music material.

Music literacy instruction

"Often a single experience will open the young soul to music for a whole lifetime"
(Zoltán Kodály)

Written language is a relatively recent cultural invention which came into existence some 5000 years ago (Rayner–Pollatsek, 1989; in Csapó–Csépe, 2012), but remained the privilege of only small proportion of the world population until a few hundred years ago. Almost 90 per cent of all children can learn to read alphabetic as well as non-alphabetic scripts and write fluently without obvious problems (Csapó–Csépe, 2012). In all cultures word literacy preceded music literacy. The earliest known musical notation is based on the alphabetic principle of one pitch represented by one symbol. The notational methods in most cultures share similarities, with many of them being alphabetic notations, using words, syllables, or letters to stand for single sounds or a

PSZ 2017. angol.szam_beliv_v16.indd 365 2017. 04. 06. 7:29:16

fixed pitch (Cole, 1974). Guido of Arezzo initiated the use of a stave of four horizontal lines. He also placed the letters C or F in their appropriate places at the beginning of each line, further refining the accuracy of the system. Bar lines, expression signs, and Italian terms to indicate tempo and dynamics came into use in the 17th century. By about 1700, the modern system of notation, using a stave of five lines had become firmly established.

Music literacy is traditionally defined as an acquired musical knowledge and a skill to translate notation into vocal sound (reading/singing) and sound into notation (notating/ writing). Thousands of pieces of researches have dealt with reading during the past few decades, but only a few of them have investigated music reading, and no global theories have been invented. The method and texts used are important to the reading motivation of the students. Students can be motivated to read more by encouraging them to act out the reading experience (Józsa–Steklács, 2012). Art education should involve visiting art institutions (theatres, concert halls, museums and exhibitions) and also the discussion of the experiences. Csíkszentmihályi found an important relationship between full involvement in the activity and the learning process. Music can cause a flow experience, which can happen if someone is able to listen to the music in an analytical way. The flow is greater in those who can play the music themselves (Janurik–Pethő, 2009).

The term 'functional music literacy' is defined by Jorgensen (1981) as the minimal level of musical skills which enables students to function with musical materials. Functional reading literacy is generally seen as an enculturation process where literacy practices at school are designed so that they resemble literacy events, practices, and authentic texts used for specific purposes in real-life contexts, emphasizing social interaction and collaborative construction of meaning (Linnakyla, 2007). The principal aim of music education is to develop functional musical literacy through solo or group (choir, chamber or orchestra) performances.

With eye tracking analysis music reading, including fixations, saccades, pupil deletions and blinks can be observed. Eye tracking technology has developed rapidly in the past few years. Researchers are examining the nature and development of information processes in several fields such as reading, mathematics, music, art, language, sciences, Information Technology and even in market research. It is suggested that the individual's musical skills significantly influence the eye movements during music reading. It was Louis Émile Javal, an ophthalmologist from Paris, who first drew attention to the behaviour of the eyes during reading at the end of the 19th century. Javal observed the eye movements of primary school students during the reading process and found that the eyes do not move continuously, but skip from one point to the other in the text. (Steklács, 2013). Musical structures are important in reading materials to enhance and facilitate students reading skills.

PSZ 2017. angol.szam_beliv_v16.indd 366 2017. 04. 06. 7:29:16

Testing music reading skills

"…it may well be hoped that by the time we reach 2000, every child who has attended a primary school will be able to read music fluently. This, however, will only be an external sign of what will surely have developed by then and will rightly bear the name of Hungarian culture"
(Zoltán Kodály)

Assessment is an essential component of music teaching and the learning process. With the help of a valid, reliable, and individualised assessment, students are able to develop important musical skills and move closer to reaching the ultimate goal of music literacy instruction: independent musicianship. Our research examined the reading skills of a total of 1071 10-18 year-old students with music reading skills based on the Kodály concept. Our eye tracking research was carried out among music and mainstream school pupils (N=78) in Germany, Hungary and Luxembourg between 2013 and 2015.

A number of conclusions on music reading can be drawn on the basis of the thermal images of the eye movement tool. The eye fixates for the longest period at the beginning of the music score, examining the meter and the different key signatures, and also fixates on the more complex rhythms and intervals. On the thermal images we can see where the eyes fixate the longest, with these parts highlighted in red, and where students looked rarely, with these areas shown in green (see Figure 2).

Figure 2: The heat map of the music reading of 14-year-old students

The importance of this research is it could be possible to determine the areas in different music materials where students have difficulties during music reading. It can also be concluded that the music structure of the exercises by Zoltán Kodály facilitates students' music reading skills.

Our online measurements were based on the results of our previous eye tracking research. The aims of the research were to develop and test an online measurement for music reading and also to examine the results in order to get an overall picture of 10-18 year-old students' music reading skills. Our assessment was carried out using computer-based musical assessment tools. These are time-efficient and easy to administer, provide a highly motivating environment for students and open new

PSZ 2017. angol.szam_beliv_v16.indd 367 2017. 04. 06. 7:29:16

possibilities in the field of technology-based transfer research. Computer-based data collection enhances the objectivity and validity of the measurement and evaluation (Csapó–Csépe, 2012).

We conducted our research in primary and specialised music schools. Our musical tests were developed to measure the disciplinary dimension of music reading and we also placed an emphasis on Kodály's music reading exercises. Our test designed for music school students contained 55 closed items. For mainstream school students a similar assessment form containing 35 items. Our online test contained an appendix of three map reading tasks exploring students' spatial abilities, because it was hypothesised that visual/spatial orientation is related to music reading skills. To my knowledge, in the international literature there are only music tests that measure mainly aural skills, and no complex measurement for music reading skills has been used in Hungary.

The findings of this research can provide information for the educational system about how familiar Hungarian students are with the components of music reading. They can further support the teaching of music reading and reading strategies as a curricular objective and the development of detailed curricula. The validity of the tests are confirmed by the better results of the music school students.

If the achievements of the two different types of schools are compared, it can be observed that the achievement of the music school students was higher, at 76.69 per cent, while that of mainstream school students was only 55.23 per cent. This is not at all surprising, as there is more emphasis on teaching music reading in music schools. The reading achievement of the upper school pupils significantly correlated with achievement in the visual/spatial test ($p<0.001$). Music school students achieved significantly better results on each task of the map-reading subtest than primary school students. In the background questionnaire the cognitive background variables were represented by the school grades. Most of the correlations were found between the performances in the music reading tests on the one hand and Hungarian literature, grammar, English, biology, music and with behaviour and diligence on the other. The music reading achievement has a connection with the use of metacognitive strategies and also with some components of functional music literacy, such as performing as a soloist, or in a choir.

Extending the online music reading testing across different cities in different countries can increase the generalisability of the results. The online platform makes it possible to bridge distances. The test also has a version in German which was used to test the music reading skills of primary school students in Luxembourg on the online platform.

These tests could be a helpful guide for future music instruction and they can serve as an objective component of the students' evaluation. They also help the students and the music educators to understand the value of achievement in music reading, both as a part of their grades and as a part of their developing musicianship.

PSZ 2017. angol.szam_beliv_v16.indd 368 2017. 04. 06. 7:29:16

Summary

"Real art is one of the most powerful forces in the rise of mankind, and he who renders it accessible to as many people as possible is a benefactor of humanity"
(Zoltán Kodály)

Zoltán Kodály composed reading and singing exercises for practicing from primary to professional levels. He claimed that music reading and writing (like the alphabet) can be learnt by anyone. Kodály wrote numerous articles and essays on his educational concept and gave many speeches at international conferences. He stressed that the goal is not only to teach music, but also to improve teaching techniques (Király, 2012). In all his pedagogical writings Kodály emphasised that music should have a central role in education. Although the application of Kodály's ideas on music education in Hungary is rooted in Hungarian folk music, his concept is easily adaptable to the folk music of any other nation. Improving students' music reading is one of the central parts of general and specialised music education and it is able to influence life-long involvement in active music making, and can also heighten the enjoyment of listening to music and add value to students' lives.

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PSZ 2017. angol.szam_beliv_v16.indd 370 2017. 04. 06. 7:29:16

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Adél Vehrer

Hungarian Folk Customs and Traditions

Summary

In folk cultures the complex system of folk customs regulated and determined the everyday lives and festivities of the members of long-established communities. As a consequence of the social and economic changes that have taken place over the past century, the entire system of traditions has been reshaped and it has become part of our everyday lives to continually pass on folk customs between nations and cultures. The passing on of traditions played a key role in peasant society for many centuries, and was influenced by a number of factors. Today, however, the place and role of the generations have been transformed by this process. In contrast to past centuries, the present day is characterised by the development of technology. The information society has brought a substantial change to people's lives, and today most of traditional folk culture is only a historical relic. Traditions can, nevertheless, still fulfil their role if we can pass them on to the coming generation, and so it is the responsibility of all of us to maintain and carry on traditions.

Keywords: folk culture, holidays, religious festivals, symbols

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The theme of folk customs has long been at the centre of interest of academic research and public opinion. The category of customs is an extreme complex concept, being applicable to the whole of the folk culture; therefore customs can also be defined in many ways. Some researchers consider them to be a pattern of behaviour that a given social group regards as appropriate and correct because they are in keeping with living cultural traditions. According to others it is the aggregate of ritual activities which are not present in urban culture. Their main characteristic is that the members

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PSZ 2017. angol.szam_beliv_v16.indd 371 2017. 04. 06. 7:29:16

of a community learn and copy them, and thus they are the outcome of socialisation. The passing on of traditions can be a result of conscious learning, but it can also be an unnoticed by-product of upbringing and following in others' footsteps (Dömötör, 1974:20–21). From another point of view, folk customs are behaviours and actions which have developed over a long period of time during social coexistence and have become permanent through repetition, and their increasingly uniform patterns have become socially accepted and part of tradition. Customs regulate, regularise and organise the ways in which people express themselves and the course of people's lives. Thus they are of normative value and the pattern nature of the customs prevalils during learning. In peasant society they were values to be followed, even compulsory, and it was not advisable to act against them within the community (Verebélyi, 1998:402).

Today's rhythm of life and work is not influenced by the changing seasons, whereas they used to determine the lives of rural people. In folk chronology the four seasons jointly comprised a natural life cycle which determined not only the order of agricultural work of the peasantry, but also their everyday lives, days of rest and feasts. Over centuries they learnt how much time t was needed for which work, and longer work processes were always followed by recreation. After successful work, they held a feast and they drank a toast (harvest toast, feast on pig-killing day, and harvest celebration).

The peasants' calendar and time schedule did not adjust to the time measured by the clock. For the people the concept of time was marked by concrete events that happened to them or happened in their surroundings (e.g. ever since I had my wits, when I was a lad, when I served in the army, when I was a baby clinging to mummy, I have lived long enough etc.). The daily working hours of peasants adjusted more to the course of the sun in the sky, and the daily schedule was different in winter and summer, depending on the length of the day. The other concept of time was defined by events linked to seasons, and field work was especially crucial in the concept of time, as this was the most important series of events in the year. Time was defined in this way: during harvesting, threshing, corn snapping or hay collection. The folk calendar based on seasons is primarily linked to the course of the moon in the sky. This "moon-time" is kept in many of our traditions: it is believed that ploughing should be started at new moon and the changing date of Easter is also based on a lunar calendar. Typically if people define time by the calendar, then events related to certain days are mentioned (at New Year's Eve, on the Twelfth Night or Epiphany, at Candlemas, during Lent, on Shrove Tuesday, or on Ash Wednesday), or names saints instead of the actual date on Saint George's day (24 April), on the Feast of Saints Peter and Paul (29 June), during the feast days of the Ice Saints (11, 12 and 13 May).

So the church year was broken up by various Christian religious festivals, which the church required to be celebrated based on the most important events in the life of Jesus. Religions before Christianity had their own feasts, for example the beginning of the year, the beginning of spring, the harvesting of the crop or the remembrance of military victories. In each case Christian holidays replaced the old festivals in the calendar, and so customs became contaminated, but as time went on they blended into each other to form a unity (Bihari–Pócs, 1985:123–124).

PSZ 2017. angol.szam_beliv_v16.indd 372 2017. 04. 06. 7:29:16

Holidays and Feast Days

A basic function of folk customs is to organise and break up the uninterrupted flow of time. Among customs, special significance was given in folklore to holidays, which were special occasions when individuals behaved differently than in everyday life and followed norms established by the customs – for example specific costumes, meals and behaviour. In our country there are two main systems that determine the forms of holidays and feast days: on the one hand *peasants' work* (agriculture and animal husbandry), on the other *Christian liturgy*. Thus customs follow the changing seasons, but also embrace the movable holidays of Christian liturgy (Verebélyi, 1998:415).

In Europe long ago, there were various customs for counting the beginning of the year. In our country, for example, the new year began at Christmas on 25 December. The first of January was the beginning of the year in the secular calendar and became widespread after the introduction of the Gregorian calendar in 1582. The naming of New Year's Day as small Christmas is a trace of the changing ways of beginning the year.

Thus the folk calendar does not start with the official beginning of the year, the first of January, and so winter festivities commence in November, starting from Saint Catherine's Day (25 November). In the folk calendar this was the first day of winter. This day is mostly associated with prohibitions on women working and with predictions for the weather, the best known among them being, "Frosty Catherine is followed by mild Christmas" ["Ha Katalin kopog, akkor karácsony locsog"].

The liturgical calendar commences with *advent*, four weeks before Christmas. Advent is a Latin word meaning 'coming', and we hold it in remembrance of the preparations for the birth of Christ at Christmas. Long ago, all festivities were forbidden during this period and, what is more, in the 18th century no weddings could be held then. What also characterises this period is the efforts made to predict or influence the next year by magic: the harvest, the success of agricultural work, marriage, children, or the reproduction of animals. As this was the beginning of the year, it was thought that whatever the beginning is like so will be what follows too, and thus the whole year (Tátrai–Karácsony Molnár, 1997:13, 25; Bihari–Pócs, 1985:125).

St Andrew's Day (30 November)

It was a widespread custom in the Carpathian basin that girls spent this day fasting and could only eat three grains of wheat and drink three gulps of water. At night they put some kind of men's clothing under their pillow and believed that in this way they could dream of who their husband would be (Tátrai, 1990:210). In Sokorópátka (in Győr-Moson-Sopron County) there is a story that people remember as true: there was a girl who saw in her dreams a tall, lean man with a whip in his hand. It was only later that she got to know her husband, who looked like the young man in the dream and was a farm labourer. There is even a well-known song about this in this village. Jenő Huszka uses this theme in the well-known entrance song to his operetta, Prince Bob.

PSZ 2017. angol.szam_beliv_v16.indd 373 2017. 04. 06. 7:29:16

"On St Andrew's day young girls sleep on men's trousers.	*[„András-nap éjjel az ifjú lányok férfinadrágon alszanak.*
I had my mother buy me a pair and hid them under my pillow.	*Én is vetettem anyámmal egyet, elrejtettem párnám alatt.*
I lay on them excitedly to dream about a handsome lad.	*Reá feküdtem izgatottan, hogy szép legényről álmodozzam.*
Although I close my eyes, I endlessly see trousers.	*De hiába hunyom le szemem, nadrágot látok szüntelen.*
I poured lead, cooked dumplings and knocked to see the devil.	*Ólmot öntöttem, gombócot főztem, fölkopogtattam az ördögöt.*
I give no credence to superstitions, I will be a bride in the end.	*Keveset adok a babonára, menyasszony leszek nemsokára.*
My life is a golden flower and a brown-eyed lad is my sweetheart."	*Aranyvirág az életem, barna legény a kedvesem."]*[1]

St Nicolas' Day (6 December)

Various customs are followed in memory of the bishop Saint Nicolas, who lived more than 1500 years ago in Myra in Asia Minor. Saint Nicolas was greatly honoured in Hungary, with more than fifty towns and villages bearing his name e.g. Kunszentmiklós, Szigetszentmiklós, and Mosonszentmiklós – he was the patron saint of these villages. The legends surrounding him tell that he did good to children, merchants, sailors, millers and fishermen.

In olden times there was a Santa Claus procession ["mikulásjárás" in Hungarian] in Transdanubian villages: young lads clad themselves in red or white clothes as Santa Claus or a chain-holding Saint Nicolas, who was flanked by a scary, black, sooty figure called Krampus. They visited houses one after the other, where they received soft sweet bread, wine or money. Krampuses scared girls with canes and chains, praised or scolded children or lightly whipped them. St. Nicolas day costumes and the giving of presents to children are new customs in our country that became popular along with the Christmas tree (Edelényi, 2005; Tátrai–Karácsony Molnár, 1997:171–174).

St Lucy's Day (13 December)

According to the legend, Saint Lucy died a martyr for her Christian faith. Her name originates from the Latin word, lux, meaning light. Before the introduction of the Gregorian calendar the thirteenth of December was the shortest day of the year, i.e.

PSZ 2017. angol.szam_beliv_v16.indd 374 2017. 04. 06. 7:29:16

the longest night. For this reason the medieval church chose this day as the feast day of Saint Lucy, who symbolises light. This was the time when people should be most afraid of witches, therefore long plaits of garlic were placed in a cross-shape in windows or the door was barricaded with a sweep. This day is also associated with customary actions and beliefs which are not linked to the figure of Saint Lucy.

At this time people began to fabricate *Lucy's chair,* which in most locations was made from thirteen different woods. The purpose was to stand on it on Christmas Eve and see witches who wore horns on their heads. The chair was put together slowly, which is reflected in the saying "it is taking as long as Lucy's chair" ["Sokáig készül, mint a Luca széke"]. There was a custom mainly in Transdanubia which was named "lucying" ["*lucázás*"] or "clucking" ["*kotyolás*"] and was when boys went from house to house, singing songs and citing poems to conjure up fecundity. The "lucies" came at dusk. They knelt down on the hay and wished all the best to the people in the house with a song that began "Lucy, Lucy, cluck, cluck, may your chicken lay eggs…" ["Luca, Luca kitty-kotty, tojjanak a tyúkok…"]. In many places housewives scattered corn on hens so that they could be as copious as corn. As a reward boys got apples, walnuts or money (Bihari–Pócs, 1985:128–130).

This day is also associated with *prohibition*s *on work*, mostly linked to fertility magic on chickens. It was forbidden to spin and weave because then chickens would not lay eggs and whoever sewed "would sow up the rears of hens" (Vehrer, 1992a:23). Housewives had to sit a lot so that hens would sit well on their eggs. *Marriage fortune-telling* procedures were performed on Saint Lucy's day. The most well-known of them was putting slips of paper with male names in dumplings and cooking them in boiling water. Whichever slip came to the surface first would be the name of the girl's husband. Similarly, male names were written on slips of paper and thrown each day into the fire. Whichever remained to be thrown in at Christmas was expected to be the name of the girl's husband. Lead was also poured into water and from the solidified form conclusions were made about the occupation of the prospective husband (Tátrai, 1990:221–228).

Christmas

In villages in olden times, it was not the decorated Christmas tree and the lit candles that signified the beginning of the festivities. In many places it was, for example, customary to hang an evergreen plant like juniper on the crossbeams. It has only become common to have a Christmas tree in the last fifty or sixty years. In former times, neither was it customary to give presents, with children receiving at most some shiny coins from their godparents. In those times it was rather the programmes that were attractive to children: they could go and sing carols ["kántálás"] and recite Christmas greetings ["mendikálás"], act out the nativity scene ["betlehemezés"] or congratulate on their name days any relatives called Stephen [István] or John [János]. Between Christmas and Epiphany adults had a rest and the family was together (Tátrai–Karácsony Molnár, 1997:186–188).

PSZ 2017. angol.szam_beliv_v16.indd 375 2017. 04. 06. 7:29:16

On 24 December, people fasted until the first star appeared, and so this day was called the fast of Christmas. The festive dinner consisted of food eaten during the fast: soup from dried fruit, pasta sprinkled with poppy seeds, pumpkin, walnuts, apples and kalács [a braided egg-enriched bread similar to challah]. Animal fodder was put under the table: hay, oats, straw or corn. At Christmas people came to *act out the nativity scene* and serenade with Christmas folk songs. They acted out the story of Christ's birth, with the addition of funny stories over time, such as the deaf shepherd who was hard of hearing and misunderstood everything. Often the actors were young people, but in Transylvania the actors were male adults (Tátrai, 1990:232–238).

On 26 December it was customary in West Transdanubia and in Transylvania to *sing and recite Christmas folk songs* ["*regölés*"]. The performers were called "regös", a word denoting travelling minstrels who used to visit medieval royal courts, but they only share the name. Calendars dating back to the 16th to 18th centuries call the Monday after Epiphany tale-telling Monday. According to the calendar this was the festival of drinking, revelry and merry-making, i.e. a part of the carnival period. The singing of folk songs at Christmas often preserves the memory of ancient magic songs and they were sung with the conviction that whatever they say will happen. This kind of singing is not, therefore, of religious origin, but it is more ancient and wishes good fortune for the beginning of the year.

Youths clad in animal skins and equipped with pipes made from ceramic jugs and sticks with chains hanging from them walked around the houses. They did not play a tune with their instruments, but accompanied the rhythm of the song. They expressed their good wishes to each family member and even extended them to animals. They wished fertility, wealth and good health for the New Year: "May God give this farmer two small oxen, a small farm-labourer, a golden plough and a silver whip handle, [chorus] hey regő rejtem, God has permitted it!" ["Adjon az Úristen, ennek a gazdának két kis ökröt, egy kis bérest, annak a kezibe arany ekeszarvat, ezüst ostornyelet, hej regő rejtem, azt is megengedte a nagy Úristen!"] (Bihari–Pócs, 1985:136). In the second part of the song, a maiden is conjured up for the young man: "There would be a pretty girl called Fanny Dutch, Ej regö-rejtem, Regö-regö-rejtem. There would be a handsome young man called Michael Shoemaker, Ej, regö-rejtem, Regö-regö-rejtem!" ["Itt is mondanának egy szép leányt, kinek neve volna, Német Franciska volna, Ej regö-rejtem, Regö-regö-rejtem. Amoda is mondanának egy szép legényt, kinek neve volna, Varga Mihály volna, Ej, regö-rejtem, Regö-regö-rejtem!"]. This was taken so seriously that even into the 1970s when old people were asked to sing these songs for recordings, ethnographers often noticed that they started to ponder over which two young people should be matched in the song, so as not conjure up a pair who would not be good partners for each other (Edelényi, 2009:95).

The singing of Christmas folk song contains some interesting elements that are still mysteries to academic research. One such element is the part of the introduction about the mythical stag. Among many European, Asian and North Indian peoples the stag is the symbol of the starry sky, principally the winter sky, so this part may evoke the winter solstice and the renewal of seasons in this mythical image. Interestingly,

PSZ 2017. angol.szam_beliv_v16.indd 376 2017. 04. 06. 7:29:16

although the custom of singing these kinds of Christmas folk songs was widespread all over Europe, its Hungarian name is special. Linguists say that the word "regölés" is of Finno-Ugric origin and the chorus "hej, regő rejtem" retains the traces of Shamanism, hinting at the trance or ecstasy that the shamans of the ancient Magyars fell into (Verebélyi, 1998:416–417).

Holy Innocents' Day (28 December)

Holy Innocents' Day commemorates the children massacred in Bethlehem who became martyrs for Christ. On the one hand *caning* and *whipping*, which was common on this day, is related to the biblical story as believed by the people: on this day in Bethlehem male children died therefore girls have to suffer at this time. On the other hand it is a ritual to bring fertility and health.

The custom of whipping was well known all over the country. The scourge used to be a clerical sacrament back in the 15th and 16th centuries. Then in one of his surviving sermons the famous preacher Temesvári Pelbárt scolded those people who distorted this clerical custom, using it for indecent jokes (Dömötör, 1979:163–164). In the 16th century, Hungarian students studying in Krakow were punished several times for this custom. Later, as the custom was fading away, only children would be flogged: "Be obedient, be healthy, be fresh and do not get boils" – they were told while they were given a light spanking with a cane. For women and girls there was a custom with a similar function. They would be caned by youths while the latter wished not to get headaches or toothache. For example, along the Danube (in Győr-Moson-Sopron County) boys conducted floggings before being initiated into manhood. The youths would go to houses containing girls and whip the people in the household. Girls would tie ribbons on the whips and mothers would give pieces of meat that had been wrapped up to the group of youths. Then the young men would return to the tavern where they cooked the meat in a cauldron. The youths would eat this together on the feast following their initiation (Bálint, 1989:127–129; Tátrai, 1990:258).

New Year's Eve – New Year

In old villages people spent New Year's Eve differently to how they do nowadays. *Noise-making* ["kongózó"] youths and shepherds went around the village, making a lot of noise with horns, bells, pots and lids. This custom evoked ancient traditions for repelling evil. On New Year's Eve people ate pork but not poultry, as people believed that pigs dug out luck, while hens kicked it behind. Lentils were believed to bring a lot of money to the household. On New Year's Day various greetings and toasts were customary. For example, groups of boys went to houses, expressing the following good wishes: "A happy New Year! Wine, wheat, apricots, piglets, wheels to my cart, bottom to my jug, red wine to my glass, let me drink plenty in the New Year!" ["Boldog új évet! Bort, búzát, barackot, kurta farkú malacot, szekerembe kereket, köcsögömbe feneket, poharamba vörösbort, hadd ihassak bőven, az új esztendőben!"]. In the end

PSZ 2017. angol.szam_beliv_v16.indd 377 2017. 04. 06. 7:29:16

they wished a happy New Year again and received money from the inhabitants of the house. In some regions it was a custom that on New Year's Day a youth would be clad as an old man and a child would flog him all along the main street of the village to symbolise that the new year had driven away the old year (Bálint, 1989:130–134).

Epiphany (6 January)

Christmastide ends at Epiphany ["Vízkereszt" in Hungarian, meaning water baptism] which was the day when people cleared the Christmas table and, in later times, removed the Christmas tree. In Hungarian, the day is named after the christening of Jesus in the temple as described in the Bible. In remembrance of this event, water was consecrated in the church in Catholic regions (the Three Magi's water). Each household kept a small portion of the consecrated water throughout the year so that it could be used to heal illnesses. Consecrated water was also believed to keep evil away from the house, and so some was poured into the well.

This was the time for the custom of the *visitation of the Three Kings*, or the Three Wise Men from the East, who were named Caspar, Melchior and Balthazar in the vernacular. This was a custom of personification, mummering and greetings. Children clad in white or young women with paper crowns on their heads would go from house to house with stars in their hands and sing greeting songs. In some regions, the custom was also called "adorning with stars" ["csillagozás"] (Tátrai–Karácsony Molnár, 1997:30–37).

Carnival Period (from Epiphany to Ash Wednesday)

In folk culture carnival time was the season of feasts and weddings. For centuries the church forbade merry-making; priests regularly preached against carnival revelry. In the 16th century, for example, Miklós Telegdi spoke from the pulpit that, "Whoever goes around in a mask against the commandment of God, men clad in women's clothes and women in men's clothes, boozing… forgetting themselves as they serve their stomach and throat, absorbed in revelry and drinking and fooling around in masks and costumes …" (Dömötör, 1979:88).

The highlight of the carnival festivities was the appearance of the masked and costumed figures at houses to perform mummery. Back in the time of King Matthias the Italian relatives of the queen sent artistic masks as presents to their Hungarian relatives. In the 16th and 17th centuries, people in villages, towns and at the royal court all wore masks at carnival time to amuse themselves. Carnival festivities were popular in the court of the ill-fated Louis II until the time of the battle of Mohács. Records from 1525 attest that on Shrove Tuesday there was a masked procession in which an elephant also participated. Louis II himself appeared at the festivities in costume wearing a devil's mask. There were storks, goats, horses, and young men and women swapping clothes, while others were clad as craftsmen and made people laugh by imitating their trade (for example tinker or smith). The best fun was had by young men dressed as expectant mothers. Across Europe there are customs that welcome spring and the awakening nature which mark the end of winter and the cold (Burke, 1991:217–221; Verebélyi, 1998:419–422).

During carnival the only sad young women were those left on the shelf, who had not managed to get married. Young men ridiculed them and made them *"pull a log"* on Shrove Tuesday. This custom had several variations; for example, in Szatmár youths shouted into the house while knocking a piece of tin under the window, "Time is up, time is up, you're still on the shelf!" ["Húshagyó, Húshagyó, itt maradt az eladó!"]. In Jászság borken pots full of ash were thrown into the yards of houses with maidens. In West Transdanubia a mock wedding was performed together with the *log pulling* if there was to be no wedding in the village that year. Its participants were a mock bride, a mock bridegroom and wedding guests (devil, gypsy, clown, and craftsman) who acted out a humorous wedding (Edelényi, 2009:98). In the Vend region[2] this still-living custom is known by a number of names: log pulling, lumber pulling, and fir tree wedding. The custom is first mentioned in the 17th century; there are records from this time referring to the custom of the community denouncing those who do not comply with their first and foremost public duty i.e. to bring offspring into the world. Csokonai also records this in his notes to Dorottya: "Pulling a stump. It is customary in many places when the carnival period ends, unmarried youths and maids were made to lift or drag a log or piece of wood from place to place as a joke. The good-looking would put wood shavings, splinters, wood chips or the like into the pockets of such people, perhaps folded in envelopes or paper" (Dömötör, 1979:93). András Dugonics also mentions the custom of log pulling: "In times past those girls of marriageable age who did not marry during carnival were made to pull stumps on Shrove Tuesday like untamed mares" (Dugonics, 1820:287).

Easter Festivities (from Palm Sunday to Easter Monday)

Palm Sunday

This day commemorates Jesus' triumphal entry into Jerusalem. People lay palm leaves at Jesus' feet. In remembrance of this event in the Mediterranean people bless palm leaves, while in Hungary they bless willow twigs in Catholic churches. The blessed willow is taken home, as it is believed to ward off illness and lightning strokes from the house.

Palm Sunday was both a clerical and a popular holiday. On this day, long ago, there was the custom of *kisze* driving or carrying, which was preserved in its best-known form in Zoboralja in Slovakia [Zoboralja was a region in the former Kingdom of Hungary] and among the palóc people along the river Ipoly. Maiden women would make a straw doll, clad it in married women's clothes and carry it through the village in a group. At the end of the village it was thrown into the water or burnt. Through this action they drove away the winter and illness from the village and signalled the end of the fasting period. The song sang as part of this custom begins like this: "Hey, out kisze, hey!

PSZ 2017. angol.szam_beliv_v16.indd 379 2017. 04. 06. 7:29:17

Come in, ham, come!" ["Haj, ki kisze, haj! Jöjj be, sódar (sonka), jöjj!"]. Names of the straw doll would be: *kisze, kiszi, kiszőce, kiszice, kice, kicice, kicevice,* or sometimes *banya* or *villő.* Maiden women would do fortune-telling on their marriage prospects from the direction in which the straw doll, or handful of straw torn from the doll, drifted away. Sometimes they rubbed their faces with the wet straw to avoid freckles. They asked for clothes for the straw doll from newlywed women and those who did not provide clothes were mocked in a song (Manga 1987:220–221). The lyrics of the songs along the river Ipoly, Galga and Zagyva all mention taking out the kisze soup and bringing in the ham with a view, perhaps, to driving away illness (Gulyás–Szabó, 1989:373–381; Vehrer, 2012:293–315).

Maundy Thursday

On this day the bells remain mute in Catholic village; they are said "to have gone to Rome". Instead they rattle away in the church spire until Holy Saturday. Often children flocked together and went around rattling on the street. The custom of rattling is a remnant of noise-making to drive away evil. In some places Maundy Thursday was also called Green Thursday, as women cooked fresh spinach on this day, believing that they were contributing to a good harvest (Bálint, 1989:207–210).

Good Friday

The church remembers the death of Christ on this day, so this is the time of the greatest fasting and mourning. Processions and passion plays were customary from the medieval era. People considered Friday an unlucky day, especially Good Friday. On this day it was forbidden to go out to the fields or to work with animals. Most of the prohibitions related to women's work, for example: whoever bakes bread this day, her bread will petrify (Bihari–Pócs, 1985:150–151).

Special powers were attributed to fire and water. Maidens and youths went out to the stream to wash in the morning in order to stay healthy. The fire was put out in houses and it was only rekindled on Holy Saturday from the embers glowing in the church yard. The new fire was believed to bring good luck and make the house's hearth lucky. If a herd of cattle was driven across the smoke coming from the new fire, it was believed to protect the animals from plague. Easter eggs were painted on Good Friday. This was the duty of women and they had to know the decorative patterns customary in the village. The old name of this ornamental pattern was "hím", and this word can be found in the word embroidery ["hímzés"], which mean "decorating" (Róheim, 1925:248–250; Tátrai–Karácsony Molnár, 1997:95).

Easter Sunday

Easter Sunday is the first Sunday after the first full moon following the spring equinox (21 March), therefore the variable date of Easter can fall between 22 March and 25

PSZ 2017. angol.szam_beliv_v16.indd 380 2017. 04. 06. 7:29:17

April. This is the greatest celebration of the Christian church, given in remembrance of the resurrection of Christ. The Easter festivities began in the afternoon of Holy Saturday, with the bells ringing again and Catholics going on procession. The "*visiting of the fields*" ["határkerülés"] that was customary on this day survived into the 20th century. Villagers went out to the land surrounding the village on the procession, inspected the green crops, prayed for good yields, and so they protected the growing crops from evil and hail with magic.

The most beautiful event of the old Easter was the *consecration of food*. In Catholic areas people would go to the morning mass with a carefully arranged basket covered with embroidered cloth, in which there was kalács, eggs, ham and perhaps even Easter lam. During the mass the priest blessed the food. By eating this food at lunchtime, they began to eat meat again after the fasting period.

The importance of consecrated meals is reflected by the accompanying beliefs. people rushed home, because whoever reached home first would also be the first to begin working in the field. The leftovers were kept; for example, what remained of the soft bread was thrown into the fire so that it could protect the house from storms and lightning strikes (Tátrai–Karácsony Molnár, 1997:96–98; Bihari–Pócs, 1985:152).

Easter Monday

Water-pouring ["locsolás"] was the holiday for young people who had not chosen their partners yet, and it was a disgrace to miss it. Rather than eau de cologne being used [the present day custom in Hungary], maidens were taken to the well and a whole bucket of water was poured on them. As a reward youths generally received painted eggs, but in Upper Hungary it was a custom for the young women to "flog" the young men in return. In Csík in Szeklerland [Csík was an administrative country in the former Kingdom of Hungary, which now lies in Romania], in Szatmár [an administrative country in the former Kingdom of Hungary, which now lies in northwest Romania and northeast Hungary] and in Nyírség maidens returned the favour on the Tuesday by pouring water on the youths. Originally water-pouring was a custom to bring fertility, as water symbolised new birth and reproduction. This is also visible in old calendars where Easter Monday is called throwing-water Monday (Bálint, 1989:312; Tátrai, 1990:159; Vehrer, 1995:7; Vehrer, 1996:48).

Pentecost

The Christian church celebrates Pentecost to commemorate the Holy Spirit coming down to the apostles after the ascension of Jesus into heaven. The name comes from the Greek word pentecostes, which means the fiftieth, i.e. the fiftieth day after Easter, and so Pentecost, like Easter, is a movable festival. In Csík in Szeklerland, a white dove is released to fly away during the mass as a symbol of the Holy Spirit.

PSZ 2017. angol.szam_beliv_v16.indd 381 2017. 04. 06. 7:29:17

Pentecost is a complex festival and there are all kinds of Christian, pagan and ancient Roman elements intermingled in its celebration. Folk customs are dominated by the celebration of fertility and nuptials and their symbolic expression. In the Roman Empire the *Floralia festival* was held during May. The celebrating crowds went out from the towns to the nearby fields, holding banners with the name of the goddess Flora, and shouting her name in a toast. Flora was a goddess of plants and flowers in Roman mythology. Flowers still play an important role in the celebration of Pentecost, above all the peony, jasmine and elderflower that are indigenous to our country (Frazer, 1993:173).

At this time of year villages were clad in green, and gates and fences were decorated with tree leaves. Long ago on this day maypoles were erected. Children also had their traditional custom in the *procession of the queen* ["királynőjárás"]. Small girls went from house to house in groups with the small queen who they elected from among themselves. She was clad in white and covered with a table cloth, which was the veil. She would carry flowers in a small basket, scattering rose petals all around. The queen was a mute character and she was not permitted to laugh if people cracked jokes. In Transdanubia the veil was lifted after the greeting and the queen was lifted up high: "Let your hemp be this high!" The purpose of this rite was to ensure the growth of hemp. As a reward for the fertility magic they received fruit or a few coins. One of the girls would bring a basket to collect the rewards (Kósa–Szemerkényi, 1973:210–211; Tátrai–Karácsony Molnár, 1997:112, 118–119).

Among Hungarian folk customs the *Pentecost king* was elected from youths taking part in races that required dexterity. In most parts of Europe this custom existed from the medieval era with horse races, various dexterity races and fights being common. In Hungary the tradition appears in written records dating back to the 16th century. The most interesting description was written by Mór Jókai in his novel *A Hungarian Nabob*. The Pentecost king "ruled" for one year after his election – therefore we say "short as Pentecost kingdom". In the 17th century he could even be a judge, but later on his power was limited to giving instructions to other youths, being able to drink for free in the tavern and being invited to all wedding feasts and parties. According to a description from the 18th century, in West Transdanubia it was a condition for the dexterity race that each lad should run a course of rope obstacles three times without interruption on his own horse and without a saddle and stirrup. The winner became the Pentecost king, who had "immunity" and could not be punished. He received a wreath of flowers from the maidens and wore it on his head throughout the evening feast. He was invited to all parties, and he could drink for free in all taverns, and his animals were kept free of charge (Verebélyi, 1998:425–426; Tátrai–Karácsony Molnár, 1997:110–111). The size of this festival the superstition surrounding it is illustrated by the following event: after the Austro-Hungarian Compromise of 1876, the Emperor Franz Joseph was meant to be crowned [as King of Hungary] on Whit Sunday, but somebody remembered that the glory of the Pentecost king is short-lived, so the ceremony was brought forward to the Saturday (Tátrai–Karácsony Molnár, 1997:111–112).

PSZ 2017. angol.szam_beliv_v16.indd 382 2017. 04. 06. 7:29:17

Csíksomlyó Festival

The Csíksomlyó [Şumuleu Ciuc] Festival is traditionally held at Pentecost and is an important holiday for the Szeklers, whose are ethnic Hungarian sub-group living in Romania. Pilgrims come from far away to the church to worship Mary. The storyof the festival dates back to 1567, when the Szekler defeated the army of John Sigismund Zápolya at the "Thieves Mountain Pass" of Harghita. Believers started to flock to the church in remembrance of this victory so that they could wait together for the coming of the Holy Spirit on Whit Sunday. Nowadays several thousand believers come from all over the world. Csángó people, Szekler and Hungarians pray together to the Blessed Virgin May, and many people hold birch twigs in their hands, which symbolise Mary. In the procession the Hungarian hymn 'Our Blessed Mother' ["Boldogasszony Anyánk"] and the 'Szekler (Székely) Hymn' are sung (Edelényi, 2006:75–77).

Erection of Maypoles

Throughout Europe spring festivities going back centuries are linked to the first of May and Pentecost. The rituals of these two essentially identical festivals have intermingled for a long time, and in certain cases are doing so even today, but nowadays the custom of *the erection of the maypole* is only connected with the first of May in our country. The historic facts show that in the north and west of the Hungarian-speaking area maypoles were also erected at Pentecost. In [modern day] North West Hungary the maypole erected on the first of May was often, and still can be, taken down at Pentecost. The taking-down ceremonies, such as tree climbing and dancing out, are likely to be related to the dexterity races of the election of the Pentecost king.

The maypole has a dual function: on the one hand it is the symbol of the rebirth of nature, and on the other hand it is a symbolic accessory of the spring customs of young people across Europe. A maypole erected in front of a public building expresses its symbolic power to welcome spring and represent the community, while a maypole erected in front of a house where a marriageable girl lives shows that it is a love symbol (Németh, 1987:506–508; Vehrer, 2011; 1995; 1996:48).

Our sources contain records of the erection of maypoles dating back to the 15th century, although the custom is even older. As with most folk customs, the erection of the maypole has a legend of Christian origin. We can read in Sándor Réső Ensel's first collection of folk customs, which was published in the 19th century, that, "It is written about the maypole that while St James and St Philip were going out to preach the gospel, an unmarried virgin girl named Valburga became their companion. For this reason the pagans declared them unclean and spoke slanderously about them. In order to chase off those mocking her, the girl took her walking stick, stood it in the ground and kneeled down in front it praying. Barely one or two hours had passed when the stick standing in the ground started to bud and bring forth green leaves. This happened on the morning of St James' Day (1 May). Therefore unwed youths

PSZ 2017. angol.szam_beliv_v16.indd 383 2017. 04. 06. 7:29:17

stand a tall green tree in front of the windows of well-behaved single girls, if possible without being noticed." The fact that the maypole is also called the James tree or James bough refers to this explanation of its origin (Tátrai, 1994:126–130).

St. John's Day (24 June)

On Saint John's Day there was a celebration of the summer solstice, from when days start to become shorter. The name of the festival originates from the event of John christening Jesus on this day in the water of Jordan. In the Orthodox church St John is named St Ivan, so the name originates from the time of the Magyar's relations with Byzantine before their conquest of the Carpathian basin. In the 16th century the church recorded that the festival of St John had taken root in the 11th century but had degenerated into a "pagan superstition" throughout the centuries and had become more associated with blinding light, jumping around the fire and ceremonial dancing.

Fire lighting was customary among many of Europe's peoples. The people of the village would sit around the bonfire, and maidens and youths would jump over the fire. Fortune-telling would be made about when the maidens would get married based on how far they had jumped, and fragrant grass was sprinkled into the fire to ward away the evil. Fruit thrown into the fire was said to have healing power and therefore children ate baked apples so that they would not fall ill. It was also a custom to make a wreath from flowers and hang it on the top of the house as protection against fire (Dömötör, 1974:162–165; Róheim, 1925:315; Bihari–Pócs, 1985:157).

Summary

From the above facts it is clear that numerous symbols appear in folk customs. *Water* was attributed cleaning, healing and fertilising power (water pouring at Easter, consecrated water), *fire* had a purging power and drove away the devil in folk customs (kisze-driving on Palm Sunday, fire lighting on St. John's Day, lighting candles at Christmas and on All Souls' Day). Making a noise was meant to drive away evil and bring fertility (Santa Claus procession, carnival, Holy Innocents' Day), while branches, twigs and canes symbolised life, fertility and the renewal of nature (carrying of willow branches ["villőzés"] on Palm Sunday, flogging on Holy Innocents' Day, erection of the maypole, which is also a phallic symbol) (Edelényi, 2009:104).

Folk customs can be individual or communal, but even individual folk customs are passed on according to community norms. In the world of peasants customs were attached to genders and age groups. In the customs of winter festivities it was overwhelmingly men and youths who took part, while during spring festivals women and maidens were more active (customs requiring the participation of men were: St. Lucy's Day merry-making ["lucázás"], the nativity scene ["betlehemezés"], Christmas singing and recital ["regölés"], the welcoming of the carnival, ridiculing spinsters; customs acted out by women included: kisze-doll carrying, and the Pentecost proces-

PSZ 2017. angol.szam_beliv_v16.indd 384 2017. 04. 06. 7:29:17

sion ["pünkösdölés"]). Folk customs can sometimes have widely differing regional characteristics – for example, the paloc wedding feast or the carnival in Szatmár –, but the customs of Christmas and carnival festivities also have regional variations. Some days may be distinguished more in one region or in one place. Individual ethnic groups have various kinds of customs such as, for example, the busó-walking celebration of the Šokci [an ethnographic group of South Slavs mainly identified as Croats] or the log-pulling of the Vends [an archaic term for the Hungarian Slovenes].

Customs may differ on religious basis, and so Catholic and Protestant customs can show differences in some cases. The customs of Protestant communities seem poorer, less colourful and less variable than in Catholic villages, although many Protestant customs retained more archaic elements. There are both sacred and secular customs, as archaic, pre-Christian elements can be found in the customs prescribed by the Catholic church. There are customs of greater ecclesiastical significance and customs that are more important in folk practice. Among the celebrations tied to specific times there are some that are linked to belief (St Catherine's Day) and others to which various customary acts are tied (St Lucy's Day) (Edelényi, 2003:60; 2009:89–90).

The complex and complicated system bound to folk customs in peasant society regulated and determined the day-to-day lives and celebrations of community members. A consequence of the social and economic changes that have taken place over the past century, as well as the rise of the information society, is that the entire system of traditions has been reshaped; today it is a day-to-day practice to continually pass on and adopt folk customs between nations and cultures. The old peasant society began to disintegrate more intensively after the World War II as it lost its economic basis due to collectivisation. The surviving elements in small household farms almost entirely lost their importance as a consequence of the changes brought about by the end of communism in Hungary. Urban life also changed but was not accompanied by the strengthening of civil society. As village people's mobility became greater, the changing cultural elements did not revolve around the values any more, and so it was no longer as important to maintain traditions (Lentner, 2005). Only those customs were able to survive which were not so closely linked to peasant work and whose power to maintain and build the community kept the tradition alive for a few decades: erecting the maypole, log-pulling, carnival and harvest processions. Tourism also played a role in the survival of these customs. Among the customs of the family and close relatives perhaps only Christmas and Easter retain century-old features. The passing on of traditions played a key role in folk culture over the centuries, influenced by a number of factors, but by today the place and role of the generations have been transformed by this process. These days it is not history, but another important factor, technology, that determines our world. The information society has brought a substantial change in people's lives, and traditional folk culture is, in many respects, merely a historical relic. A tradition can only be called living and realise its potential if we can pass it on to the coming generation so that it can find its identity and community, and so it is our common responsibility to maintain and carry on traditions.

PSZ 2017. angol.szam_beliv_v16.indd 385 2017. 04. 06. 7:29:17

Notes

[1] Data provided by Mrs Lajos Tuba née Adél Novák, born in Sokorópátka on 24 April 1929 and residing in Sokorópátka.

[2] Slovenian villages in the West of Vas county: Kétvölgy, Orfalu, Apátistvánfalva, Felsőszölnök, Alsószölnök, Szakonyfalu, and Rábatótfalu (today a part of Szentgotthárd).

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PSZ 2017. angol.szam_beliv_v16.indd 387 2017. 04. 06. 7:29:17

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Szabolcs Pinnyey

What Is the Third Dimension of the Economy Like?

Review About Book by Sarolta Laura Baritz, OP

Summary

The book *Three-Dimensional Economy* introduces a paradigm change in the economic thinking. It puts the elements of traditional economics into a new, value based approach. The book appoints human being as base and goal of economic activity, the system is embedded into the dimension of moral. The third dimension consists of values connected to moral, this way economy becomes a whole, integrated system.

Journal of Economic Literature (JEL) code: I2, I3, N3, P4, Y3

Keywords: moral good, virtue ethics

Work arises from man's created nature. He did not invent or discover it, but received it as a duty. What has been entrusted to him is to be cultivated, kept and passed on. From the very beginning, man recognised the importance and essential attribute of work, and pursued it not only for himself but also for others and for the whole community. The recognition and execution of this duty led to man organizing himself into communities and populating the earth, while working unceasingly, observing things around him and accumulating ever more valuable and useful knowledge. This process has continued ever ever since. Our everyday life is marked by work and all its implications to such an extent that a whole branch of theoretical and practical science has been organised around it. As part of the process, this science has become stratified and polarised.

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PSZ 2017. angol.szam_beliv_v16.indd 388 2017. 04. 06. 7:29:17

The recently published book by Sarolta Laura Baritz, which is her doctoral thesis for Corvinus University, makes the direction of her endeavours in this multidimensional space absolutely clear. She does not entrust the correct and necessary orientation of the economy to the reader's subjective assessment.

The title is both enigmatic and promising, veiled and transparent. Three-dimensional. Three-dimensional? Three-dimensional?! What on earth can it be? Is it some science fiction story? Yes, in a way, it is. Firstly, because for many people the ethical economy is nothing but fiction, and secondly, because such positive insights, which are presumably well beyond the imagination of the reader, prove themselves right. Nevertheless, the book is not about predictions or an imagined future but about well-founded objective scientific arguments for a human-centred economy based on theoretical and practical research. Having read the book, we can boldly say that a whole economic programmes is unfolding before the eyes of the reader.

To better understand the book, it is worth having a look at the career of the author. Sarolta Laura Baritz graduated as an economist in 1983. Thanks to her knowledge of Russian and English, she worked for foreign trade companies and then ended up at Pepsi Cola Hungary. After being a successful manager for many years, her life was radically changed. In 1994 she joined the Hungarian Province of the Dominican Order, where she still serves today. Her leaning towards economics, however, did not end. She started to do theoretical and practical research. With the recognition of her vocation, her mission was also beginning to take shape; it is – to use her own words – to explore and get to know the virtue ethics-based or anthropocentric economy or, as the title of the book puts it, the three-dimensional economy. She spreads the details of the economic-related social teaching of the Catholic Church among believers and non-believers alike. She wants to make clear that the Church has social teaching, that this social teaching on economics is exceptionally profound and well thought out, and is meant for all people of good will. That is how postgraduate training in Christian Social Principles in Economics (abbreviated as KETEG in Hungarian) started at the Sapientia College of Theology in 2010 and whose little sister – as Sister Laura puts it – is an optional one-semester subject at Corvinus University in 2014.

A manager, then a religious sister. Not a typical career. Difficult and irrevocable decisions. Commitment to Somebody and something. Faith in God and in anthropocentric economics. The fullness of Heaven and Earth in the author's life.

Now, let us turn back to the book. After analysing the title and the author's career, it is worth dealing with the structure of the book and the content of each section. The book is divided into three large and clearly distinct structural units.

The first section deals with the theoretical foundations. The theory, however, covers not only economics but – due to its interdisciplinarity – also provides an exciting excursion into philosophy, psychology and theology. Finally, the theoretical foundations of the three-dimensional economy are presented as a coherent whole made up of different elements and submodels.

The second part of the book focuses on empirical research. Attractive hypoth-

PSZ 2017. angol.szam_beliv_v16.indd 389 2017. 04. 06. 7:29:17

eses, concise explanations and detailed methods are shown as sets in various diagrams and graphs. The reader is not left to their own devices. The questions and hypotheses will not only be addressed but also proved right.

The third section integrates the theory and practice. The river reaches the sea. Theory and practice complement each other to create a common platform for three-dimensional economics.

As an added bonus, we are provided with numerous appendices and supplements which serve partly as keys to the terminology and partly as descriptions of research work.

The book does not start from Adam and Eve, but it does go back to the beginning, summarizing the main points of economic thought and activity from Aristotle through St. Thomas Aquinas to the modern age. The history of the Aristotelian terms 'oikonomia' and 'chrematistics' is presented as a real novelty. The two contrary economic "paradigms", of oikonomia and chrematistics as the two main types of economy can be traced back to Aristotle's *Politics.* They are the archetypes of natural and unnatural economy respectively. The difference lies in their purpose. Natural economy (oikonomia) is to keep and maintain the community, the family and the city state while unnatural economy (chrematistics) is to accumulate wealth. The resemblance between the anthropocentric or virtue ethics-based economy and the profit maximizing or profit-centred economy is not due to chance.

One of the key ideas in the theoretical section is based on Aristotelian thought or rather its Thomistic adaptation. This is the right order of "goods". It was St Thomas Aquinas who explored and rethought the right order of "goods". St. Thomas differentiates the useful good, the pleasant good and the moral good. The useful good is a means, not an end in itself. The pleasant good is a type of accompaniment to reaching a goal but never an end in itself either. The moral good is what we love for its own sake, and which comprises non-material values. Therefore, the useful good serves as a means of attaining the moral good. Useful goods include not only profit and material goods in general, but also the economy. What conclusions can be drawn from this? Well, let us see. The economy as a useful good is a means of realising moral good, which means that the economy is useful but only at its own level, as an instrument rather than a goal. Hence, the purpose of the economy is not to maximize profit but to serve the community or – using the relevant Catholic terminology – the common good. The difference between the profit-maximizing and the anthropocentric economy is that the former is reduced to the useful good while the latter is organized around the moral good. From here it is only one further step to understand the three-dimensional economy. This logical step is the moral good itself and whatever is based on it. The three-dimensional economy is one based on morals, where anthropocentrism and morality is the foundation, and this ensures the operation of the economy serves as the regulatory principle of the economic order.

The empirical research is based on thorough, deliberate and solid theoretical foundations. The research findings appear already in the subtitle of the book: *It is Possible to Operate Within a Virtue Ethics Paradigm.* The author played it

PSZ 2017. angol.szam_beliv_v16.indd 390 2017. 04. 06. 7:29:17

safe. Knowing the theory and the practice, she boldly proclaims far and wide that it is possible. This section shows how the research was planned, conducted and analysed as well as the methodology used. Here the reader is sailing into more difficult waters but experienced sailors know that the goal is to reach the opposite shore rather than take a pleasure cruise. And we are not disappointed here either, because we do not have to wait long for the lights on the other shore to appear. We are approaching our destination.

The synthesis of the book comprises two main areas that run through the whole book. One is the connection between the scale of human values and economic order, and the other is the relationship of the individual to the structure. The theoretical and practical implications of both subjects – and, of course, a number of others – are abundantly presented at the reader's table. Meat and potatoes are there. Bread will not be needed. We are full and satisfied. With our doubts and uncertainties disappearing, we unknit our brow. Yes, it is possible.

The synthesis sums up and confirms the findings in the previous sections of the book and answers the hypotheses and other assumptions. The connections are supported not only by the extensive literature of the relevant hypotheses and theories but also by the empiric research – or, if you like, mathematics – done by the author. Countless conclusions and intriguing statements are presented. A man striving for the moral good is able to think and operate within a virtue ethics paradigm. Nevertheless, strong inner motivation itself is not enough to make a virtue ethics-based person; other characteristics are needed, too. What these characteristics are is abundantly outlined in the book. A virtue ethics-based person thinks of profit in terms of virtue ethics, that is, they consider it as a means rather than a purpose. The same applies to the economy and to the usefulness and instrumentality of the material world. The virtue ethics based-person considers them in terms of virtue ethics.

The philosophical and theological description of natural law also adds to the interdisciplinarity of the book. Natural law, which, unfortunately, has largely been forgotten, belongs to the author's faith, and so it is not surprising that it plays a prominent part in the book. Natural law is based on the simple thesis that man is inclined to do good. Based on reason, he is able to identify what is good and what is evil, follow the former and avoid the latter. Seemingly, these lines are far from the economic relevance of the book. But only seemingly. Recalling what we have read about profit and profit maximisation and comparing it to natural law, a new connection will be revealed. Profit maximisation is not a natural concomitant of economic activity or a natural response of the economic person. The natural attitude is to serve and increase the common good.

The same logic is applied when discussing man's inclination to virtue ethics or happiness. These inclinations correspond to man's potential, desires and purposes. Whether this potential is realised and these desires are fulfilled depends, at least partly, on man's freedom. The dimension of organisation theory dealing with the relationship between structure and the individual appears at the right time and the right place in the book. The circumstances of the individual do mat-

PSZ 2017. angol.szam_beliv_v16.indd 391 2017. 04. 06. 7:29:17

ter, but it is not known how each person is affected by their environment because the structure undoubtedly impacts the individual, who, nevertheless, is still free to make their own decisions not only between good and evil but also to recognise and follow good.

We should not panic. Virtuousness and honesty are not synonyms of starvation in economic life either. On the contrary, they lead to happiness. The book reveals that the virtue ethics-based person is clearly happier than those focusing on material gains. This is not surprising as Aristotle showed that oikonomia, that is natural economic activity, is meant to serve the community and the happiness of all its members.

And why is happiness important in the context of this book? Primarily because happiness, which is not to be mistaken for pleasure, also correlates with economic activity. Economic activity is the means by which happiness is to be achieved as a goal. We already saw a similar connection when analysing the correlations of "goods" as defined by St Thomas. Behold, another argument for the instrumentality of economy! We may slowly start to believe that this is how the economy can be most useful with regard to the relationship between the individual and the community or the individual and structure.

And what is happiness? Is it not the yardstick and the very purpose of our personal fulfilment? Of course, personal fulfilment does not occur automatically but presupposes development, which – according to the social teaching of the Catholic Church – can only be complete if it applies to every person and to the whole person.

We have reached our destination. The opposite shore is no longer a loose group of glimmering lights but lightness itself. Development and personal fulfilment. The three-dimensional economy provides both development and personal fulfilment. Man can and is capable of developing and, through this to develop the economy. This development will be accompanied by personal fulfilment if we start to become rich in virtues. Needless to say, it was St Thomas Aquinas who worked out the Christian concepts of cardinal virtues although they were first referred to by Aristotle. The cardinal virtues are prudence, justice, courage and temperance. Quite simply, virtues are the most effective way of reaching our proper goals. When we develop, these effective instruments, i.e. the virtues, become fixed patterns. This is what will enable us to always realise our proper goals prudently, justly, courageously and temperately.

If we perceive and carefully contemplate the interaction between man and the economy, we will also understand that human values are always economic values, too. Man's development, however, is not an end in itself. Our transcendental destiny and the permanent development of the people living in our environment also need to be taken into account. The key to our personal fulfilment is focusing on others.

Developing the virtues leads not only to the personal fulfilment of the individual but also to a prospering community. Man's comprehensive development can serve the common good more effectively if he is joined by others. If our good intentions are isolated, we can become fatigued, exhausted and weary. If, however, people with the same scale of values join

PSZ 2017. angol.szam_beliv_v16.indd 392 2017. 04. 06. 7:29:17

forces, they can act as effectively as no isolated individual ever could. The power of this solidarity comes from co-operation and the strength of community. Often, the very fact that you know you are not alone and others also want to develop virtues is a powerful motivation, even if no actual help is available.

Finally, I want to draw your attention to the fact that moral values and the Christian scale of values can be openly undertaken and these values and this scale of values can be represented in the language of the economy, too, which is also evidenced by this book. Yes, discussing moral values is also a philosophical, theological and economic issue.

However, we should not be deceived by the joy of arrival. The book is not easy reading for summer nights or a funny piece in a "colourful news" column but a synthesis of the author's lifework, research, publications and her activity as professor and mentor in the postgraduate subject of Christian Social Principles in Economics, and is meant not only for the mind, but also for the soul.

Let us not spare ourselves the time or the trouble. This book is an answer, a clear and definite answer, to our doubts, uncertainties and half-heartedness. The fact that man is able to make radical changes to achieve good is also evidenced by the career of the author, Sister Laura. Let us take courage and start, firstly, to read the book and, then, to change things.

Tough decisions await us.

Sarolta Laura Baritz, O.P.: Three-Dimensional Economy. It is Possible to Operate Within a Virtue Ethics Paradigm. Kairosz Kiadó, Budapest, 2016, 314 pages.

PSZ 2017. angol.szam_beliv_v16.indd 393 2017. 04. 06. 7:29:17

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Csaba Lentner

The Taxonomy of Success

Review of a Book by György Matolcsy

Summary

This review puts under the microscope the book by György Matolcsy, Governor of the National Bank of Hungary, and the successful economic policy lurking behind it. This monograph is richly illustrated with elements from economic history and familiarises the reader with Hungary's achievements in the field of fiscal and monetary policies, and their academic taxonomy.

Journal of Economic Literature (JEL) code: E5, H6, G01, P10, Y3

Keywords: economic policy, fiscal policy, monetary policy, Hungary

Introduction

Academic theoreticians frequently struggle with the problem of translating their intellectual creations into practice. On the other hand, practical specialists often face the question of the extent the systems developed by them can pass the scientific test. However, in this case these two challenges and the good solutions elaborated for them seem to have been tackled simultaneously. In front of our eyes and now also read from a book, given that this is a review of György Matolcsy's book entitled *Balance and Growth,* which is compared to the practice followed and results achieved in the past few years.

The book was published in 2015 in Hungarian and English and, in essence, it is his lifework. And not merely in a scientific sense. The author, Governor of the National Bank of Hungary, former Minister for National Economy between 2010 and 2013, and Minister for Economy between 2000 and 2002, is the person who dreamed up and implemented the Széchenyi National Development Plan of Hungary. These governance experiences and the related scientific attitudes to the methodology of governance have always been present and had their impact felt simultaneously in Matolcsy's work.

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PSZ 2017. angol.szam_beliv_v16.indd 394 2017. 04. 06. 7:29:17

From the mid-1990s, he led a conservative economic workshop, where he established a solid grounding in economic theory for his service as a minister at the turn of the millennium, and then in the period between 2002 and 2010, once again a researcher, he built the theoretical framework for Hungary's economic improvement, and, with the approach of the general elections, a government programme (Matolcsy et al., 2008). Returning to the position of Minister for National Economy in 2010, he implemented a successful fiscal consolidation and created the fundamental conditions for growth. Once he has re-established fiscal health, he was appointed to head the central bank, which had been pursuing a homogeneous monetary policy for more than twenty five years. To adjust to international changes and Hungary's economic and social demand, he introduced unconventional instruments. In other words, he restored the refinancing[1] capacity of the real economy and ensured additional monetary tools[2] for reducing government debt in a way that the contribution by the new government and György Matolcsy as minister and governor of the central bank were at all times characterized by a stable economic policy and an accelerated tempo of activity.[3]

Why this hyperactivity?

For one thousand and one hundred years, the Hungarian nation and Hungary have been characterized by a phase delay and the consequent desperate attempts at convergence. The conquest of the territory of Hungary took place among European nations who had inhabited the area for several centuries and formed various states. Then Hungary's sovereignty was lost in 1526. This entailed a gap in national influence on economic policy, and for the next five hundred years our relations were characterized by a series of struggles for liberty and attempts at convergence and independence which, at times, also involved economic reforms. After World War I, territory, people and economic strength were lost. World War II was followed by forced inclusion into the Soviet bloc. By the end of the 1960s, reserves of domestic resources had run out, so then market elements were used to boost the planned economic system.[4] From the early 1970s, external indebtedness was inevitable to offset the waste of resources and losses made by the planned economy regime, in other words, the power of the communist élite was extended for two decades with the help of Western loans. In the current era, an effort has been made at convergence by importing the "raw" Anglo-Saxon neoliberal market economy model, gradually increasing the government debt from USD 20 billion at the time of the change of regime to USD 140 billion, while as a result of the unreasonable and fast privatization of state property, the nation was deprived of its wealth, which was still worsened by the population's USD 40 billion of indebtedness through foreign currency loans taken out after 2004. All the frenzied neoliberal reform actions taken in the past few decades have failed one after the other.[5] Our transition to a market economy ran aground.[6] However, relying on appropriate social support (and expectation), from 2010 the new government was in a position to take action. It was obvious that if we continued to use the economic policy means that led us to

PSZ 2017. angol.szam_beliv_v16.indd 395 2017. 04. 06. 7:29:17

the crisis we would hardly recover from it. So we needed a new method of economic policy, determination and, most of all, social support.

The essence of the New Hungarian Model

Unless public finances are balanced, economic growth and convergence remain vain hopes. There was a requirement for the inclusion of international companies and banks in public financing – in other words, in the payment of taxes and contributions according to their capabilities – and, simultaneously, for lowering taxes payable by domestic businesses and the population,[7] for streamlining government expenditures, and for a strict control of public funds, with the aggregate result that Hungary was released from the European Union's Excessive Deficit Procedure. Without IMF loans and economic policy expectations[8], public finance positions were consolidated from Hungary's own resources. The government ensures room for manoeuver for the operation of market participants through the active economic policy framework of influencing[9] and regulation[10].

It should be emphasized that there were reasons for the changes. By the second half of the 2000s, Hungary's economy was facing increasingly conspicuous growth problems, a considerable budget deficit, a high sovereign debt and current account deficit. Certain periods were characterized by economic growth, others by financial equilibrium. However, the two – equilibrium and growth – never coincided. After 2013, they did.

Since 2013, fiscal policy has been strengthened by reinforcing the elements of monetary mechanisms. The National Bank of Hungary is characterized by a more active citizenship manifest in the system of multiple mandate objectives. The central bank's aim is to serve the common good at a macro-economic and social level. In the interest of the common good, it uses the available instruments to curb inflation and promotes economic growth and the maintenance of financial equilibrium. The first step in the change of monetary regime was the cycle of interest rate cuts launched by the external members of the Monetary Council in the summer of 2012.[11] The first phase of interest rate cuts lasted until July 2015, and saw the refinancing base rate fall to 1.35 per cent, the lowest rate in its 90 years of history, which then further dropped to 0.9 per cent by May 2016 as a result of repeated rate cuts. The cycle of interest rate cuts reduces commercial banking rates and supports economic growth, while also facilitating the achievement of the central bank's targeted medium-term inflation rate. Moreover, this also triggered a positive change in the market for government securities and improved the safety of government debt financing.

The Funding for Growth Scheme was launched with a method similar to the Funding for Lending Scheme of the Bank of England or to certain elements in the Quantitative Easing (QE) applied by the Fed. The FfG Scheme substantially improved access to loans for small and medium-size enterprises and agricultural producers, and so the corporate lending market regained impetus and could play a significant role in the unfolding of a change in investments.[12] Access to loans opened up for 31,000 business entities, who borrowed more than two thousand

PSZ 2017. angol.szam_beliv_v16.indd 396 2017. 04. 06. 7:29:17

billion forints. This scheme contributed to economic growth and an increase in employment and, together with the beneficial impacts of the cycle of interest cuts, it has catalysed economic growth in the past few years.

The Self-Financing Programme launched in the spring of 2014 and was aimed at encouraging the purchase of liquid assets acceptable as collateral in order to reduce the country's external vulnerability by cutting the gross external debt. The programme intensified commercial banks' purchase of government securities, which in turn also contributed to the mitigation of long-term government security yields and so the (interest) costs of financing public spending fell.[13] One of the most significant actions taken by the central bank to achieve stability and ensure the efficient operation of financial markets was the consolidation of retail foreign exchange loans by the central bank and the government,[14] which improved the financial equilibrium for households and banks alike.[15] The integration of the Hungarian Financial Supervisory Authority into the central bank and the introduction and operation of macro-prudential instruments also strengthened financial stability. The new system allows the National Bank of Hungary to prevent the building up of harmful risks at the level of the national economy, and to balance the financial system's capacity to finance the economy.

The central bank has made an effort to support the government's economic policy. This monetary policy does not interfere with the independence of the central bank. What is happening is that the Government and the central bank are thinking in terms of a complex and unconventional system of public finance assets that serves the common good, as the fundamental goals of these two public finance authorities are identical.[16] In order to grow, the real economy needed an appropriate expansion of the loan portfolio, which was accomplished by the central bank through its Funding for Growth Scheme. International experience shows that central banks only assume an "extreme" role in bridging crises and boosting economic upturn.[17] However, maintaining the optimum level of commercial loans falls within the competence of the market and is increasingly a fiscal category. As a signal for these future processes, in November 2015, the central bank announced and then, in early 2016, launched its Growth Support Scheme, in an effort to use its more moderate means to keep the economy on a sustainable development trajectory. In addition to the gradual phasing out of the Funding for Growth Scheme, the purpose of the Growth Support Scheme is to encourage commercial banks to increasingly satisfy the borrowing demand of participants in the real economy. Besides the third phase of FfG, the Growth Support Scheme also comprises the Market Lending Scheme, which uses various risk and liquidity management tools to boost commercial banks' lending activity. Through the Growth Support Scheme, net corporate lending, and especially loans to small and medium-size loans, may further increase.

After 2013, in addition to undertaking intensive development of the economy, the central bank also helped fiscal stabilization through various channels. On the one hand, base rate cuts and the Self-Financing Programme contributed to the moderation of government security yields

PSZ 2017. angol.szam_beliv_v16.indd 397 2017. 04. 06. 7:29:17

and interest expenses to a major extent. Between 2008 and 2015, interest payments were reduced by nearly 1 per cent of GDP.[18] On the other hand, the central bank's Funding for Growth Scheme had a beneficial catalysing impact on economic growth, and through an increase in the taxable amounts, it helped maintain the budget deficit below the level of 3 per cent that had been achieved by 2013.

As a result of the change of the monetary regime and responsible management, the National Bank of Hungary has been achieving a public accounting and national economic profit since 2013.[19] It pays part of the profit, taken in an accounting sense, to the central budget, and in the spirit of corporate citizenship it uses another part for the renewal of financial thinking, financial culture and the financial and economic refashioning of higher education. It supports higher education as an economic sector that produces new knowledge capital to the debit of its own profit rather than using budgetary funds or the taxpayers' forints, i.e. public financing.[20] It supports the intellectual and academic workshops that create new and sophisticated knowledge capital to replace the old and obsolete system.[21]

Summary

Balance and Growth, a 644-page book by György Matolcsy, is divided into 24 chapters and describes the policy changes listed in this review and their impacts. You will not be able to put it down once you start reading it. It is about our daily life and economic relations, and explains them both in scholarly terms and in an easy-to-understand language.

This makes the monography an academic outline of the practical system, and so the appreciative reader cannot avoid judging the current practice. Therefore it is perhaps even more objective and comprehensive if we do not predict the expected reception from the opinions of individual researchers, intellectual schools or parties. Recently, one of the international rating agencies[22] evaluated Hungary's economic policy of the past few years. In their notice they list the factors underpinning the upgrading and specify the extent to each factor contributes. Based on the latter, there are two categories:

– factors considered as highly significant ("high"),

– factors that justified the upgrading to a lesser extent ("medium").

The "high" category includes a reduction in external vulnerability, in other words, the rating agency upgraded debtor rating primarily for this reason. They traced back the reduction in external vulnerability to 5 factors:

1. High surplus in the current account balance – this can be considered a structural feature.

2. Influx of funds from the European Union – for the most part, this is also a feature, although in this case, the very high ratio of drawdown can also be considered a Hungarian success.

3. Reduction in the external debt to banks – this is partly due to an endowment, but the National Bank of Hungary also targeted numerous programmes (e.g. during the conversion of foreign currency loans to forint loans, when the National Bank of Hungary offered conditional facilities, as a prerequisite it required reduction in the short-term ex-

PSZ 2017. angol.szam_beliv_v16.indd 398 2017. 04. 06. 7:29:18

ternal debt to banks, and certain macroeconomic prudential regulations also had such indirect effects).

4. The Self-Financing Programme – the rating agency specifically highlights this central bank programme, which is a fairly significant recognition for the scheme (and could well end the relevant debate stirred in the Hungarian media).[23]

5. The conversion of foreign currency loans to forint loans – naturally, this programme is not exclusively run by the National Bank of Hungary, however, the central bank was the catalyst of the process and provided the required nearly EUR 10 billion worth of currency for the conversion.

Thus, overall, the upgrading was due partly to improvement in the structural fundamentals of the economy and partly due to the successes of the specific economic policy programmes – and the schemes launched by the National Bank of Hungary were especially emphasised in the latter group, while debt cutting and the budgetary processes can be classified in the other category ("medium"), which means that despite their positive effects, they contributed less to the upgrading.

This book by György Matolcsy is about the economic policy innovations leading to success, in other words, the manner and instruments applied in achieving this success. It is worth reading.

György Matolcsy: Balance and Growth. Kairosz Kiadó, Budapest, 2015, 644 pages.

Notes

1 By ensuring longer-term loans at a lower than market rate for the investments of less well-capitalized and liquid businesses and agricultural producers. For a more detailed explanation and the significance of this financial category, see Lentner, 2016.

2 Low interest rate, the expansion of supervisory powers, a Self-Financing Programme, the Funding for Growth Scheme, and the creation of an efficient system of financial customer protection.

3 With strong political, government and Prime Ministerial support. Quoting Prime Minister Viktor Orbán, "one of the most important parts of economic policy is policy". In other words, the implementation of clear political value principles and their good political communication by competent persons, and political support for fruitful actions and concept makers are indispensable for success.

4 The New Economic Mechanism of 1968 put market elements into operation in a limited way that would not violate the basis of the planned economy. In the early 1970s this new trend lost a significant amount impetus as a result of the political restoration.

5 The avid enforcement of the New Public Management DPM paradigm, i.e. in the spirit of decentralisation, privatization and the operation of the state with a management approach (to maximize profit). In the real economy and in finances, deregulation was undertaken and the loss-making sectors were eliminated without pondering their social effects. Recurrent tightening and austerity measures were imposed on residents, the most significant being the 1995 economic policy adjustment package and the convergence adjustment package launched in the autumn of 2006.

6 In my opinion, a stagnant "transitional" economic policy prevailed between the late 1980s and Hungary's accession to the European Union, although accession did not bring along consolidation and, what is more, the macro-economic and equilibrium data deteriorated, and so I would rather extend the period of homogeneous Hungarian economic methodology to 2010.

7 Halving the corporate income tax rate levied on (typically domestic) businesses with net sales revenues up to HUF 500 million, and cutting personal income tax from 36 to 16 and then to 15 per cent.

8 By the elimination of the mandatory economic policy consultation (literally meaning: force) according to Section IV of the IMF Statute, with the most frequent element being the budget

tightening policy imposed on residents from Africa to Central Europe.

9 The generation of domestic solvent demand, opening to the East – as a result of government actions.

10 Bank regulation, financial customer protection, and fiscal and monetary mechanisms.

11 This was the time when the members delegated to the Monetary Council by the Orbán regime attained a majority.

12 The FfG also provides an opportunity for prefinancing the investment funds frequently difficult to draw down from the European Union.

13 For more details about the Self-Financing Programme, see Kolozsi, 2015.

14 It started in 2011 with the granting of prepayment and final repayment and the setting of an exchange rate cap, continued with the strengthening of financial customer protection, and was completed, at the end of 2014, with the conversion of foreign currency loans into forints using the central bank's foreign currency reserves.

15 For more information about the foreign currency loan consolidation, see Lentner, 2015.

16 Separately, with their own particular instruments.

17 See, for example, the interest rate policy and other monetary tools adopted by FED after the QE period.

18 For a comparison: it increased by nearly one per cent in Romania and by 2 per cent in Slovenia in the same period.

19 The accounting profit, or the profit recognized in the annual report, and the economic profit, whose effects are enjoyed by families relieved from exchange rate exposure, businesses contemplating investment and public finances.

20 However, this is done in a way such that only the interest paid on the capital available for the various Pallas Athene foundations is allowed to be used as resources for the support.

21 Similarly, it backs other intellectual workshops provided that they are capable of renewal and the generation of new scientific results.

22 Quoted from the May 2016 upgrading by Fitch Ratings, which classified Hungary among the countries recommended for investment, https://www.fitchratings.com/site/pressrelease?id=1004883. Since then, Fitch's favourable rating was followed by another agency (Standard and Poor's), and so Hungary has been upgraded to investment-grade.

23 See, for example, the article entitled Aim and Reality by György Surányi, former central bank governor, in: *Népszabadság*, 14 May 2016.

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PSZ 2017. angol.szam_beliv_v16.indd 400 2017. 04. 06. 7:29:18

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Tamás Prugberger

A Fictitious Discussion by Financial Experts About Hungary's Position in the Changing World

Review of the Book Entitled *Hungary in the Changing World*

Summary
A collection of interviews with Mihály Patai, Chairman of the Hungarian Banking Association, László Parragh, Chairman of the Hungarian Chamber of Commerce and Industry, and Professor Csaba Lentner, Head of the Institute for Public Finance of the National University of Public Service, has been published by Éghajlat Kiadó under the title *Hungary in the Changing World*. In the book, Hungary's economic policy is discussed from the change of regime and the collapse of the Socialist planned economy to the present day, seen from the perspective of the three above-mentioned leading economists. This original and unconventional book examines problems in a complex manner and provides proposals worthy of consideration by political and economic leaders.

Journal of Economic Literature (JEL) code: B10, D6, E6, F01, F34, F5, F6, I2, G01, H6, N13, N5, Y3
Keywords: unorthodox economic policy, loans, financial policy, history, higher education, agriculture

Éghajlat Kiadó has published an extraordinary book with Klára Lengyel as editor: the participants include moderator and interviewer Lajos Péter Kovács, and three interview subjects and discussion partners: Mihály Patai, Chairman of the Hungarian Banking Association, László Parragh, Chairman of the Hungarian Chamber of Commerce and Industry,

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PSZ 2017. angol.szam_beliv_v16.indd 401 2017. 04. 06. 7:29:18

and Professor Csaba Lentner, Head of the Institute for Public Finance at the National University of Public Service. The novelty of the book's content lies in the moderator-interviewer's discussion over the course of nine chapters of Hungary's economic and financial problems, and breakout and development opportunities with the three experts, followed by separate conversations with each of the three interview subjects to enable them to expand upon the deeper interrelationships of their views.

The first topic, *called 'mischief', is about Hungary,* where – as the respondents show – people were able to secure their livelihood by various semi-legal means that were tolerated by and evolved during the Kádár regime. At that time, the state not only put up with these ways but it even supported them. As the interviewees also mention, these means included various economic and corporate economic partnerships and moonlighting performed during or after official working hours, in the course of which company employees in cahoots with one another could obtain additional private income using the material and equipment of state-owned companies. It was under these conditions that spontaneous privatization and official government-controlled privatization occurred before and after the transition to democracy. The experts around the fictitious roundtable of the book also established that the application of various techniques and methods of corruption prevented the government from realizing considerable revenues from either spontaneous or government-controlled privatization, as the majority of foreign companies liquidated the bulk of the companies sold to them and reorganized during the 1980s from loans; in other words, their goal was market penetration rather than the continuing operation of these companies. The speakers also mentioned that Hungarians (with notable exceptions) also acquired considerable business assets through corruption, although most of them were squandered instead of being turned into businesses. This was also characteristic of the newly-established commercial banks, which granted a considerable quantity of long-term loans nearly free of charge to people within the orbit of the former Socialist political elite so that they could make a success of their businesses; for the aforementioned reasons this success was not realized. The commercial banks that went bankrupt because of this had to be replenished from public assets, and due to the government's sales activity they ended up in the ownership of foreign banks and continued their operations as subsidiaries.

In the chapter on this topic, the three specialists mention that after the Soviet Union had run short of funds to support the loss-making provinces of their overgrown empire, Hungary was compelled to take loans from the IMF and the World Bank, and so started to go into debt. In this context it is worth stressing the words of Mihály Patai that after the transition to democracy, negotiations were held about Hungary repaying only the principal amount of the loan, without any interest being accrued. Patai merely stated that "József Antall simply stopped the negotiations". He did not mention the weight of either direct pressure by the US or the indirect pressure placed on him through the Social Democratic Party. In my opinion, the Social Democrats and

PSZ 2017. angol.szam_beliv_v16.indd 402 2017. 04. 06. 7:29:18

József Antall, who cooperated with the US and the Social Democratic Party, are completely responsible for the fact that, unlike Poland, we are still burdened by debt servicing.

Quite rightly, Csaba Lentner pointed out that after the transition, there was only one option: the adoption of a market economy. However, according to the professor of economics, the problem was that adoption was extremely fast, and the Hungarian population was unprepared for it. As the other speakers also noted, the overwhelming majority of the population wanted to get rich quickly and were incapable of using the partly illegally-obtained wealth in a moderate, disciplined and professional manner, which was manifest in the operation of Hungary's manufacturing, services and banking sectors. Being far more disciplined and capable of rationally enforcing their self-interest, foreign companies and financial institutions could use this for their own benefit and to the country's disadvantage.

Finally, a few words were said about the unconventional economic policy that helped Hungary free itself of dependence on the IMF. In relation to this, Mihály Patai noted that Matolcsy's achievements in central banking and the government's results in financial policy should be termed 'new-orthodox' rather than 'unorthodox'. Everyone agreed, however, that today's generation of middle-aged and older economists still follow the anachronistic neoliberal policy that their instructors taught them.

The second topic essentially carries on from the previous one, and is entitled "MNCs and the friendly zoo". In this chapter the moderator investigates how aggressively the multinational corporations that have come to Hungary are enforcing their interests, to what extent they suppress Hungarian businesses and how much of their operating profits they take away and how much they leave in Hungary. During the conversation it was made clear that, in the course of their operations, foreign manufacturing and trading companies, in the same way as the subsidiaries of foreign banks, provide insufficient help for Hungarian businesses to develop, with most of them only taking care of their own interests and extracting their entire profits from the country. For this reason, though to different extents, the interviewees are positive about the state taxing foreign companies and about it introducing the bank tax. The debaters also pointed out the social problems caused by unfair procedures adopted by foreign banks, as well as by the Hungarian OTP Bank, in the course of forex lending, and by the irresponsible propagation of this lending by the former left-liberal regime, and how the incumbent government and the central bank were able to solve a significant part of the social problems by conversion into forints and derecognition of forex loans.

These government actions led to serious tension between the current centre-right government and MNCs, which the interviewees considered natural. They think the government must take note that companies coming from abroad will primarily consider their own interests but at the same time, these companies must also recognise that the host state and society have expectations of them. For this reason, Hungary's economic policy must attempt to reach a compromise with the companies operating in the country, while respecting each other's interests, in

PSZ 2017. angol.szam_beliv_v16.indd 403 2017. 04. 06. 7:29:18

order to secure their long-term presence. This is the only way to develop, on one hand, the useful cooperation between small, mid-sized and large corporations and, on the other hand, the good relations between Hungarian and foreign companies,that will make the allegorical "zoo" become friendly.

In the third topic, entitled "In the wake of global developments", the talk centred on how this current evolved in the past and today, and Hungary's place in this current, specifically its place within the present day global centres of economic and political power. The discussion partners set out from the fact that with the collapse of the Soviet Union, the two power centres, namely the eastern Soviet and the western American, ceased to exist. Consequently, a unipolar economic and political centre evolved with US dominance. At the same time, as László Parragh brought up during the discussion, this unipolar power centre is increasingly being changed into a multipolar one by the economic rise of China and India. The moderator leading the discussion suggests that in this emerging power centre, once again heading towards a multipolar system, a place is being demanded by a renewed Russia that is regaining strength and does not wish to give up its imperial status. Russia and the US are, it is pointed out, fighting a tough battle for the Ukraine, which has been brought into the sphere of interest of the US. At the same time, the Crimean Peninsula, which previously belonged to Russia, has been annexed by it. Located in the buffer zone is the European Union, which placed Russia under embargo at the request of the US. The EU and its Member States will come out badly from this, while the USA profiteers, since – as was established during the discussion – the goods missing because of the EU's embargo will be supplied by the US.

During the discussion the debaters raised the point that in this process of realignment, the EU is becoming weaker despite the fact that the centralisation that began in the US has also started there both in the banking and insurance sector and in industry and services. It also emerged in the discussion that both the oil crisis and the banking crisis that started in 2007 hit Europe harder than the US. The discussion partners provide excellent analyses of both. The relevant professional financial analyses by Patai and Lentner are worth special attention, while the effects on industry and trade are explained by Parragh. Mention is made again of forex lending, which also appeared in certain Western European states, but caused serious financial and social problems mainly in Central and Eastern European post-communist countries. While discussing Hungary's case, the interviewees mention that the transformation of this form of lending through conversion into forints was, from a social point of view, an appropriate solution by the government acting in concert with the National Bank.

Returning to the lines of force, it turned out during the discussion that Hungary, among all of the member states of the EU, is in the most difficult situation vis-à-vis the Russian–American conflict, as it lies on the borderline of the historical cultural areas of the Catholic Western Roman Empire and the Orthodox Eastern Roman Empire, just as has been the case in history going back a thousand years. This was one of the reasons why Hungary had significant markets in the Slavic east,

PSZ 2017. angol.szam_beliv_v16.indd 404 2017. 04. 06. 7:29:18

which were lost partly during privatization and partly through the embargo resulting from the Ukrainian conflict. The discussion concluded that the emphasis of Hungarian economic policy should fall on regaining these markets, which is justified by the country's economic geographical situation. All I wish to add is that it was a mistake to incarcerate József Stadler twice for his habitual offending for tax evasion, as he had excellent contacts in the Russian and Ukrainian markets, which were lost after his two periods in gaol. In my opinion, the financially- and politically-sound solution would have been the imposition of a large fine in the first case, and a suspended sentence, a fine and the enforcement of the payment of the unpaid taxes in the second case. Thus the country could have continued to benefit from him and his activities.

In the fourth topic the discussion partners dealt with the benefits of the adoption of the euro for the countries that have joined the euro area and the disadvantages, or possibly benefits, for those who have not. The related analyses focused heavily on Hungary. The various governments of Hungary put accession to the euro area on the agenda, and then extended its deadline on several occasions due to failure to meet the requirements. As this failure became permanent, the country has not joined the euro area. The reasons for Hungary not meeting the accession criteria are explained in detail and at length by Csaba Lentner, and the consequent disadvantages are summed up by Mihály Patai. During the discussion of the related correlations, further mention is made of the Russian–Ukrainian conflict and how the EU built a trap for itself with the embargo, weakening the euro with respect to the US dollar.

Lajos Péter Kovács mentions that highly conflicting developments are taking place in the euro area because the strengths of the participating economies vary. Csaba Lentner points out that the European Central Bank endeavours to strengthen economically weaker states by purchasing the sovereign securities they issue. In László Parragh's opinion, the problem in these states is that, due to the weakness of central authorities, structural reforms have been postponed, and this has resulted in a very high unemployment rate. In order to strengthen the euro, the debaters believe that this situation must be changed.

The fifth topic of the fictitious discussion tackled *the question of the revival of regions*. László Parragh thinks Hungarian foreign policy has "led to a dead-end" in this respect. He explained that Poland has adopted a maverick economic policy, and has markets of its own, although Galicia is its only region that once belonged to the Austro-Hungarian Empire. For this reason Hungary does not belong to the same region as Poland. Hungary would form a region with Romania, Slovenia, Serbia, Croatia, Slovakia and Austria. However, Austria, which can be classified as part of this region, would regard Hungary and the other aforementioned Central European countries as if they were colonies. Romania represents an opposing position to Hungary and most of the other Central European counties on the migrant issue and in other respects. Moreover, as referenced in the book, due to the suppression of the rights of Hungarian minorities living in the neighbouring countries, Hungary has serious conflicts

PSZ 2017. angol.szam_beliv_v16.indd 405 2017. 04. 06. 7:29:18

with Romania and – on this question – with Slovakia. As for Serbia and Croatia, there are no problems in relation to the Hungarian minorities living in these countries, but there are considerable differences in approach to stopping the pressure of migration, as was also alluded to during the discussion. It should be noted, however, that since the publication of the book (in the summer of 2015), a favourable change has taken place in this respect in Austria, Croatia and Serbia.

Lentner and Parragh established that Hungary does not cooperate, or try to cooperate, with the countries in its own region. Nevertheless, the roundtable also ascertained that there are considerable differences in the standards of the various countries classified in this region, and that these should be levelled out. Here, the conversation partners alluded primarily to the advantage of Slovakia, a member of the euro area, over Hungary, which is outside the euro area. The discussion partners arrived at the conclusion that Hungary should first and foremost close the gap by reducing these drawbacks, analysing foreign solutions and taking them into consideration. The banking system, tertiary education, the management of unemployment and the promotion of employment should be reformed to a certain extent on this basis. Regarding the promotion of employment, all of them were of the opinion that the significant proportion of community work areas which still remain unproductive should be channelled in a useful direction, primarily towards production. They went into more detail about the proposals affecting the economic and financial system and already mentioned in the previous topic.

The sixth topic of the roundtable discussion concerned *bank loans, growth* and *opening to the east.* The conversation started with a historical reference to the transformation of a single-tier centralised Hungarian banking system into a two-tier one in the second half of the 1980s, with the second tier, called commercial-economic, initially lending to consumers and the business sector alike. It was also mentioned that due to irresponsible lending made with all-too-favourable conditions, second-tier banks, with the exception of OTP Bank, went bankrupt and needed recapitalisation before they were sold to foreigners. OTP Bank was also sold, but the internal management was given a significant role. The Hungarian subsidiaries of banks sold abroad – as mentioned several times during the discussions – sent a considerable part of their operating profits to their parent banks. The problems caused by forex lending were repeatedly mentioned, as the foreign parent banks do not assume any liability whatsoever for such transactions.

As to the character and role of Hungarian capitalists, the debaters find them rather uncreative, as they came into existence through state support rather than with their own resources. An argument developed about the political affiliation of the new Hungarian capitalists. Csaba Lentner is of the opinion that over the longer term they are shifting towards the right, which is, however, contested by the other two discussion partners based on the assumption that this layer of society is always rationally attracted to the side that can best serve its interests. In relation to this, László Parragh suggested, and Mihály Patai agreed, that a Hungarian business stratum should be created. In re-

PSZ 2017. angol.szam_beliv_v16.indd 406 2017. 04. 06. 7:29:18

sponse, Csaba Lentner mentioned that in the framework of the Funding for Growth Scheme, the National Bank of Hungary has invested several thousand billion forints into Hungarian businesses, primarily SMEs and small agricultural producers.

The discussion also covered the issue of a correlation between company subsidies and corruption. The question was raised of whether the assignment of the majority of public procurement tenders to a single company should be considered as corruption. In Mihály Patai's view the misgiving related to this are unfounded. Csaba Lentner thinks that corruption is ruled out when the majority of public procurement tenders are granted to a proven company that seems to be the most suitable for fulfilling the mandate.

Opening to the east and the efforts made at penetrating eastern markets were raised as final topics, covering not only Russia, but also a more extensive area including the Middle East. In relation to this, the Russian contribution to the renovation of the Paks Nuclear Power Plant was mentioned, the soundness of which is not disputed by several of the older EU Member States, as they have realized that this is the most efficient solution for securing Hungary's long-term energy supply. The discussion partners also agreed that Hungary needs an economic policy which places equal emphasis on maintaining western economic relations and opening to eastern markets.

The 'fictitious meeting' convened for the seventh topic included a discussion by the three interviewees and the moderator who channelled their conversation about *Hungary's international judgement.* According to Lajos Kovács Péter, the West has a very low tolerance of Hungary, and he asked why this was so. Mihály Patai thinks the West does not blame Hungary for its interest in eastern markets, but they disapprove of the management of the Norwegian Fund, the tax on advertising, the comparison of Moscow to Brussels and its illiberalism. He thinks the most serious problem is the atypical articulation of Hungarian politicians towards the West. On the other hand, Csaba Lentner is of the opinion that the West has no moral basis to criticize us as they are competing against us in eastern markets. László Parragh attributes Hungary's negative image in the West to the fact that Hungarian economic policy broke with mainstream economic policy, and chose to become independent of the IMF through loan repayment, stopping forex lending and the PPP programme. In addition, he thinks that any measure taken in the national interest is a thorn in the flesh for westerners, because they hamper the integrationist goals of Brussels and the US. The discussion arrived at the conclusion that for the West the main problem is that Hungary sympathizes more with an economic system close to social market economy rather than the relentless competition-driven market economy supported by Brussels.

The last discussion was held about *the starting points for the market economy of the future.* To launch the conversation, the moderator asked about the most important factors that need to be considered for planning the future economy. Taking the floor first, Mihály Patai pointed out that the European Union has less than 8 per cent of the world's population but produces 25 per cent of the global GDP, and this situation is untenable over the long term. Consequently, a change is expected and

PSZ 2017. angol.szam_beliv_v16.indd 407 2017. 04. 06. 7:29:18

will begin from an "extraneous environment". (Since the time of the discussion, the said change has already started: it is the migration threatening Europe with an invasion. – *T. P.*) Another factor in fast and constant changes is the movement of multinational corporations towards more favourable commodity and labour markets, which has a positive impact on employment when they arrive, although their departure causes serious economic and employment policy problems. In order to avoid the latter, compromise must be reached with MNCs, but efforts must also be made to enable Hungarian companies to expand and take roots abroad. In Csaba Lentner's opinion, primarily agriculture and the food-processing industry should be developed, while László Parragh considers the harmonization of social resources as important in enabling us to manufacture high-level technical devices (e.g. sensors and navigation software) to replace low-level assembly jobs. All three agreed that a positive direction for Hungary's future depends on high-level business and supplier activities. This, however, requires reforms in education, vocational training and healthcare, and improvements in infrastructure.

The second structural part of the volume contains *separate conversations using the same methodology* with László Parragh, Csaba Lentner and Mihály Patai. All three of them gave their opinions about the topics discussed during the roundtable meeting, this time placed in context. For this reason it is unnecessary to repeat them, and only the most important points of view are highlighted below in a synthesis. A discussion conducted with László Parragh is published under the title *Let's Not Stop Halfway,* and with Csaba Lentner as *Compromise in the middle ground...* In the chapter entitled *The Western Roman Empire and Fault Lines,* Mihály Patai went into further detail about the topics he had explained during the fictitious roundtable meeting.

During the conversation with László Parragh, he said that the change in the structure of industry during the Antall regime had a negative impact due to the unwise and sneaky privatization. Whatever the Hungarian elite obtained on the cheap was bankrupted. There was no capital to invest, however they withdrew and used up the companies' capital, and during privatization the overwhelming majority of foreign capital was merely invested to gain market share and consequently ended up in company liquidation. SMEs were unable to develop due to lack of capital. Low revenues flowed into the state budget due to tax evasion, tax allowances granted to MNCs, and chicanery with offshore tax havens. The role of the state was abortive, as illustrated by the government's contribution to forex lending. As a positive development, however, he mentioned the onset and completion of the long dragged-out structural reforms. In relation to their continuation, he notes that a closer link must be established between research, which costs the government a lot, and the economy, and the significant resources need to be harmonized with government cooperation. In addition, small businesses should participate in the economy primarily as suppliers, and should excel in handicrafts, a sector that is currently in an upturn. He thinks that vocational training and trade schools can be efficiently operated to high standards if they are linked to large corporations. So he would welcome

PSZ 2017. angol.szam_beliv_v16.indd 408 2017. 04. 06. 7:29:18

the restoration of the system of training workshops and training places.

In the course of the conversation with him, Csaba Lentner explained that the success of the incumbent government results from the unorthodox and good economic policy, which put an end to dependence on the IMF. This is the reason for the attacks from the European Union and from foreign and Hungarian left liberals. However, the government's economic policy, which uses non-conventional instruments, enjoys the support of Hungarian society. With the exception of the Internet tax, this also applies to the new taxation system, as the majority of multinational manufacturing companies are increasingly satisfied with its calculability. Although the Hungarian subsidiaries of foreign banks are unhappy with the bank tax and are threatening to move out of the country, once the Hungarian economy takes a sustainable growth trajectory, they will return, as they may find safe internal markets and business opportunities. Until then, the gap may be bridged with the help of OTP Bank, other banks of Hungarian affiliation and the central bank, which is focusing on growth. Loans for investment in rational production will always be needed. Lentner made a positive statement about the activity of the National Bank under Matolcsy's control. He reminded us that similarly to the US Fed, the MNB has targeted not only cutting inflation, but also reducing unemployment and getting economic growth moving. In an analysis of the current community work scheme he, quite rightly, notes that its current, mainly unproductive, character should be transformed towards the productive. I believe an example if this could be the involvement of community workers in the production of agricultural raw materials. The professor appreciates the MNB's activities in education, foundations and research institutions, and I share his appreciation, as economists are still advocating the orthodox economic thinking learnt from the professors of the previous generation. Regarding tertiary education, similarly to László Parragh, he also presses for the closure of subjects, faculties and tertiary educational institutions with low student numbers and/or offering non-marketable qualifications. However, I would be careful with radical action, and instead of abolition, I find placing humanities (e.g. archaeology, art history, Assyriology, Egyptology) on the back burner a happier solution, even if a low number of students are taught. This is essential, among others things, for maintaining the country's overall cultural standard.

During his interview, Mihály Patai explained that from the 1980s onwards huge financial pyramids were made, first in the United States and then in Europe, and this process stopped somewhere between 2003 and 2005. These giant monsters enabled the financial elite to gain independence from the political elite. In the past three or four years, however, an opposite development has begun: the political elite has retrieved the initiative from the financial elite. He criticized the European political elite for being unable to adequately respond to the American challenges, because the financial concept behind the euro clearly includes political, budgetary and tax union, areas that are experiencing numerous problems, resistance and a deficit of consensus-building capacity. Patai said that to be fair to Swiss franc-based lending, which has spread in the past dec-

PSZ 2017. angol.szam_beliv_v16.indd 409 2017. 04. 06. 7:29:18

ade, one must add that it also had a positive role, as 1.2 million families are now living in better homes than they would be without these loans. He added that several independent factors also contributed to the collapse of CHF-based lending, and this relieves the government and the customers, but not the banks, of responsibility. As a criticism, he recalled the political promise that Hungary would join the euro area in 2007. Had employees been paid in euros by the time of forex loan repayment, no problem whatsoever would have been encountered. The chairman of the Hungarian Banking Association considers the government's consolidation measures as the opening up of a new era in banking, and the process of globalisation, which also includes Hungary, as a continuing "process" that cannot be concluded.

All the reviewer wishes to add in summary is that this original and unconventional book examines problems in a complex manner and provides proposals worthy of consideration by the government. The book sheds light on numerous interrelationships.

The English version of the book is forthcoming in 2017.

Mihály Patai – László Parragh – Csaba Lentner: Hungary in the Changing World. Éghajlat Könyvkiadó, Budapest, 2015, 325 pages.

PSZ 2017. angol.szam_beliv_v16.indd 410 2017. 04. 06. 7:29:18

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Zoltán Nagy

Review of Books on the Scientific Taxonomy of New-Type Public Finances

Summary

As in numerous other places all over the world, unconventional instruments have come to the fore in Hungary since 2010 in fiscal policy and since 2013 in the monetary space. Changes in public finances have revealed the need for the writing of a scientific taxonomy to support practical mechanisms and its inclusion in the university curriculum. The main framework of a scientific taxonomy of Hungarian public finances, a taxonomy placed in a Hungarian historical and in an international context, is given in *Public Finances and the Study of the General Government, Volume I,* while a more detailed study of public finances, including financial and governmental management, taxation and control, is given in the volume entitled *Fiscal Policy and the Management of Public Finances.* Below is a review of these extremely significant books and the scientific taxonomy they reveal.

Journal of Economic Literature (JEL) code: E52, E62, Y3

Keywords: monetary policy, public finances

In recent decades, public finances and monetary policy have increasingly come into the focus of public thinking, and academic researchers are also increasingly engaging in this topic. The financial and economic crisis highlighted the need for governments to exercise increased control over the system of financial institutions, and for the building of a system of public finance management that increases resilience to financial crises and sustainability over the longer term. The crisis drove governments to moderate public spending. For a small and economically vulnerable country, excessive indebtedness gives rise to concern, as in a financial market crisis these economies suffer most. In addition to the system of financial institutions, insufficient supervision of the financial system may also affect economic developments and result in serious social problems, as seen

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PSZ 2017. angol.szam_beliv_v16.indd 411 2017. 04. 06. 7:29:18

in relation to foreign currency lending. All these developments encouraged legislation to renew regulation, and so a profound change started in 2010 in the areas of both fiscal and monetary regulation. All of this justifies the elaboration of regulation for educational purposes. Finances are characterized by rapid regulatory changes, but the systematization and publication of the new phenomena and new legal institutions are indispensable for educational and academic purposes. It is a recurrent problem that the Hungarian population is poorly educated in finance, and this may cause considerable losses both to individuals and to society as a whole. For this reason it is especially important for financial subjects to be given the place they deserve in education, primarily in higher education. Books of a high professional standard that facilitate students' acquisition of financial skills are important. This, as the author also points out, is the aim of the two books reviewed here: to familiarize students of political science and law with the mechanisms of governmental finances and financial management.

The two books are reviewed together here because they are closely interconnected from both a topical and a teaching point of view. The first volume gives a comprehensive overview of the fiscal and monetary institutional system in a historical and international context, while the second one provides details of the individual areas in the form of excerpts. Professor Csaba Lentner, Head of the Institute of Public Finances at the National University of Public Service, is the author of the first volume, and the creative editor and author of some especially significant chapters about taxonomy in the second book. Both volumes have been published with support from the National University of Public Service. The first volume was edited by the National Public Service and Textbook Publisher in 2013, and the second one by the University Press in 2015. The author's academic and textbook writing activity is hallmarked, among others, by several academic financial studies recently published with his contribution as editor and proofreader, which are also suitable for educational purposes: *Bank Management. Bank Regulation – Financial Customer Protection* (2013), *Finances in Social Security* (Péter Novoszáth, 2014), and *The Great Book of Foreign Currency Lending* (2015). These works are closely related to the two books about renewed public finances and regulation that are reviewed here.

The standard of the monographs and their usefulness is considerably increased by the extensive literature references at the end of the chapters and by several hundred footnotes.

In the first volume about public finances, the author sets out the scientific taxonomy of public finances straight away in the first chapter. Due to his profession, the author primarily has an economist's approach to the taxonomy of public finances, although he builds up his methodology on the interdisciplinary boundary of law and economics. The significance of public finances is highlighted on the basis of historical economic experiences. The financial crisis revealed that leaving financial markets to operate on their own leads to crises, and for this reason, public finance regulation is particularly important. The author agrees with theoretical economist Dani Rodrik, who claims that four major groups of institutions and

PSZ 2017. angol.szam_beliv_v16.indd 412 2017. 04. 06. 7:29:18

rules constitute indispensable preconditions to economic and social development: the institutions guaranteeing the protection of property rights, market regulatory institutions, the institutions of stabilisation and the institutions of legitimation.

The author includes monetary policy regulation within the system of public finances, as justified, among others, by the economic crisis, when special focus was placed on the significance of harmony between the fiscal and monetary aspects. In the author's view the two backbones of public finances are fiscal policy and monetary policy.

In terms of taxonomy, Csaba Lentner includes public finances within political science (public administration), and does not talk about public administrative law. The reason for this lies in his interdisciplinary approach to both public administration and the study of public finances. (The interdisciplinary approach means a combined legal, economic and political scientific approach.) This system also includes the study of general government finances, which is the technical – both economic and legal – framework for public finances and financial developments. In my opinion, the development of this new approach and the complete rejection of the financial law approach may trigger serious debates from the representatives of jurisprudence, especially of financial jurisprudence. Although financial jurisprudence has not been averse to the new kind of complex interdisciplinary approach, as an area within jurisprudence its focus is on regulatory issues and marks off this legal branch from other branches of law (public administration law) and other areas of knowledge.

The second chapter of the book also endeavours to lay the economic foundations of public finance management. In this chapter the author explains the significance of the provident state as the most important factor in the solution of the economic crisis. The author is of the view that efficient state regulation and conscious governmental influence are significant factors in reorganization, since a provident state is capable of mitigating the impacts of crises and regulating market developments to avoid market failures. As a related experience, he highlights the success of Hungarian economic policy after 2010. Following an outline of the evolution of the financial crisis and the related economic-theoretical reasoning, the author goes on to explain the role of Hungarian fiscal policy in consolidation. In his opinion, as in the current economic conditions the centre-right government did not have the opportunity to use fiscal means to boost the economy, it was compelled to increase revenues by levying various "crisis taxes" and by a broadening of the burden of taxation, in order to consolidate the budget. The author considers recent Hungarian economic policy as successful, in contrast to neoliberal economic policy, and describes it as a good example. In order to facilitate students' understanding of the material and recognition of interrelationships, in this chapter the author defines the basic terms required to understand the management of public finances.

The next chapters, up to the fourteenth, describe the current public finance system. The author analyses the past twenty years of developments in public finances, and concludes that a reform is required. Renewed regulation is

PSZ 2017. angol.szam_beliv_v16.indd 413 2017. 04. 06. 7:29:18

based on carrying out a reform in public finances, including the determination of the size of public finances, a change in the method performing public duties, and the development of an efficient and transparent system of institutions that determines the operation of the budgetary system. Chapter 3 also describes the structure and basic principles of public finances, the operation of the Fiscal Council, budgetary revenues and expenses, and the system of rules by which national assets are managed.

The chapter on the central sub-system gives an excellent overview of central budget management. Quite rightly, the operation of social security funds and extra-budgetary funds is presented in this chapter, as under the new regulations these are not separate sub-systems but are included in the central sub-system.

In chapter 5, the author also gives a comprehensive analysis of the system of local governments, the constitutional foundations of local governments' financial independence, their asset management and budget management. Among the introductory thoughts, the author quite rightly points out that a genuine system of municipalities can only be operated if local governments are independent, which in turn requires financial independence as a significant element. He emphasizes that following the change of regime, duties were considerably decentralised, and the central government assigned an increasing number of responsibilities to local governments. However, the transfer of tasks was not followed by a proportionate re-allocation of central resources. Consequently, local governments accumulated a considerable operating deficit, which limited their financial management, and the autonomy of local governments decreased. The author tackles the recent problem of local governments' debt consolidation. He gives a summary analysis of the consolidation solution and its results. The author points out the risks inherent in local governments' financial management. Due to underfinancing, the local government sector faced a shortage of operating and accumulation funds, while the exposure of local governments to banks was constantly increasing and had reached HUF 1247 billion by 2010. He discloses that 84.6 per cent of the debt was accumulated in the capital and in cities with county rights. Such a sizeable debt also involves higher risk in the course of business management. In order to secure the funds payable in contribution as a precondition of support from the European Union, local governments raised funds from the issue of foreign currency bonds, so they were increasingly exposed to currency rate risk, especially during the financial and economic crisis. It is also important to stress that the investments implemented using support from the European Union are not productive, and cannot generate the funds required for repayment. Based on all this, the government considered it justified to assume their debt, which did not affect sovereign debt, as the debt owed by the local government sub-system is included in the government debt anyway.

The chapter entitled "Main Features of Taxation" is relatively short, but it is completed by the sufficiently detailed second volume, which gives a thorough description of the rules of taxation as well as the regulation of the individual types of tax.

A far more detailed and comprehensive picture is given of monetary policy and the National Bank of Hungary. The author describes the central bank's legal status and fundamental responsibilities. The central bank's role in financial stability and economic growth is also shown from the perspective of economic theory, with the outcomes and achievements of the Funding for Growth Scheme discussed separately. In the remaining chapters of the book, an overview is given of the organizational structure of the treasury and the rules for managing budgetary organisations. Especially interesting points in these chapters include a discussion of government debt and the illustration of the detailed economic analysis. Particularly interesting is the comprehensive analysis, given in the last two chapters, of the past few years from a public finance perspective (convergences, unconventional ideas, prevailing economic policy programmes, crises and prospects). The chapter describes the requirements of the European Union and their interrelationships with the Hungarian budget. Devoted to unconventional economic policy, the author is of the opinion that the new government's economic policy resulted in the consolidation of public finances, and the new monetary regulation and monetary policy trends have efficiently facilitated this economic policy. He supports his view by the presentation of various economic policy programmes and development plans. In the last chapter he places the Hungarian crisis management of recent years in historical and international perspectives. An analysis of results and errors obviously looks different from a historical perspective, and yet the taxonomic textbook presentation of the period is to the credit of the author.

The second, far more bulky volume elaborates on and completes the topics of the first volume in more than 800 pages. This volume was compiled with contributions from several authors, as is mentioned by the editor in his introductory thoughts. The authors include, among others, teachers of the Institute for Public Finances of the National University of Public Service, lecturers of the University of Miskolc and the Financial Law Department of the University of Pécs, and the senior specialists of the National Bank of Hungary, the State Audit Office, the Ministry of the National Economy, the Hungarian Tax and Audit Office, the National Tax and Customs Authority, the Treasury, the Ministry of the Interior and the Chamber of Hungarian Auditors.

The editor had a difficult task: he had to compile the studies covering a fairly wide area, and divide them into chapters. Clearly, he asked the authors to elaborate on various topics in relation to the previous volume. However, these studies also serve as independent reading, as they explain individual areas of public finances. The book tackles, among other issues, specific budget management areas (control, ethical issues, public procurement, budget support, and planning), a detailed presentation of fiscal and social security regulation (including the specific tax types, the rules of taxes, and fiscal theory), and operative public finance management.

These two volumes certainly fill a gap, as no academic study elaborating on the recent changes in public finances and monetary policy has been written in a textbook form in relation to the agenda of studies in law and political sciences. I regard publication in two volumes as a

PSZ 2017. angol.szam_beliv_v16.indd 415 2017. 04. 06. 7:29:18

good solution, as this way the taxonomic structure is combined with a thorough and professional analysis of the individual areas.

Csaba Lentner: Közpénzügyek és államháztartástan I. [Public Finances and the Study of the General Government, Vol. I]. Nemzeti Közszolgálati és Tankönyv Kiadó [National Public Service and Textbook Publishers], Budapest, 2013, 341 pages; Csaba Lentner (creative editor): Adózási pénzügytan és államháztartási gazdálkodás. Közpénzügyek és államháztartástan II. [Fiscal Policy and the Management of Public Finances. Public Finances and the Study of the General Government, Vol. II]. NKE Szolgáltató Kft., 2015, 857 pages.

PSZ 2017. angol.szam_beliv_v16.indd 416 2017. 04. 06. 7:29:19

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Melinda Koczor-Keul – Tamás Molnár

A 'Bittersweet' Story

The Privatization of the Hungarian Sugar Industry

Summary

Dr Péter Bertalan's monograph, *A 'Bittersweet' Story. The Privatization of the Hungarian Sugar Industry in the Light of Globalization and Geopolitics* reveals the economic history of an era with scientific fastidiousness, but nevertheless in a readable and understandable style, by depicting an authentic picture of the privatization of the Hungarian sugar industry after the transition to democracy. Although his inquiry focuses on a single industry and, in particular, the Kaposvár sugar factory, he is not analysing a unique phenomenon. He places the bittersweet story of the sugar factory in a broader context, and points out the deep-rooted conflicts and complex processes which accompanied the change of regime.

Journal of Economic Literature (JEL) code: N64, O25, P21, Y3

Keywords: privatization, socialist planned economy, sugar industry

Péter Bertalan is a historian, political scientist, and Associate Professor at the University of Kaposvár. In this book he covers a topic which remains relevant today. He raises and attempts to answer an important historical question: has the political and economic transition been completed? The author's position is that the change of regime is an ongoing process that continues today.

I must begin the appreciation of this book by mentioning that it is a very important work not only for general readers but also for experts, and that it fills a gap in the literature. The author studies and provides a structure for a vast range of sources, and does this not only as an economist, but also through the eyes of

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PSZ 2017. angol.szam_beliv_v16.indd 417 2017. 04. 06. 7:29:19

an historian. His research areas are the impact of globalization on regionalism and area development, and social, political and economic trends in the 19th and 20th centuries. The book is therefore not unexpected and without precedents; it is an organic continuation of the author's previous research. Besides overviewing the available academic literature, press articles, reports, and memoirs, he has conducted extensive archival research. The great merit of the book is the presentation of all this information that he has collected.

In the book the era of the political and economic transition unfolds before us, with all its conflicts, political games, and hidden contexts. The story guides the reader through the internal and external difficulties that the small Central and Eastern European had to contend with during the change of regime and the privatization that accompanied it. Although the study focuses on a single industry and on a single company within this sector, it analyses a very important general issue which has significance beyond the individual character of the industry. He describes the problems faced by the majority of domestic companies during the sudden collapse of the centrally planned socialist economy and the transition to the capitalist market economy.

The story begins in the historical period of the Cold War, at the end of which the Soviet system was losing out to the dominant position of the USA in the field of the development of military technology and armament. It was not necessary for a shock to occur, as the Soviet planned economy collapsed in exhaustion. This significantly changed the international geopolitical environment. With the ending of the bipolar world order and, the shift in the balance of power, the geopolitical fault lines were opened up again in the Balkans. This series of political earthquakes, as the author puts it, in the countries along the central and eastern European fault line as well as in Ukraine, occurred at different times and with different rates. The author points out that, "the process called change of regime is a protracted sequence of events" and draws attention to the interesting perspective that, "we should avoid the currently still accepted conclusion, arising from the rapid succession of the events, and from the domino effect, that the transition has definitively ended."

The small states of Central and Eastern Europe were doubly lagging behind the West. They struggled not just with technological disadvantages but also the structural composition of their economies was not capable of a smooth transition from the socialist planned economy to the newly established market economy. The Central and Eastern European countries had to face new challenges in a globalized world. The author considers that the primary problem of globalization is over-indebtedness.

The increase in revenues from the sale of petroleum resulted in a large amount of free cash existing in the newly emerging financial system. These funds were made available at a seductively low interest to countries wishing to close the gap. After 1980, however, the cost of interest on loans increased as a result of the rise in the US dollar exchange rate. Countries unable to service the increasing instalments of loans tried to repay the earlier debts by additional borrowing. But the new loans were obtained on less

PSZ 2017. angol.szam_beliv_v16.indd 418 2017. 04. 06. 7:29:19

favourable terms, and in this way a debt spiral began. These problems were compounded by the fact that, "the countries receiving the loans witnessed a slowdown in economic growth, partly caused by the deterioration of exchange rates, and on the other hand by the fact that a substantial part of the loans was used not for investments but for direct measures aimed at maintaining or increasing the standard of living."

The Hungarian government had already begun the accumulation of external debt in the years between 1970 and 1989 i.e. during the previous regime. The National Bank of Hungary took out foreign (IMF and World Bank) loans in US dollars on behalf of the Hungarian state. The original conception behind and goal of these loans was the technical modernization of the Hungarian economy. In the 1970s investments and equipment purchases were made of unprecedented size. These investments primarily served the strengthening, stabilization, preservation of communist state power. Economic efficiency and profitability played only secondary roles. The proportion of unproductive construction was significant. Similarly to the other small countries in the region, Hungary used the funds received for maintaining and improving the standard of living, and not for investments in improving efficiency. Because the unrealized or failed investments did not provide a return, Hungary was not only unable to generate enough resources to repay the loans, but was also incapable of covering the interest payments. This situation was partly due to the extremely adverse conditions of the loans, and partly due to the tragic deterioration in the balance of foreign trade and the exchange rate (oil price explosion). Beginning in 1982, the state had been forced to take out new loans in order to ensure the necessary amounts for interest payments. This started the 'debt spiral'. Because of the low and declining performance of the Hungarian economy, by the end of the 1980s the external debt had increased to over 20 billion US dollars.

The solution for financing the repayment of these debts was the selling of national assets. State ownership of these assets was exchanged for cash, and this cash was used for debt repayment. The post-communist government accepted to become the legal successor of the external debt, and assumed the payment of the previously accumulated debts. The explanation for this was to maintain the country's creditworthiness.

Referring to the shocking fact that "twenty years after the first years of the regime change (1989–1990) Hungary's government debt had reached 140 billion dollars", the author asks a very important historical question, "Has the political and economic transition been completed?"

At the time of the change of regime everything was legally owned by the state. In order to be able to sell public asserts, a new law was necessary. The door to privatization was opened by the 1988 Company Act, which created the legal framework for the establishment of the different types of company familiar in market economies. This law also allowed foreigners to acquire property. The next step was to transform state-owned enterprises into companies; limited liability companies and joint stock companies were formed. The political leaders opted for the privatization of national assets in order to be able to pay the interest on loans taken out earlier.

PSZ 2017. angol.szam_beliv_v16.indd 419 2017. 04. 06. 7:29:19

Immediately prior to the change of regime every publicly managed property and asset was socially owned. Immediately afterwards, however, the state arbitrarily changed its management rights into ownership, because this was the only way that it could sell and privatize the property of society. The government used the wealth of society "guarded" by the state as the source of financing for the accumulated public debt, i.e. it sacrificed the national wealth to pay off overdue loans. The author pertinently states that, "The balance of demand and supply evolved to the detriment of the sellers and to the benefit of the buyers. The great range of choice offered the opportunity for 'asset stripping'. There were buyers only for the most valuable assets. What happened was the automatic auctioning of the national economy in the given market situation."

The author explains the situation of the Hungarian sugar industry in this economic climate. Immediately prior to the transition, Hungary had twelve sugar factories. These plants had been operating for decades; the majority had been established in the period 1880–1912. They survived the World War II and all the adversity of the subsequent decades. Due to investments made in technology in the 1960s and 1970s, about half a million tons of sugar were produced annually. This covered not only the 300 thousand tons of domestic consumption, but also allowed a significant amount to be exported. Sugar production was one of the most successful sectors of the Hungarian economy, a fact which is explained by the well-organized vertical integration, the favourable natural conditions for beet production, and the up-to-date technology used.

The Hungarian sugar industry was one of the key players in the transformations during the change of regime, and it was among the first victims of privatization. Its particular situation and its strategic importance is explained by its significant role in the traditionally prestigious and successful Hungarian food industry and its close connection with the agricultural sector.

The industry's importance is repeatedly emphasized by the author: "Hungarian food production is highly-ranked in the world market. Sugar production is the flagship of this multi-constituent industry. The sugar industry can be considered the heavy industry of the food-production sector. It is in contact with the entire chain of the food-production industry and agriculture. Its position and condition was, and still is, an important indicator of the state of the Hungarian economy."

As mentioned above, significant investments have been made in this industry, and a series of technological improvements have been implemented, so that the Hungarian sugar factories were considered valuable items of property at the time of the change of regime. Their importance is emphasized by the fact that the most important sector of our national economy at that time was the food industry, in which sugar beet growing and sugar production was an important component. In these conditions finding a buyer was not difficult. Foreign producers were eager to take advantage of the newly opening market, often with the sole intention of purging the market. The foreign owners were not interested in production; their main goal was to close down the purchased companies, with the purpose of reducing competition and obtaining a market for the existing capacity in their home countries. All the 12 state-owned sugar factories were bought up by western European multinational sugar companies in 1990. All but one, the Kaposvár sugar factory, were shut down after the EU's sugar reform and the introduction of production quotas. In order to protect sugar production in their home countries, the foreign owners ceased production in Hungary.

The fate of the Kaposvár sugar factory represents one of the most important chapters in the industrial history of Somogy County and the surrounding region. The factory had an important role in the development of Kaposvár by providing workplaces and developing infrastructure.

The author guides the reader through the history of the refinery. He provides an overview of the circumstances of nationalization in 1948, and the development priorities of the Communist Party until the 1960s, when the reconstruction of the sugar factories fell by the wayside because at that time the focus was on heavy industry. We can also read about the problems of the early 1980s (sugar beet shortage, underutilization of capacity, deficiencies in management, and profit deterioration) and about the end of the decade when the refinery struggled with major financial difficulties. The author concludes that, "The transformation into a company represented an escape, but external help was needed for this at that moment. Government resources were not available; only a foreign buyer could undertake the burden of the transformation, because lending had faltered. Therefore, it can be stated, based on the documents analysed, that the transformation into a company and the spontaneous privatization occurred in a single step."

Reference is made to the way that the factory was influenced by the changes in sugar beet production. The author reveals the macro- and micro-economic factors that influenced the area under cultivation and the volume of production, so we can see that beet production was stressful and full of conflict. Readers can follow the evolution of production capacity, the way that cooperation developed with the beet growers, the personnel changes that took place, the changes made in technological investments, and the way the factory was transformed into a joint stock company. During the privatization, the factory became the property of the Austrian Agrana GmbH, and now it is the only sugar factory in Hungary. All the other 12 refineries that were once active were shut down after the EU introduced the sugar reform and quota-based production, slashed sugar price subsidies, and even offered incentives for producers to cease activity.

The author closes this bitter story with a sweet ending. For the factory there is hope for staying alive, which is not only of local, but also of national interest. The encouraging hope for the future is represented by the already implemented or ongoing multimillion euro investments of recent years, the successful increase in the number of sugar beet producers and the extension of the area under cultivation. As a result of continuous innovation, in 2007 the factory started to produce biogas based on plant waste by using domestically developed technology. Besides covering the needs of the fac-

PSZ 2017. angol.szam_beliv_v16.indd 421 2017. 04. 06. 7:29:19

tory, the energy produced is capable of heating different local facilities, such as the local swimming pool or the Kaposvár FC football club. The goal is to achieve total independence from external fossil fuel energy sources by replacing them with green bioenergy.

At the end of this chapter, the author concludes that the present and the future of the Hungarian food industry, and of the sugar sector within it, is and will be determined by the fate and the economic policies of the European Union. As a result, the question arises: what is the way forward for Europe and for Hungary?

From here onward the attention is redirected towards the global space. The author provides an insight into the most important geopolitical changes of the 21st century. It is interesting to follow him through the analysis of the conflicting spheres of interest of the major powers. We can read, among others things, about the crisis in Kosovo, about the so-called Arab Spring, the war in Georgia, and the political games between Russia and the USA.

A particular emphasis is given to the Syria situation. In Syria the Arab Spring provoked a civil war with significant consequences in time and space. The author states that this has a bearing on our present and future: "Syria is located in an important geopolitical area. The ongoing civil war clearly demonstrates the interdependence between geopolitical and global political and economic processes." By using a historical analogy, the author calls the situation in Syria, "the new approach of the 'Eastern Question'". Because of the Syrian civil war and its direct consequence, the formation of Islamic State, the world has to face two relevant phenomena of globalization: the strengthening of global terrorism, and modern migration.

In the preface of the book, the author writes about his intention of placing the story of the Kaposvár sugar factory in a broader perspective: "The history of the modern economy and the analysis of related social trends are understandable only by taking into account the complicated paradigm system of globalization and geo-economics." Because of the size and geopolitical location of Hungary, its internal politics depends largely on the external political environment. The situation of the Hungarian sugar industry is closely determined by the international economic trends and economic processes.

The book is structured as follows:

The first chapter discusses the economic history of the change of regime in Hungary in the context of globalization and geopolitics. Here not only the Hungarian political and economic transformations are discussed, but the reader also receives a full overview of Central and Eastern European developments of that time. The book explores and explains the reasons why the changes were inevitable. The author analyses global political relations, the processes taking place in the world, and the interactions between geopolitics and the change of regime, helping the reader to put the Hungarian privatization into context. The economic processes of the Cold War era are analyzed from a geopolitical point of view, and the author explains the economic crisis in which the Eastern European countries faced the constraints of regime change and privatization. This period was characterized by a lack of economic restructuring, state-owned companies operating with obsolete tech-

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nologies, fierce price competition following the market liberalization, the loss of Comecon markets, and increasing public indebtedness. Under these circumstances quick measures were needed to create the economic and legal conditions of privatization, to demolish the socialist economic structures, and to build a new market economy.

The second chapter is dedicated to the 'bittersweet' story of the Kaposvár sugar factory. Here the author analyses the Hungarian change of regime in the light of the cataclysm of the sugar industry. The history of the refinery unfolds before us page by page, with all the turning-points, major changes, and difficulties that had to be overcome.

In the last part of the book, a light is shone on current geopolitical movements: the extraordinary strengthening of the position of the United States, the direct US presence in the Balkans and in the Middle East, the most important changes generated by the Arab Spring, and Russia's active involvement in the Middle East with the aim of reducing western influence.

Overall, I highly recommend this this great political scientist's new book to anyone who is interested in a non-politicized and ideology-free insight into the authentic history of the years before, during, and after the change of regime in Hungary. The book has the great virtue of meeting, at the same time, the requirements of readability and scientific rigour. The following main questions will probably arise in the mind of every reader: was the privatization necessary? Was this the appropriate way to sell the wealth of the nation? Did privatization serve the public interest? The author provides plenty of information, but leaves the drawing of conclusions and the finding of answers to the reader.

Péter Bertalan: A 'Bittersweet' Story. The Privatization of the Hungarian Sugar Industry in the Light of Globalization and Geopolitics. Éghajlat Kiadó, 2017, 186 pages.

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