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1. CHANGING WORLD ECONOMY

1.1. KATALIN BOTOS: WHERE IS THE FLAGSHIP GOING?

If somebody raises the question what the greatest change was in the world in the 1990s, nine out of ten persons in Middle Europe will answer it like this: It was the collapse of communism.

Fifteen years ago the processes which disrupted the Soviet empire and replaced the socialist system with restored capitalism began to emerge. Through democratic elections the political systems became multiparty democracies; private property was declared to be the basis of economy. However, actually, most of the means of production were state-owned in East-Central Europe. Therefore, a grand-scale of privatization process was launched in the formerly Soviet-dominated territories. Those who might hesitate were criticized and were accused of the intent to restore socialism.

The moderately progressive experts who did not want to eliminate the state's role-taking entirely were denounced retrograde. The owners of political power were accused that they wanted to have a hold on a part of the means of production and the large systems of redistribution in order that they would be able to intervene in economic affairs, probably, for the benefit of their own political supporters. You could hardly hear of the fact that those who urged on changes were not uninterested in the latter either and economic liberalism favoured definite groups of interest, i.e. people with inside knowledge and foreign owners.

The transition - as this period usually has been called - absorbed all intellectual energy. We hardly paid attention *where we had been going to*.

Anyhow, capitalism is not a uniform system at all. We are inclined to regard the events which have taken place in our hemisphere and region as being of great importance in world history - *as they are, indeed* - but we forget about the fact that *it is not only we that have changed.* There have been enormous changes in the world over the past half-a-century. And what is more important, there was another radical change just before the millenium.

1.1.1. The impact of the Great Depression

The standpoints of the classics of marxism almost proved to be true. In the early 1930s the economy of Europe was in ruins. Italians established the large state holding, IRI for financing the bankrupt companies what, eventually, led to the nationalization of a significant part of Italian economy. The English and French carried out nationalization to a greater extent after World War II and most of the colonies liberated sought to catch up with the help of state property and the state role-taking in economy. In the leading industrial great power of the world, too, the contradictions became so accentuated and the crisis of overproduction resulted in such a recession that tension in society had reached fever heat. As a contemporary, László Cs. Szabó said in his work on Franklin Delano Roosevelt what a great shock it had been for American citizens when *the democratic power,* the social system of which had been an example for the world, *gave order to fire at veteran protesters.* Americans came into conflict with themselves. Solution had to be found to the growing deterioration of social morals which had been induced by the unbridled speculation on the Exchange. (Even the President of the U.S. Exchange who was a Harvard graduate became involved in a fishy business!!!) Samuel Insull, the talented manager of the Edison Works built a pyramid-like empire of companies which ruined hundreds of thousands of small shareholders after the 'exchange fever' dropped. The way out of this crisis was setting-up the institutions of state regulation and the use of budgetary policy. In forms of diversity state ownership, state regulation and boom regulation became general in the developed world. The German economy followed a special way with the establishment of a social market economy in which the nationalization of the competitive sector did not take place but the state role-taking became immense in infrastructure, social policy and regulation. The new economic theories which emphasized a more vital role of the state seemed to conquer the leading capitalist economies and societies, as President Nixon said in a quarter of a century later: 'We all are Keynesians.' But by the time he uttered it, the period had been over. The monetarism of Friedman and liberalism of Hayek were on the way to conquer the 'heights of management'. Truly, the adherents of welfare capitalism shared the successes half and half with the liberals in 1974 because Gunnar Myrdal, the socially sensisitve Swedish economist and Alfred Hayek, the Austrian social scientist who stood for unconstrained freedom shared the Nobel Prize in economics. But Hannibal was 'ante portas'. Soon there came Thatcher's take-over of power in Great Britain and Ronald Reagan won presidency in the USA. The pushing back of the state became the target of formal economic policy since state intervention of a significant degree seemed not to be the guarantor of welfare anymore but the source of stagflation.

Privatization, deregulation and liberalization started everywhere. The 'left-over' of the Great Depression was intended to be swept out and people wished to return to the principles of classical capitalism: the full freedom of undertaking and the unrestricted flow of production factors.

It was not extraordinary at all that Eastern Europe took this way, too, after 1989. Truly, here there were much deeper changes since not only the democratization of economy but that of the whole social system was aimed at.

It can be stated that in the turbulent 1990s there were parallel economic revolutions in the eastern and western parts of the world the resultant of which showed to the same direction even if causes were somewhat different. Both wanted to push the state back and make private economy more competitive. The difference was that the institutional background of all this had to be established again in Eastern Europe that was lagging behind in competition to a great extent because the communist planned economy made the institutions of the market wither. And if we copy a system, let us copy the best one, i.e. the structure of the highly successful American economy.

However, we did not know much about what changes took place in the flagship of capitalism, i.e. in the USA in the 1990s, *what capitalism was brought about by the processes occurring parallel with our ones in the U.S. economic and social system which we wished to resemble* since its success seemed to be obvious. What is today's capitalism like, indeed? What is the USA to which we would intend to approach like?

1.1.2. Chatting on the surface

What is the modern USA like? With one word we may say: it is *successful*. From bird's eye view, from a great distance it seems to be like that and this can be proven by measurable indicators, without any doubt. The USA faced new technological challenges with success. It is in the forefront of framing the new economic structure: 14% of the total of manpower works in processing industry. The proportion of services - and within this, that of the up-to-date science-based services - is the highest in the sectorial structure. Its per capita GDP is one-and-a half times as high as those of Europe and Japan. Its employment indices are far more favourable than those of Europe; the state share in GDP is considerably lower than those in the other two power centres. The burdens of taxes and contributions which are so important from the aspect of competitiveness are smaller. The USA succeeded in overcoming the recession phenomena of the 1980s and had a continuous growth almost over two decades. The nature of capitalism seemed to change: cyclical fluctuations had come to end. Truly enough, U.S. economy had some seamy sides as well, namely: significant budgetary deficits, accumulated debts and chronic deficiency of the balance of payments. But since difficulties of financing did not hamper sustainable growth - there were a great many of dollars outside the USA which ought to find secure investments - the outsider was inclined to forget the aforesaid seamy sides. However, these questions were also on the agenda in domestic economic policy. It is no wonder that the Clinton administration aimed at the reduction of budgetary deficit and achieved that goal, too. It is also true that this melted away in a second during the Bush administration and a great many of macroeconomists are concerned with the problem of deficit again today.

The development of fantastic nineties stopped short and the illusions based on them vanished due to the slackening of the momentum of 'IT business'. The hope that there would not be crises anymore since more up-to-date monitoring of stocks would be rendered possible by modern technology and thus, cyclical overproduction could be hampered faded away. U.S. economy fell into deep recession accompanied by scandals.

1.1.3. Silence in depth

Technologial development caused a historical turning in the world: the fundamentally labour-based economy became capital and labour-based. After the New Deal the USA moved to a greater degree of equality in property and income. In one of his papers published in 1935 J.A. Ryan traced three major deficiencies of U.S. capitalism, namely, wages were insufficient to make a living; there were great differences in property between the poor and the rich and there was a high concentration of capital. He considered the latter the greatest problem, stating that it would jeopardize the stability of the whole system. (Alford-Naughton, p. 277). In 1936 Hilaire Belloc pointed out if economic freedom was accepted, the aim should be the restoration of property. Political and economic reforms which disperse property increasingly to the extent while the number of owners in possession of proper quantities of the means of production are high enough to determine the image of society should be elaborated. (Alford-Naughton, p. 285). Only a person with property may state that he is relatively free since he has certain financial background which makes it possible for him not to 'sell himself' under any and dictated conditions. Otherwise, the bargaining position of capital will be stronger and exploitation will be increasing, i.e. the distribution of new value will always occur to the benefit of the capital. But from the 1970s on there have been significant changes. Incomes began to differentiate. This process slowed down a little in the Clinton era but later it continued. From the economic growth of the past decade, practially, only the upper 5% of families have had a share - stated Robert Freeman in 2004. Since the early 1970s the income of the richest 1% has doubled while the family and household incomes of the 80% of the population have been stagnant or decreased. According to the figures of the Office of Labour the average hourly wage, taking inflation into account, shrank from $ 8 and 3 cents to $ 7 and 40 cents between 1970 and 1994. In the 1990s productivity increased by 7% but wages and benefits did only by 1%. According to J. Annable, the economist of the First National Bank of Chicago, they witnessed it that the field of income redistribution shifted from labour to capital. (Alford, Naughton, pp. 276-278). Since 1973 the U.S. poor have become poorer. Here the income differences are not so great as they are in Latin America but much greater than in East-Asia or in European democracies. (Stiglitz, 2004. p. 34) Who is poor in the rich USA is poorer due to the differentiation of incomes than those in the group of European countries which have a GDP 50% lower on the average than the USA. The cause and explanation of this can be attributed, among others, to the relative underdevelopment of American social network and the insufficient structure of social securities and health care which fail to cover the whole population. Between 1973 and 1994 the proportion of those covered by pension funds dropped from 62% to 46%... According to the international comparative studies of the Pázmány Péter Catholic University the efficiency of the system of U.S. health institutions leaves much to be desired. It is really shocking *how low the efficiency of health care* is in the most advanced economy of the world: the expenses spent on this are nearly the one-seventh of GDP, however, this system produces a state of health worse on the average than the systems of countries which spend half or one-third – compared to the US data, that is much less than int he USA - proportionately to their GDP on this purpose. What is remarkable, this sphere has been organized by the partial or full participation of the state in the other developed countries, while in the USA it has been organized on market basis decisively.

Is it sure this is the example to be followed by all countries of the world?

From the macroeconomic data it can be seen that people in the USA work more than in Europe. In 1992 an average American worked one month more in a year than a European, although in 1973 their work burdens were approximately the same. Thus, we can say that we need not long for the average U.S. living standard here, 'East to Eden', but our activity rate should be raised and we must work more intensively. (By the way, in the USA this is also compelled by the fact that can be experienced with social security: if somebody loses his job, practically, he is unable to pay for the expensive private insurance and thus, he will not have any benefits or allowances). It is true that the lower burden of contributions - what may be smaller than in Europe due to the lower level of compulsory contribution of social security - is favourable for American entrepreneurs; it makes them more competitive - but is it good for employees, esp. if they have lost their jobs? American people achieve higher average living standard but a lower quality of life. Is it an objective for Europe, too? Or probably, is it a constraint owing to globalization?

However, let us consider the widening differences of wages more thoroughly. Here not only the differences themselves are in question, since the salaries of top managers jumped to incredible peaks. According to the Wall Steet Journal 1996. No. April ll. the salaries of managers grew four times as much as did the average wages but their growth was even treble as fast as that of company profits.

Here there is something new, something more what is worth considering.

1.1.4. Whose is the USA?

W. Greider said it would be time to pose the question what had always be unanswered by modern liberalism: Whose is the USA? (Alford-Naughton, p. 278.)

The endeavour to make an ever greater number of U.S. citizens a proprietor became reality by the turn of the century: more than 50%
of the population had acquired shares. The 'people's capitalism was realized through various institutional forms: employee's program for part-ownership, pensions funds investing in shares and, perhaps, direct purchase of shares. There are estimates according to which shareholdings cover not more than 30% of the population. Anyhow, it is true that the scope of owners has been enlarged, but it does not mean that each of the owners may exert the same

influence on his property since small shareholders only endure or enjoy the value change of their shares. Moreover, the developments of the 1990s just strengthened what the outstanding economist Schumpeter referred to in the 1930s and so did Galbraith in the 1950s and 1960s, namely: the real owners of modern age are managers. At least, they exercise the strategic rights of disposal that are the very essence of ownership. Naturally, in the modern form of a joint-stock company to exercising the aforesaid rights the approval of the community of owners, i.e. the general assembly is necessitated but in a significant part of the cases the general assembly gives a nod of assent to the proposals of management. As long as the value of shares is proper or perhaps is increasing, management need not worry: in the boom on the Exchange owners were generous at the general assembly and approved the high payment of the CEO, the top-managers. When the option of shares was introduced, it was emphasized that everybody would benefit from the strengthening of ownership feeling; the old shareholders would benefit more because the managers who turned to be owners would be more interested in the success of the company what is, let us add to it, does not depend only on them but on a team work as well. Yet, the company management had it approved that the payments of top-managers could be *even four or five hundred times higher than the average income*! American managers get multiple the sum of their European or Japanese counterparts. In Japan the salary of a managing diretor is 10-fold the average wage, in Great Britain it is 25-fold, in the USA it has climbed from 85-fold to 500-fold over the past decade. (Stiglitz, The roaring nighties, 2004. pp. 124.)

And what made it possible? Practically, the external circumstances did it, namely: the economic boom and the rise of the quotation of shares assisted by several factors. They were as follows: the interestedness of the financial sector, the spread of the socalled creative book-keeping and the short-sighted approach of co-owners who thought that the growth of the 'bubble' was infinite and the boom would be an endless process, too. It did not disturbe them that managers became co-owners since they profited from that,too, owing to the rising quotations. However, since everything must come to an end once, the great American miracle was also finished spectacularly. The quotations of IT shares began to drop, the investments in information technology proved to be excessive. Even the most developed technology was unable to safeguard the gready human species from cyclical fluctuations. Many people lost much. *But the ownership structure of the company changed. Managers remained inside.* The value of a company may be stabilized at a realistic level but, in the meantime, the managers have aquired or have been able to acquire a significant influencing participation; it can be said

- all this happened to the detriment of the small shareholders since, obviously, the value of the company will or can be maintained but that of the individual shares may decline as now it is spread among several owners.

Although it is worth while mentioning that the separation of the legal structures of actual management and control, too, plays a role in the realization of the above-mentioned possibilities, esp. if moral motives are pushed into the background by strong financial interests, because joint stock companies have board of directors, boards of supervision or socalled external directors responsible for control - but how do they get among the members of these boards? Generally, the management themselves make a proposal to these persons. In addition to prestige, these jobs are concomitant with significant benefits which would not be missed by the lucky nominee at all. Thus, they 'shut one of their eyes' not to see when, in extreme cases, the management have not only advantageous options of shares but special credits for themselves approved. The supervisors, external directors protect not the interests of shareholders but those of the managers and their own ones. Naturally, this is not always so spectacular like that, and in most of the cases - in the phase of the booming business cycle - it seems not to be in conflict with the shareholders' interests. Truth comes to light when the market position is deteriorating. But one may pose the question: How can this happen as joint stock companies have to have themselves audited? But, the independent auditors are also elected by the general assembly - on somebody's recommendations. And on whose ones? You may have 'three guesses'... Also, the auditors could not afford these highly profitable businesses to be passed until the audited data get very far from real facts - while, so to say, they are in no collision with professional aspetcs. Of course, departure from facts has already occurred long before but truth does not come to light until a downward trend in quotation of shares presents itself.

1.1.5. Conclusions

If we want to make a pointed remark, we may say that traditional capitalism in which there were employees and capitalists - may the theory have justified the existent conditions by the 'returns' of the production factors - was based on the exploitation of workers. This is why such a shortage of income that, finally, led to the crisis and overproduction in the 1930s emerged due to the wages reduced at microlevel. This is why since the publication of the Encyclic Rerum Novarum the message of the Catholic Church had taken, several times, a definite stand on a fair wage which should take into consideration the dignitiy of workers and his family circumstances; it should make possible for him to educate himself and to sustain his family. It has emphasized that this is why workers have the right to struggle through the organizations which safeguard their interests, and the state is obliged to give market participants an 'economic constitution' which would guarantee the fair distribution of incomes. However, modern capitalism is not based on the only contradiction between the capitalist and the worker anymore. Under present conditions employees themselves may be shareholders in their own 'company' since there are such programs, too, or they keep their savings in other companies.

A great number of today's citizens are capitalists - even if to a lesser extent - and they are persons who earn wages or salaries at the same time. Thus *they are often deprived of the fair part of the value produced by them through a double channel.* If not the shares of their own company drop, they will lose through the decline of the value of shares owned by their pension funds. Millions of Americans invested their savings in shares with confidence in the 1990s and, at the turn of the millennium, $ 8500 billion 'disappeared' from the accounts of individual savings!!! This sum is one-third of the value saved in this type of form!!!

It can be said that the drops of exchange rate make only the paper profits blown up disappear and this is right and desirable, indeed. There will not be either more or less value than it has really been produced. Actually, every owner loses something but only that which he/she has never had.

This argumentation may be quoted but it is not the full truth. Besides losers *there are always winners, too, and they are typically the managers* who got bonuses by a fluke. Undoubtedly, the value of bonuses decreased, but still, it can be attributed to luck that, based on favourable trends, they obtained the co-owners' right from the other owners (from the general assembly) at all. Obviously, 'they have worked hard for it.' But a competent person knows well that the conditions of regulation, the concerted managerial, banking and auditorial interests and, the short-sighted approach of shareholders are the sources of the wealth of company managers which they acquired in the aforesaid way.

Before accusing me of the fact that this argumentation is a mere speculation, I would like to begin admitting that, basically, I relied on the latest book by J. Stiglitz entitled 'The Roaring Nighties' (2004). J. Stiglitz, the ex-vice president of the World Bank, the ex-president of the Economic Advisory Body of the Clinton administration, professor of Stanford University and a Nobel Prize winner outlined the above-mentioned relationships - which can be observed even in our domestic circumstances as well.

Nobody is envious of the benefits of a manager's work - not at all, if there is a real work in the background. If trickery, the lack of regulation or the utter degeneration of morals can be traced behind managerial benefits, criticism should not be hidden under a bushel. We are responsible for our environment and our value orders transmitted to future generations. We may not stand for Wall Street as opposed to Silicon Valley - in order to cite Stiglitz again.

Society needs a more righteous and brotherly world. This is true for the U.S. society, so is it for the Hungarian one to a greater extent. We long for a capitalism of more human face - perhaps, it would not be called like that either - in which not cruel laws but labour and respect towards well-earned property prevail; in which the possession of property means to have responsibility for the common good; in which we make use of and not misuse our rights.

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1.2. KATALIN BOTOS: EAST TO EDEN

Here, on this side of the River Lajta, we all are East to Eden. How many years we had been longing to make a shopping trip to Vienna, to see the Big Ben of London and the Eiffel Tower of Paris. All these places were the symbols of Eden. Nowadays, we may go to 'the West' to see these miracles if we have enough money.

Yet, the western part of Europe, too, is East to the USA.

There is a great international competition between the leading centres of the world. There are no arguments: priority is not dubious. But is this situation so determined that it cannot be changed? Since what depends on a human being, it may be changed! Or is there any objective feature for which the American methods cannot be copied at all? By any means, what is there in today's science-based and postindustrial society that depends on external fundamentals and is independent of human beings?

1.2.1. Lisbon targets

It is sure that Europe must accept the challenge. Therefore, ambitious targets have been set to increase competitiveness in Lisbon.

The EU would like to form a fast-growing, **competitive** and science-based community out of its member countries **which will realize social cohesion, too**. This is the goal of the EU the member of which we already are. The goal involves a double task, i.e. we should be competitive in an international context but should not give up the notion that the members of society are responsible for one another, i.e. we have to guarantee social cohesion as well. These two tasks are not easy to be implemented! May they be carried out? And what is the relationship of Hungarian economy and society to them?

My favourite saying is: we are shooting at the moving game. We seek to adapt ourselves to the EU challenges, and the conditions of competitiveness but the pattern to be followed is changing and altering. The competition of international power centres makes Europe play according to the rules of the Eden desired. The question is only that these rules can be copied or not. And are we, Hungarians, able to create a competitive economy in compliance with these rules?

In my present paper I would like to discuss what the secret of the success of a model state is. My figures rely on the 2003 Annual Report of ECB and its Statistic Pocket Book, November 2004[1]/ . I compare currency units and not countries. I hope, at the end, it will turn out I do it not by accident since the role of the currency system is great in real economy relations established. We study the data of USA, the euro area and those of Japan through a special logic.

1.2.2. The three centres

The unified Europe cast covetous glances on to the U.S. economic results. For the time being, that we have exceeded the number of U.S. population, it would be nice to reveal the secret to what the fantastic success of the USA can be attributed; what is the reason of the fact that **the GDP per capita is l,5 times higher in the USA** than that in Europe or that of Japan.

Truly, after World War II USA's share in the world GDP was even higher. Europe succeeded in catching up but it can be seen that the ability to create incomes is higher overseas.

If the sectorial structures are under scrutiny, it is apparent that the economies of all the three territories are dominated by the postindustrial sector. In this field, too, USA is in the frontline, here the proportion of the servicing sector is the highest, Japan and the euro area are almost at the same level. The data of agrarium is within a hair higher, with one percentage point in the euro area, but compared to East-European data and, thus, to the Hungarian ones, too, are much lower.

1.2.3. Manpower market

Is the clue to the aforesaid that people in the USA devote their lives to work more than people in Europe? Certainly, the activity of people is much higher in the New World. They start to work early and stop working late. American students earn the money which they need to their studies and elderly people become 'war dead' of work. We do not say less when stating that a particular American character and the love of independence above all manifest in the approach that people like to stand on their own legs and, perhaps, to avoid the others' assistance - what is also a constraint, at the same time, because there are no social care and welfare network similar to the European ones. Because of a particular social organization and ideological background there is a high activity among the Japanese, too. What are impressing, not to say, enviable, indeed, are the low American and Japanese unemployment rates. That is, he who wants to work will find a job in these countries. But why? Would we be just lazier than they are, or have we given up work because there is another solution owing to social market economy and one does not starve to death necessarily if he/she does not work? It cannot be denied there is something in this statement.

But it is also true that manpower should be associated with **capital** in order that a working process should emerge out of it even if we live in an economy of service type. Or we must accept a certain degree of overemployment, a lower level of productivity in order that everybody should have a job - what may corrupt morals and undermine the work morale, moreover, may deteriorate competitiveness. (I put it in brackets: we need eastern morale, the maximum degree of the sense of duty that the aforerunning should not come true. Besides high employment the competitiveness of Japanese people originates from this.)

Where do Americans acquire enough capital to make so many people employed? Would there be so much domestic net savings to this? Not very likely, as it is widely-known that all market participants are indebted. But how is this possible for the market participants? Because the market makes it possible... That is, the institutions which are able to raise money are willing to extend credits for the activities of the market participants. Why does this possibility exist for American market participants and why does it not for the Europeans? It may be stated that here, too, we may give a sociopsychological answer. Although the American citizen is sensitive to his freedom, he is less sensitive to indebtedness as a factor of dependence. Contrarily, it is typical of many European nations that they like to live within their purse. To tell the truth, a European feels to be free only if he does not depend on creditors and the Japanese are famous for their thriftiness. If we want to find an explanation of economic psychology, by all means, I provide that, too. The American financial system prefers capital market financing, so the dependence on creditors is less since he who has purchased my securities, which are, actually, loans, can hardly intervene in what I do with his money - the risk is with him. In the European systems based on credits the patronizing attitude of banks is stronger since it is they who are responsible for repayment to the creditors. Thus, dependence is stronger, too. Therefore, let us have a look at the other side, as well! It is not indifferent

either why capital flows to the venturesome American willinly. Probably, we are not wrong if we trace the cause of this to the favourable U.S. taxation system.
Direct taxes are lower, so are the indirect ones. They are lower than the tax on venture incomes in other places, i.e. capital flows here willingly. The personal income tax is lower than elsewhere, i.e. the basic wage can be raised without the deterioration of cost competitiveness. Turnover-tax is lower what is favourable again in the reduction of price level. (The level of direct taxes is lower only in Japan than in the USA. The Japanese government does its best to maintain competitiveness.)

Thus, the income concentration is smaller than in the other two regions, namely, the proportion of the compulsory redistribution is also lower. Its value is considerably lower than that in Europe, although it is true that expenses cannot be reduced that much. Therefore, it is not surprising at all that American deficit is higher than the European one, although it does not reach that of Japan...It can be seen that the Japanese do not increase their revenues but they try to stimulate boom from the side of expenditure. This results in the nearly 7% budgetary deficit that is approximately the double the American figure. The Japanese economy has been struggling with continuous deficit for long. No wonder, because from the three regions the state debt is the highest here. The American figure, as compared to GDP, takes the third place but taking into account the absolute amount of the U.S. GDP and the fact how long - practically, since Reagan's coming into power - the USA has been struggling with a serious budgetary deficit and has accumulated debts, it is true that the USA is the greatest debtor of the world.

In the USA the level of social security contributions shows a record lowness; it exceeds half the European contribution level somewhat. This is why Americans have to remain - willy-nilly - active since there is not enough money for welfare targets. From European budgetary expenditure it is spent nearly as much as on social expenses (17%) as on final consumption (20.3%) while in the USA both figures are 5 percentage point lower - naturally, it is always estimated in the percentage of GDP. With regard of social expenses financed by the budget Japan diverts from the aforesaid to the greatest extent: it stands out with the lowest level. Corresponding to Eastern philosophy the provision of a family and a small community is a typical phenomenon rather than reliance on the impersonal state and, as far as the pensions are concerned, we have already referred to the extraordinary length of working years.

But the deficits of the budget must be financed from somewhere! Obviously, the domestic financing of deficit is a smaller problem where private savings are high. Basically, in the USA external financing can be taken into account.

1.2.4. External trade and the balance of payments

Europe is a more open economic region than the USA. For the countries of the euro area external trade is not only a possibility but a constraint as well, since the acquirement of energy needs may take place in the international market. However, the external trade which functions, more or less, according to liberalized rules makes the production in every competitive sector face a challenge. Therefore, the preservation of competitiveness is extrordinarily important. Undoubtedly, it is a great advantage if somebody can pay for his imports with his own currency since, in this way, he averts the currency risk to his partners. **The currency of international trade is still the dollar decisively**. The continuous deficit of the U.S. balance of payments has assured the expanding liquidity of the growing international trade over the sixty years, and for the USA it has ensured a pleasant external financing.

The U.S. balance of trade is passive even if we take the services into account. But the partner who has the imports surplus,- in a sense of real economy, if financing is not a serious obstacle - benefits since domestic demand faces the abundance of goods, and this is favourable from the aspect of inflation. And the current balance of payments shows even a deficit higher than the deficit of the balance of trade (4%): it makes up 4.6%, as compared to GDP.

Europe cannot afford the luxury of deficit; the euro area 'produces' only a modest deficit. The role of euro as a currency of international trade is strengthening only slowly. And Japan struggles with a continuous surplus of the balance of payments. Its currency strengthened by exports surplus and its extraordinarily low price level threaten the country with a deflation problem.

The status of reserve currency is changing slowly, too. The world is full of dollars which cannot be converted, e.g. to euro in a great number without a loss.

The world economy flooded by dollars can be described like this: they, both, are not able to get rid of themselves.

1.2.5. European possibilities

Thus, let us study the sketch given above. Can we copy U.S. solutions to catch up with it in competition? Can we afford here, East to Eden, the same techniques as our great rival can? Esp. when we say that we would like not to weaken but strengthen social cohesion.
The answer is briefly as follows: No, we cannot. Not only because it is not easy to alter the psychological characters of a society; not only because we have not the same quantity of natural resources, but because the international monetary system was based on the standard of dollar what, as has been pointed out, strengthened U.S. positions with favourable financing possibilities.[2]/ And when it turned out clearly after the two first oil price explosions that the competitiveness of an energy-wasting economy decreases; that it loses continuously through its terms of trade; that a flight from the dollar began, the IMF changed the rules of the game. This helped the situation somewhat: the system of floating exhange rates was instituted in which it was also difficult to get rid of the dollar load. He who wants or would want to get rid of his dollars, probably, will/would experience a considerable loss of wealth. (By all means, the great volume of dollar funds moving to and fro may shake the economies of individual countries, e.g. through the enforcement of revaluation. The exports sectors of countries which aquire a signifiant proportion of dollars in their external trade, will face unrealizable challenges because of the drastic revaluation of curreny, esp. if this is strengthened by speculative exchanges. Obviously, this is inadmissible, and induces the intervention of currency market in compliance with the practice of dirty floating. However, the making of a domestic surplus money threatens with the growth of inflation, what demonstrates that the sovereignity of currency policy is violated greatly in these countries.) To this situation the response was the European currency integration; that was why the Germans, too, replaced their successful mark with euro.

What has been discussed less so far is with what USA strengthened its position besides the change of the rules of the game in the currency system.

It was nothing else but Reagan's economic policy.[3] / Here I do not think of the run-out ideas of supply-siders, just the simple fact that military development financed from budgetary sources was concomitant with enormous advantages. It increased the U.S. military and civilian level of technology what made it possible for the USA to preserve its leading role and competitiveness in key technolgies. As a result, U.S. share in international trade has been maintained for more than 30 years. The price of this was that the U.S. debt trebled during the Reagan administration; around 2003 it reached $ 4000 billion so the USA is the greater debtor of the world.[4]/

Yet, this can be financed! The immense amount of dollars 'that is wandering about' in the world finds no securer and more liquid investment than the purchase of U.S. government securities.

This economic policy may be pursued for quite a time but not infinitely though. However, for us, Europeans, this policy cannot be followed, this is why the state of the budget is so imporant in the stability pact. Naturally, there is another way to increase competitiveness: it is the reduction of expenses with the lightening_of public burdens. However, this necessitates the reorganization and cut back of the large systems which will probably be concomitant with the shaking of social cohesion. Thus, it will be difficult to meet Lisbon principles. And how difficult for us, Hungarians, it will be to chase the moving game, I cannot even say.

Appendix

ECB Statistics. November, 2004. Structural Indicators.

2003	Unit	Euro area	EU	United States	Japan
Population, GDP and labour					
Total population [1]	millions	308.7	456.7	291.1	127.6
Labour force participation rate [2]	%	68.6	69.3	75.8	78.2
Age dependency ratio [3]	%	49.4	46.7	50.3	49.0
GDP (PPP)	EUR trillions	7.3	10.1	9.9	3.2
GDP per capita (PPP)	EUR thousands	23.6	22.1	34.1	25.1
Labour productivity (PPP) [4]	(euro area = 100)	100.0	93.9	130.5	90.9
Labour income share [5]	%	68.9	.	70.0*)	-
Value added by economic activity [6]					
Agriculture, fishing, forestry	% of total	2.2	2.1	0.8	1.2
Industry (incl. construction)	% of total	26.9	26.8	19.7	29.2
Services (incl. non-market services)	% of total	70.8	71.1	79.5	69.6
Saving and investment					
Gross saving	% of GDP	20.2	-	13.5	26.3
Gross fixed capital formation	% of GDP	19.8	19.2	18.4	23.9
Households					
Gross disposable income (HHGDI) per capita (PPP)	EUR thousands	15.7	-	25.3	16.5
Gross saving	% of HHGDI	14.3	-	3.8	14.0
Financial assets held [7]	% of HHGDI	286.2	-	417.8	457.6
Gross debt outstanding [7,8]	% of HHGDI	81.1	-	113.1	107.0
Non-financial corporations [9]					
Gross saving	% of GDP	8.9	-	10.2	16.0
Financial assets held [7]	% of GDP	131.8	-	112.7	148.1
Gross debt outstanding [7,10]	% of GDP	79.0	-	67.5	112.3
Government					
Expenditure [11]	% of GDP	49.1	48.5	32.4	38.7
Surplus (+) or deficit (-) [12]	% of GDP	-2.7	-2.9	-4.6	-7.7
Gross debt outstanding [7,13]	% of GDP	70.7	63.3	47.8	149.2
External [14]					
Exports of goods and services	% of GDP	18.8	12.4	9.3	12.2
Imports of goods and services	% of GDP	17.1	12.1	13.8	10.6
Current account balance	% of GDP	0.3	0.0	-4.8	3.2
Net b.o.p. direct and portfolio investment	% of GDP	0.5	1.0	3.1	-2.8
Net i.i.p. [7,15]	% of GDP	-10.5	-11.1	-24.1	37.6
Monetary and financial indicators					
Credit (market exchange rates) [7,16]	EUR trillions	10.4	13.4	7.7	5.9*)
Total outstanding amounts of debt securities (market exchange rates) [7]	EUR trillions	8.7	11.6	16.4	6.3
Stock market capitalisation (market exchange rates) [7,17]	EUR trillions	3.6	6.0	10.7	2.4

*Sources: for the euro area and EU: ECB, Eurostat, national data and ECB calculations; for the United States and Japan: national sources. *) 2002 figures*

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2. CHANGING EAST - EUROPE

2.1. KATALIN BOTOS: THE AGE OF 'TRANSFORMATION' IN EAST-CENTRAL EUROPE

Changing of the regime happened at an unexpected pace. This resulted in the fact that even those - among them e.g. Hungary, too - who had had the reform of the system of the inner control at the agenda over decades were not quite ready yet. But there was no other alternative...

2.1.1. “Ticket to market”: the big U-turn

Change rushed at us just like a hurricane. (I. Table) Although over several decades Hungarian scientific and political life had deployed considerable forces which indicated the inevitability of political changes, rapidity was unexpected. First of all, it was surprising how simultaneously processes had started in all the one-time CMEA countries. And what was really shocking had been the rapid disintegration of the Soviet Union. The fact that the economic foundations of this military and political great power were so weak was unknown even by the West. Having studied the reports on Eastern Europe submitted to the US Congress we can see that there were clear signs of the serious malfunctioning of the system in the late seventies but its collapse in the forthcoming future was not predicted anywhere at all. [1] In the eighties the leading military power of the world was not inclined to intervene e.g. in the Polish domestic events, namely, when the military rule and emergeny measures were introduced, and it refrained from changing the status quo in any form.

The fact that thirty years before the idea of intervention had not been raised in the case of the Hungarian revolution in l956 owing to the atmosphere of the cold war and under the power relations of that time may be understandable. But in the eighties from the cracks of the system much more could be seen. However, in those days the socialist stronghold seemed to be unshaken. Direct political intervention would have been accompanied with high military hazards, therefore slow economic penetration into the region seemed to be much safer through the widening of foreign trade and credit relations. From inside what we, the dissenters and reformist members of the intelligentsia, could experience was only that criticism and 'constructive critique' might be much more far-reaching without serious existential consequences, e.g. imprisonment. (But, just as the author of this paper, one had to face the loss of job even in l987!) And it cannot be ignored either that the leaders of existing socialism in some countries, too, were ready to launch reforms to some extent. By all means, the political and economic change of the regime following the Polish events in some years' time was unexpected not only for us in the former socialist planned economies but by the West as well.

But this came as a godsend for European partners. It was just a deus ex machina for them to solve their multiplying problems.

Out of the three centres of the world two struggled with recession in the late eighties. [2][3] Europe would not have been able to cope with the USA if a new and a large market with favourable conditions had not emerged. Truly enough, this unexpected opportunity meant heavy burdens for the German economy owing to unification. This is why it was all the more important for Germany to establish beneficial relations with the other countries. But that could be realized without the EU accession of the countries in question, too. In commercial relations we were taken into account as a buyer's market - no doubt, mutually - and as far as Hungary is concerned, often with a fairly good balance! The further commercial opening up was of vital importance for Hungarian economy with a shortage of foreign exchange as well. Understandably, opportunities for privatization, too, were exploited by EU members. On Hungary's part it was again a pulling effect that the country was badly in need of capital inflow to cover the deficit of the balance of payments. The establishment of institutional relations was not urgent for the EU. Our application for membership in the early nineties was considered rather premature.

Since we should have liked to be a part of Europe not only informally but formally as well, finally, our country and some other ones were given the opportunity to submit the application for accession. (And the fact under what diplomatic and bureaucratic conditions this took place may be judged only by the direct personal impressions of the participants in the event. There were some who spoke about offensive and off-handish treatment and negligence. This foreshadowed the probability that we, the applicant countries from the Eastern part of Europe might be 'outsiders' even when inside?!...)

At that time only an enlargement with fewer members seemed to be feasible. As far as the closeness of economic relations are concerned, we were already 'fairly inside' by the late eighties: we had been integrated in the economies of the West-European countries. (II. Table) A significant proportion of the external trade of Central European countries was directed towards the EU at the end of the eighties. In the case of Hungary the socalled convertible trade approached 5o % and our leading partner was Germany. The share of EU continued to increase in a way that the terms of trade were in favour of EU definitely, i.e. what they had lost owing to the consecutive oil price explosions was recovered through the trade with the joinging countries. [4] In addition, there were opportunities for privatization in which the players of West-European economies took part with full interest. [5]

Of course, others, too, appeared in the market both with capital investments and the acquisition of markets but in foreign trade relations it was the EU member countries that dominated.

Who were able to accomodate to the new situation from inside the most rapidly? It was the former management. With an impressively quick recognition of the situation they understood that everything had to be changed in order that everything should remain unchanged...

While the members of the one-time élite seemed to have lost their power at the beginning of the political changes, they regained their strength soon. But the new democratic forces at the forefront of the East-European countries did not prove to be successful in the confirmation of their power. On the one hand, despite their theoretical expertise in reforms the former dissenters had no operative practice in the organization of economy. Almost without any exception they had been cast onto the periphery formerly and, at best, they had acquired theoretical knowledge in research institutions. Thus, e.g. the Czech Deputy-Minister of Finance, the political Under-secretary of the Hungarian Ministry of Finance, later the Minister responsible for the banking system and the Minister of External Trade as well as the President of the Bulgarian National Bank also came from academic or financial research institutes. Their theoretical qualifications were unquestionable but they were untrained in daily struggles for power and political conflicts.

On the other hand, it was difficult for the new governments to face the enchantments of the illusions and shadows of the past. After l990 citizens expected their fate to change for the better and they would not think of future that might result in a situation worse than the previous one. They thought that, parallel to political changes, the former circumstances owing to which they had not been able to reach the living standards of western democracies watched on the TV and experienced during their tourist trips - even if they had worked hard enough - would cease overnight.

Out of the determinations of the past a chronic shortage of capital, technology backwardness, the lack of the knowledge of modern technology and organization as well as a considerable foreign indebtedness in some of the countries were a heritage which could not be overcome easily by companies and enterpreneurs who found themselves under hard market conditions. But it was not easy for the government organizations responsible for economic policy either, and the fact that the circumstances turned to be hard market ones, as if by magic, at all fronts was guaranteed by the collapse of eastern markets. The foreign advisers who 'supported' governments and represented a considerably liberal market fundamentalism also urged a complete market competition. Owing to the disintegration of the CMEA the previous barter agreements ceased and producers had to redirect the goods which were saleable at all, to the western markets of fierce competition. And the governments facing indebtedness and badly in need of IMF assistance followed the 'instructions' of the IMF and the World Bank experts even if they did not like them in order that they should avoid international crash which would have led to the rapid fall of governments and the drastic decline of the living standard. By the way, the advisers coming with U.S. government aid and aid programmes from Brussels made similar proposals. They proposed liberalization, budget cuts, the cancellation of supports and introduction of international standards in the practice of state regulation. In Hungary, liberalization was also continued vehemently since there had been some modest initiations towards it before the change of the regime. First of all, striking the balance of the budget had to be implemented and, this joined with liberalization at some points. Liberalization of 75 % of the prices meant a release from a considerable burden of price support, although further steps were inevitable and difficult. A new banking law, law of accountancy, law of bankruptcy and law of competition were formulated with a relative haste, although the unfavourable consequences, namely, failures, closing down of enterprises, unemployment, tax deficits and the constraint of bank consolidation also presented themselves.

Although there were international and domestic debates over how rapidly transition to market economy could be implemented, in the background of the theories of the supporters of slower transition and those of shock therapy - at least, in the arguments asserted - there were different approaches to the problems of welfare. Which is better: To adjust to market relations quickly or to assure time of transition to adjustment? Looking back to the period past and tracing the same and different characteristics in the transformation of the various countries, it seems to me that real causes were different. By our days, at a price of significant recession though, transformation has come off: After the disintegration of the Soviet Union and Yugoslavia capitalism is being built in 25 states ...

Indeed, this sentence says much only to the elder generation who lived in the fifties and sixties when every day we could read about what a progress the building of socialism had made. Whether the masses who voted for political changes wanted capitalism is highly questionable. Rather, they knew what they did not want, i.e. the system which was called socialism formerly. However, it is certain that a reorganization of the institutional system, companies, product and capital structures similar to 'wild capitalism' (i.e. classical capitalism) took place. Why and at what price did all this happen? And what are the results? Now let's have a closer look at it!

2.1.2. Privatization and liberalization

For reformers the possibility given by the coming round of the decade of the nineties meant a return to the 'normal social system' after a long detour. The slogan was: 'Back to Europe!' Let's restore the rule of law and order which, practically, was non-existent during the former regime and from the vertically controlled economy let's switch over to the horizontal organization of economy based on market signals.

Since the basis of market is private property, one of the most important tasks was **privatizaion**. But how could it be done? Should private properties be restored to their original owners? Should properties be distributed among all the citizens in compliance with a certain principle (voucher privatization)? Should state property be sold for cash? If so, where will people get money for it? Should we sell it to those - i.e. to foreigners - who have capital? (III. Table)

It is obvious the region was unprepared for the implementation of the task. There were some reform ideas formulated before according to which workers' self-government as a quasi owner should manage companies or, at least, workers should have a stronger voice in the company management, or they should be made interested in the successof the enterprise. In Hungary the latter was one of the objectives of the l968 reform of economic mechanism even if in a modest way. In addition, the following fantastic proposal (propagated by Tibor Liska) was discussed: property is every citizen's legal due and he may claim it only if he is a good manager of it, otherwise it may go under hammer and he will lose it. But the idea to restore the states of ownership which had existed several decades - nearly half a century - before was not discussed even by the most daring reformers either before the change of the regime. No doubt, with privatizaion the time of the redistribution of economic power came about. By 'normal states' a society based on the sanctity of private property is meant. He who has acquired ownership will obtain power. First, he will have only economic power, then the latter may be converted into political one, too. Practically, this is also the case in the bourgeois societies since even in the constitutional democracies based on a multi-party system the various groups of society are separated from each other not only by values but by interests as well.

As far as the Hungarian situation is concerned, macroeconomic data revealed that net savings in society were minimal, [6] i.e. there was no free capital for purchases through privatization. Otherwise, sale for cash would have meant - if there had been domestic capital for it - that state property would change only its form, i.e. productive capital would turn into money capital that could be used to stimulate economy by the state or to reduce its debts.

And there was the key problem in the case of Hungarian transformation. The bulk of Hungarian state debt was in foreign exchange; now the National Bank of Hungary (NBH) was 'the state'. This institution was able to pay its debts only through foreign exchange acquisition so NBS preference was, willy-nilly, a sale to foreign owners. The situation was like that even if the importance of keeping properties in Hungarian hands was emphasized by the existing political coalitions, moreover, some political forces urged reprivatization permanently.

The change of ownership itself - if the majority of the firms to be privatized for Ft had been transferred from a domestic state owner to a domestic private owner - would not have been enough to the operation of the privatized sector. The quality of the existing real capital would have been an obstacle to modern production. Even if the state had had capital in Hungarian currency - let'say, out of the privatization incomes of state companies - to finance a programme for the stimulation of economy, the problem of the shortage of foreign exchange would have been raised again because to modernization and up-to-date production imports surplus is/was needed permanently. By all means, this would have been a further pressure on the balance of payments and would have resulted in indebtedness in foreign exchange again. At best, it would not have been the state that made the debts. (Incidentally, it was like this in Hungarian practice since the state's foreign exchange debts decreased but the foreign debts of the companies - frequently, in the form of loans from the parent companies increased considerably.)

Over Hungarian transformation during the successive governments - mainly during the period of the socioliberal coalition - practically, privatization resulted in a significant (V. Table) growth of the proportion of foreign ownership. To this respect our country hardly differs from the other transforming countries 'which are building capitalism'. In these states, too, a significant penetration of foreign ownership can be experienced.

The socialist nationalization which deprived the individuals of their properties and proprietary rights without any compensation (and was unable to operate them efficiently) was accomplished now. Citizens lost their properties once for all, even the indirect ones that were owned by the state. Perhaps, new owners continue to invest here but it is highly probable that, unlike domestic capitalists, they will not do that. In this case - since foreign acquisition of property is one-sided and the outflow of domestic investments to other countries is much less - the repatriation of the profits of the capital operating in Hungary may be assumed, just like it happened during the previous economic 'conquests'. Truly enough, this occurs in a different legal context, namely, not in the colonial absence of rights but as a consequence of the inequality of chances of the freedom offered by liberalism.

To avoid any misunderstandings, it should be claimed that we do not oppose the inflow of capital but it should be pointed out that the state was unable to use the privtization incomes of the property confiscated from its citizens before for the welfare of the community, i.e. it was unable to spend the money from the privatization after l990 on the development of community assets as well as on the stimulation and support of ventures. No sensible economist wants to restore the power of state ownership the list of the disadvantages of which may be enumerated for long but it is very distressing that practically, <u>the population will not get anything</u>, e.g. a more advanced infrastructure, common goods, better health care and education <u>for the property confiscated</u>. From the privatization funds the community will never receive anything because this sum will be spent on filling in the gaps which have originated from the operation of the former system. The only advantage is that, (perhaps) there will not be any damages done (due to the lack of owners) in the future.

Another cardinal question of the economic change of the regime is liberalization. Disregarding some of the one-time Soviet republics (Belorussia, Turkmenistan, Azerbajdzan or Tadzhikistan) where there has been hardly any privatization yet, only the symbols of the communist rule have been removed, the other economies performed reforms, without any doubt, some of them many, the others only few. What has motivated these processes? According to outstanding experts [7] it was the conscious rent-seeking. They claim that in many transforming countries the managers and leading officials of the former area but new enterpreneurs as well made use of the transformation itself to acquire rent-like incomes. The best method of that was ambiguous regulation which made possible price arbitrage. (In Hungarian relation the socalled 'oil bleaching' (oil falsification) is worth mentioning.) Therefore, the players are interested in a mix of total freedom and the strictest regulation. Frequently, they always refer to welfare reasons but they bother about welfare not at all. A clear example of this was shown by Ukraine in the mid-90s. A semi-privatized, a semi-liberalized and a semi-free country emerged from the one-time Soviet successor state. Bulgaria and Romania were in a similar situation till the l997 financial crisis. At the beginning, Russia launched reforms but soon it became influenced by rent-seekers. Still, it can be experienced that the countries taking just half-steps ahead have made a better progress than those where despotic rules have been maintained after the repainting of the name-board, similarly to some Central Asian countries.

There are some specialists who claim that transforming countries followed the same political pattern. Difference was only in various preceding events and preconditions and this led to various outcomes. [8] Indeed, many kinds of mixed policy led to the present state but it is unquestionable that those who had been devoted to reforms earlier and implemented them the most consistently showed the best results. [9] Although it should be noted that there have been some critical remarks on comparative studies based on GDP statistics, namely: There is no point in drawing far-reaching conclusions from growth data which are compared to a given time [1o] not only because statistical data themselves are not perfect but because there are several factors in the background which aggravate cmparisons; e.g. one of them is the grey economy (IV. Table) neglected which blurred the effect of dramatic declines [11] and another one is the fact that individual economies were at different phases of booming at the change of the regime. Naturally, the latter is charateristic, primarily, of the Central European countries several of which experimented with the introduction of market elements in economic control during the socialist era. E.g. Hungary was at top speed due to the impact of the growth stimulating measures of a former party congress the year before the elections while Poland touched bottom. [12] The postwar boom exerted a great influence on the development of Croatia. However, a decade's time is not enough to make far-reaching comparisons. Two or three years' dynamic development may be as much the forerunner of depression as the organic outcome of a cardinal economic adjustment carried out earlier. But it can be stated that the achievements of the reformers at the forefront are better than those of the other countries in their group.

Here it is worth mentioning that economic facts often made even the prominent experts of the international economic community alter and refine their opinions. Thus, the complete turnaround of J. Stiglitz, the leading economist of the World Bank is an example of that. Shocked by the impacts of the Russian financial crisis Stiglitz called radical reforms a 'Blitzkrieg' which disintegrated the former institutional system but did not assure - as it could not do so - its quick replacement properly. The too rapid privatization caused more damages than benefits and it would have been better to maintain state ownership in several segments of the economy [13]. Ashlund challenges this opinion fiercely saying that for the situation the failure of the support of international financial institutions and 'the absence of external financial assistance' can be blamed. ([l4], p.l06.)

2.1.3. Who is the winner?

Having accepted the position that statistics often distorts; that the neglected features of the grey economy exert an influence on comparisons; that lo-l2 years are not enough for investigating things from a historic perspective, moreover, the experts who make assessments from inside are biased owing to the closeness of time, let's quote the results of some surveys! When we do this, we follow József Eötvös's instructions who said he loved statistics because the makers of confused theories would be forced to arrange their stock of arguments somehow...

In general, about the starting point it can be said that the state of macroeconomic equilibrium in the one-time Soviet countries were much more unfavourable than in Central Europe. Czechoslovakia started with the most favourable macroeconomic indicators and Hungary, too, was in a comparatively good position by international comparative studies. Bulgaria, Croatia, Hungary and Poland inherited considerable amount of foreign debts, with the others this factor was insignifiant. The one-time Soviet debts were inherited by the Russian Republic after the disintegration but their proportion was not too high. [l5] It should be noted that these statements cannot be left without comments because the per capita Hungarian debts in foreign exchange and the amount of foreign exchange reserves were, by all means, alarming. But the macroeconomic situation were considered 'relatively good' by international experts.

It was studied what role the initial conditions played in further development. Seven indicators were taken into account in the analysis: the share of agriculture in GDP, supplies of natural resources, years under communist rule, the ratio of secondary school students, commercial dependency, the degree of overindustrialization, the respective country's distance from Düsseldorf considered to be the centre of Europe.

Two factors seemed to be the most important ones: the ratio of the secondary school students and the years under the communist rule. Those two factors were responsible for over the 5o % of the ability for growth what is not very surprising. The years under the communist rule influenced the drawing-away from the market relations of economy and the role of qualified manpower in modern production is of basic importance. It is not surprising either that taking any analysis as a basis, [l6], [l7], [l8], the Hungarian, Polish and Estonian economies are always on the top and, generally, the Czech and Slovenian economies belong to the group in the forefront. Ashlund summarized the success of the transformation process in a table in which he investigated the accomplishment of the structural reforms, the control of inflation, the implementation of privatization, the ability for growth, the democratic administration and the corruption reduced. It can be seen Hungary and Estonia are heading the list; they have received maximum scores in all the fields under study. (VI. Table)

If our attention is directed not to the past but the future, the survey on the would-be EU member countries' competitiveness made by v. Hagen et al. last autumn (2002) for the World Economic Forum is worth mentioning. (VII. Table)

This survey starts from the fact that 'we are shooting at a moving game.' EU itself is changing, at least, it wants to. The analysis took the supposition as a basis that the Lisbon meeting set itself the following targets: EU would be the most competitive and dynamic science-based economy with more and better jobs and greater social cohesion by 2010. The report to the Forum analysed where the EU member countries stood with respect to meeting their objectives set and where the would-be member countries were. The basis of this analysis was Global Competitiveness Report of the World Economic Forum. The leading businessmen's responses to the questionnaire ranked respective countries on a scale ranging from 0 to 7. Taken their average it was determined what the joining countries had achieved with respect to the Lisbon targets. Growth potential, resear/development, the degree of liberalization, the modernity of the support systems, burdens and obstacles of enterpreneurs, the advancement of financial intermediaries, social cohesion and sustainable development and standpoints of ecology all were 'scored'. If we study the table, it can be seen that the average of the East-Central European countries are below that of EU in every field but it is above the most ill-performing EU member countries in several respects. The best performing Central-Europeans just like the Estonians, Hungarians, Slovenians and the Czechs are above the EU laggards in almost every field, moreover, they reach the EU average at some points. From this the conclusion can be drawn that competitiveness after joining the EU is expected not to be the worst in these countries. However, according to the survey it is not comforting at all that Poland will lag behind even the worst-performing EU countries in every respect and forms a group with Romania and Bulgaria which have not been included in the countries joining in the first round. Poland is the biggest among the states that intend to join EU for the time being.

The picture may alter from day to day, as compared to the situation in 2002. First of all, it is alarming that the signs of a general recession present themselves in the European economic region since the most important external markets of Hungarian economy are in question. The disagreement in foreign policy and the expectable impact of the war conflict are none the less thought-provoking. It is not encouraging either that instead of an overbureaucratized CMEA, we shall be the members of an international organization burdened heavily by bureaucracy, too. It is to be feared as well that stricter rules will shake the state of several small ventures and, thus, social tension will increase. What has been solved by the society on the verge of 'the grey economy' will turn out to be unsoluble at all. Let's say, tax payments to the state have not been too high so far but from now on the enterpreneurs will queue in front of the pay-office. In a booming world economy these problems would be handled with less difficulty. However, the world economy is not under our influence. What can be done at best is that we are going to make a virtue of necessity: While organizing our regions along the principles of sustainable development, we shall make attractive our relative backwardness. Whether there are enough governmental wisdom and individual initiatives to do so in our society is an open question yet.

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[l3] Stiglitz: Whither Reform? Ten Years of Transition Washington DC. Annual l. Bank-conference on Development Economics, Apr. 28-3o. l999

Tables:

I. Table: GDP at Constant Prices (Annual percentage change)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Poland	-11,6	-7,0	2,6	3,8	5,2	7,0	6,1	6,9	4,8	4,1	4,1
Czeh Republic	-1,2	-11,6	-0,5	0,1	2,2	5,9	4,8	-1,0	-2,2	-0,2	3,1
Slovakia	-2,5	-14,6	-6,5	-3,7	4,9	6,7	6,2	6,2	4,1	1,9	2,2
Hungary	**-3,5**	**-11,9**	**-3,1**	**-0,6**	**2,9**	**1,5**	**1,3**	**4,6**	**4,9**	**4,5**	**5,2**
Romania	-5,6	-12,9	-8,8	1,5	3,9	7,1	3,9	-6,1	-5,4	-3,2	1,6
Bulgaria	-9,1	-11,7	-7,3	-1,5	1,8	2,1	-10,9	-6,9	3,5	2,4	5,0
Estonia	-6,5	-13,6	-14,2	-9,0	-2,0	4,3	3,9	10,6	4,7	-1,1	6,4
Latvia	2,9	-10,4	-34,9	-14,9	0,6	-0,8	3,3	8,6	3,9	0,1	6,6
Lithuania	-5,0	-5,7	-21,3	-16,2	-9,8	3,3	4,7	7,3	5,1	-4,2	2,9

Sources: Aschlund, 2002.

II. Table: Share of Total Trade With Nontransition Countries, 1991-1999

(Percentage of total trade)

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Poland	83,2	84,4	87,7	86,3	82,3	79,3	75,5	77,4	79,3
Czeh Republic	-	-	-	68,6	68,1	71,3	72,1	74,3	73,9
Slovakia	-	-	39,5	44,9	45,6	49,4	54,2	62,0	62,0
Hungary	**83,2**	**80,6**	**78,2**	**79,1**	**77,7**	**77,0**	**81,2**	**84,3**	**87,9**
Romania	65,8	74,8	84,4	86,2	88,8	88,9	86,5	88,0	89,5
Bulgaria	80,0	85,1	84,2	76,14	65,4	66,2	72,0	76,9	80,4
Estonia	-	-	54,8	54,5	61,6	59,5	73,1	64,3	76,3
Latvia	-	46,8	43,6	46,4	49,5	50,0	56,7	66,4	-
Lithuania	-	-	75,0	35,0	43,0	38,8	54,6	46,6	50,9

Sources: Aschlund, 2002.

III. Table: Methods of Privatization of Medium-Sized and Large Enterprises

	Sale to Owners Outside	Voucher Privatization (Equal Access)	Voucher Privatization (Significant Consession to Insiders)	Management-Employee Buyouts	Other
Poland	Teritary	Secondary	-	Primary	-
Czeh Republic	Secondary	Primary	-	-	-
Slovakia	-	Secondary	-	Primary	-
Hungary	**Primary**	**-**	**-**	**-**	**Secondary**
Romania	Secondary	-	-	Primary	-
Bulgaria	Secondary	Primary	-	-	-
Estonia	Primary	-	-	Secondary	-
Latvia	Secondary	Primary	-	-	-
Lithuania	-	Primary	-	Secondary	-

Sources: Aschlund, 2002.

IV. Table: Underground Economy, 1989-1995

	Unofficial GDP as a Percentage of Total GDP							1995 GDP Index (1989=100)	
	1989	1990	1991	1992	1993	1994	1995	Official	total
Poland	15,7	19,6	23,5	19,7	18,5	15,2	12,6	98,3	94,9
Czeh Republic	6,0	6,7	12,9	16,9	16,9	17,6	11,3	84,3	89,3
Slovakia	6,0	7,7	15,1	17,6	16,2	14,6	5,8	83,1	82,9
Hungary	**27,0**	**28,0**	**32,9**	**30,6**	**28,5**	**27,7**	**29,0**	**84,7**	**87,1**
Romania	22,3	13,7	15,7	18,0	16,4	17,4	19,1	77,7	74,7
Bulgaria	22,8	25,1	23,9	25,0	29,9	29,1	36,2	73,7	89,2
Estonia	12,0	19,9	26,2	25,4	24,1	25,1	11,8	69,1	68,9
Latvia	12,0	12,8	19,0	34,3	31,0	34,2	35,3	47,3	62,3
Lithuania	12,0	11,3	21,8	39,2	31,7	28,7	21,6	45,1	50,6

Sources: Aschlund, 2002.

V. Table: External Debt, 1991-1999 (Percentage of GDP)

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Poland	61,5	56,4	54,9	47,1	38,0	35,2	36,0	36,2	38,3
Czeh Republic	26,4	23,8	24,3	26,0	31,8	36,0	40,6	43,1	42,3
Slovakia	-	24,1	26,6	32,0	30,9	38,8	48,5	55,9	53,1
Hungary	**67,8**	**58,1**	**63,7**	**68,7**	**70,4**	**61,1**	**51,9**	**56,9**	**59,9**
Romania	7,4	16,5	16,1	18,3	24,1	29,5	30,1	24,0	27,1
Bulgaria	157,4	160,4	127,7	116,8	77,4	97,7	95,8	83,7	80,5
Estonia	-	-	18,2	23,4	22,1	31,8	55,3	55,6	56,0
Latvia	-	-	-	-	31,8	39,4	48,4	50,3	60,7
Lithuania	-	3,1	12,2	12,4	22,8	26,4	32,8	33,3	40,8

Sources: Aschlund, 2002.

VI. Table: The Success of Postcommunist Transformation, 1999

	Structural reform	Inflation under Control	Privati-zation	Growth	Limited Couuption	Democracy	Total Score
Poland	X	X	X	X		X	5
Czeh Republic	X	X	X			X	4
Slovakia	X	X	X	X		X	5
Hungary	X	X	X	X	X	X	6
Romania	X		X			X	3
Bulgaria	X	X	X			X	4
Estonia	X	X	X	X	X	X	6
Latvia	X	X	X			X	4
Lithuania	X	X	X	X		X	5

Sources: Aschlund, 2002.

VII. Table: Lisbon Scores

	EU mean	Four worst EU countries mean	CEEC mean	BU	CZ	EE	HU	LAT	LIT	PO	RO	SLK	SLV
Information Society	5,42	-1,04	-0,91	-1,56	-0,04	0,32	-0,01	-0,70	-0,74	-1,10	-1,36	-0,80	-0,21
Innovation, R & D	5,07	-1,57	-1,27	-1,8	-0,57	-0,79	-0,71	-1,18	-1,25	-1,21	-1,87	-1,06	-0,63
Liberalization	4,78	-0,77	-1,27	-1,59	-0,77	-0,66	-0,55	-1,17	-1,03	-1,27	-1,92	-1,16	-0,46
Completing the Single Market	5,17	-0,93	-1,35	-1,71	-1,04	-0,94	-0,80	-1,33	-1,08	-1,27	-1,92	-1,23	-0,66
States Aids	4,39	-0,60	-1,19	-1,46	-0,50	-0,34	-0,30	-0,81	-0,99	-1,26	-1,92	-1,08	-0,27
Network industries	5,70	-1,37	-1,35	-1,89	-0,38	-0,38	-0,73	-1,13	-1,21	-1,46	-1,92	-1,10	-0,52
Telecommunication	5,71	-0,97	-0,94	-1,53	-0,05	0,12	-0,20	-0,87	-0,90	-1,02	-1,46	-0,83	-0,37
Utilities, Transportation	5,68	-1,76	-1,77	-2,24	-0,72	-0,89	-1,26	-1,38	-1,52	-1,91	-2,38	-1,36	-0,67
Financial Services	5,13	-1,05	-1,25	-1,84	-1,78	-0,24	-0,55	-0,94	-0,90	-1,08	-1,61	-1,27	-0,53
Enterprise Environment	3,80	-1,37	-0,76	-1,46	-0,94	0,28	-0,30	-0,53	-0,64	-0,77	-1,44	-1,01	-0,28
Conditions for Start-ups	4,14	-1,87	-0,94	-1,84	-1,06	0,28	-0,31	-0,55	-0,44	-0,66	-1,56	-0,97	-0,12
Regulatory Burden	3,46	-0,87	-0,58	-1,09	-0,83	0,28	-0,28	-0,51	-0,84	-0,88	-1,32	-1,06	-0,44
Social Inclusion	4,85	-0,91	-1,04	-1,73	0,36	-0,36	-0,53	-1,49	-1,27	-1,27	-1,47	-0,32	-0,05
Life-long Learning	5,16	-1,21	-0,75	-1,43	0,02	-0,30	-0,20	-0,97	-0,96	-0,85	-1,03	-0,35	-0,41
Mordenizing Social Protection	4,53	-0,61	-1,33	-2,03	0,71	-0,43	-0,86	-2,01	-1,57	-1,70	-1,91	-0,28	0,32
Sustainable Development	5,51	-1,20	-1,43	-2,03	-0,47	-0,82	-0,85	-1,13	-1,21	-1,51	-2,00	-1,30	-0,53
Environment	4,93	-0,65	-1,16	-1,51	-0,56	-0,57	-0,60	-0,94	-1,03	-1,31	-1,59	-0,66	-0,27
Climate Change	6,09	-1,75	-1,70	-2,55	-0,38	-1,06	-1,11	-1,3	-1,39	-1,70	-2,41	-1,95	-0,78

Sources: von Hagen

2.2. KATALIN BOTOS: BURDEN OF THE PAST AND CHALLENGES FOR THE FUTURE

2.2.1. What happened in 1990?

A political change of regime which declared that private property as one of the democratic rights regained its *raison d'ętre*. This shook the foundations of the former economic system, too, since it had been based on the state ownership of the means of production and had been centrally controlled. This is also true in the case of Hungary, although our economy was a 'modified centrally planned economy' and a bit different from the others. In Hungary a fairly broad scope of economic interests was introduced, and the elements of market, prices and supply and demand were given a greater play in the change of the processes. But, essentially, central will, too, manifested itself here, at least, in an 'indirect way' through the establishment of such a system of economic regulations which directed the economic development of the country in compliance with central objectives.

Naturally, declaration of the right to private property is much simpler than to make it the basis of the economy. This process is privatization which is not unknown in the Western world either since here, too, the privatization of state property is on the agenda. However, in East-Central Europe there was more in question than that: the proprietary attitude that had been seriously harmed over the past forty years had to be restored in the economy.

The dilemma with which the democratically-elected government was faced from where to take the owners if there were none. Wealth can be distributed - there were also theoretical roots and representatives of this in Hungary - but the easily-acquired property might be easily lost as well. Moral hazard would have been greatly encouraged by the distribution of national wealth based on the right of the citizenship. Therefore, Hungary chose the privatization of cash.

Simultaneously, the country made a decision on who would be the owners of Hungarian wealth in the near future: they would be foreigners, i.e. if we sell state property for money, there should be enough capital to purchase and that was a total nonsense. The proportion of net savings to GDP of Hungarian population was minimal, almost zero.

Factors influencing the net financial arsets of the Hungarian housholds

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP	0,97	0,88	0,97	0,99	1,03	1,02	1,01	1,05	1,05	1,04	1,06
net wealth/GDP	0,13	0,27	0,30	0,29	0,31	0,32	0,35	0,41	0,43	0,45	0,43
changes of net wealth/GDP	-	0,14	0,03	-0,01	0,02	0,02	0,03	0,05	0,02	0,02	-0,02
3 month treasury bill nominal %	0,31	0,34	0,21	0,18	0,28	0,32	0,23	0,20	0,18	0,14	0,11
3 month treasury bill real %	0,97	1,09	0,99	0,99	1,00	1,07	1,04	1,05	1,07	1,04	1,02

Source: P.Csillik calculations, based on HNB Yearly Reports

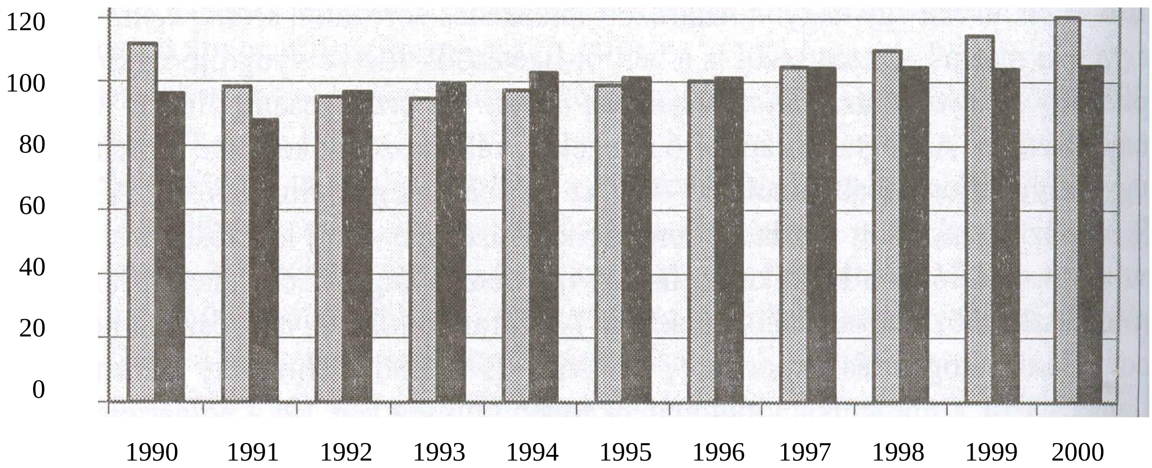
Choice in this field was rather narrow because the per capita debt of Hungary was the highest among the countries of the region and for the debt-servicing the inflow of operating capital was wanted. (Botos-Antalóczy 1990). The author of this paper pointed out the inevitability of this when the programme of the party which changed the regime was under elaboration as well as in her scientific papers preceding the change of regime. (Botos, 1989)

If the question is raised why the Hungarian economy and society were the most indebted, I myself give the following reply: Because it was rather the first in the introduction of market elements but the reforms were not and could not have been so far-reaching that the society might have observed the problems of a half-reform. Probably, this accentuation seems to be strange but it is one of the most important statements in connection with recent Hungarian economic history. The widely-known economic thesis of the socialist-controlled economy is that soft budgetary limits - the expression has been used by János Kornai - stimulate overspending. Parallel to the existence of state property, the decisions of the bureaucracy are not restricted by strong personal interests which are bound to the acquisition, maintenance and growth of property and, thus, wasting is always restricted from the outside, from the other side. Let me add to this that the dictated rates of foreign exchange restrictions, together with the mechanism of external trade of the CMEA, encouraged Hungarian economic units to the US$/Rouble conversion which was one of the most important sources of indebtedness. The CMEA external market was „a consumer" of Hungarian products. The Hungarian 'New Economic Mechanism' created interest in exports and Hungarian economic policy did not recognize that beside non-market exchange rates, this stimulated an exaggerated demand for convertible foreign exchange, which would result in indebtedness. Naturally, in the emergence of debts the significant deterioration in terms of trade which was the result of the oil price explosion and to which the country had not adjusted properly, played a role as well. By the revaluation of forint - that lacked all economic bases - the then ruling financial policy reduced the impacts of this change and disoriented the economy.

We could not get out of the debt trap with the help of our IMF membership (1982) either; it only made our debt manageable. Owing to the restrictive IMF policy, unaccompanied by real reforms, the average annual growth of Hungarian economy in the 1980s was hardly 1%.

Thus, the change of regime made a stagnant and indebted Hungary independent and democratic in a political sense. However, the concept of political democracy was erroneously the synonym of welfare for Hungarian society. They expected that the growth of the freedom of decision-making would result in better decisions which would increase social welfare. Instead, a drastic economic recession ensued. (Table) A decade was needed for the Hungarian economy to reach again, after the recession, the economic levels preceding the change of regime.

GDP in Hungary (1990-2000, %)



Source: HNB (2000)

What was the main reason for the economic recession? It was that Hungary fell between two stools. As an economic thesis, this statement seems to be rather ridiculous: however, it well characterizes the situation in its entirety in which the country, similar to other East European countries, found itself after the change of regime. The CMEA integration had already fallen apart and EU integration has not yet received us. The reorientation of external trade - though Hungary launched it fairly rapidly - could only be partial since the goods which only met

CMEA standards could not in practice be sold anywhere else. It is worth having a closer look at the change of the structure of the external trade over the decade. Here it should be pointed out that pushing a country's economic structure to and fro will be accompanied by huge losses. HUNGARY IS A FERRY BOAT COUNTRY. Its external trade orientation has drifted to and fro during the past six decades. Before World War II, Germany was our most important commercial partner with about 30% of our external trade. The trade with the Soviet Union did not reach l%. In 2002 Germany is again our leading partner with a similar proportion and, out of the disintegrated ex-states of the Soviet Union (the "NIS"), our trade with Russia, that is very important in energy supply, is slightly above 4%. Practically, the capacities suitable for the production of unsaleable goods are not needed. Superfluous capacities meant losses the burden of which was of course transferred to the Hungarian population. The question was only that how, when and to whom they would be transferred.

2.2.2. Challenges

Simultaneously, the change of regime had to face the following:

- to maintain solvency and manage debt-service,
- to re-orient external trade to solvent markets,
- to wind up or consolidate companies which became insolvent owing to their unsaleable products,
- to stabilize the banking system the position of which deteriorated due to insolvent partners,
- to solve the social welfare problem of people who lost employment,
- to launch economic growth and reduce inflation.

In addition, the switchover to the market economy and building up the internal system required by the EU had/have to be implemented. As has already been mentioned, out of these the greatest problem was privatization. The route to the acquisition of EU membership obliged us not only to take over Community norms (*acquis communitaire*) the work of which seems to last for many years and with which we still have something to do but to acquire OECD membership as well. And that was impossible without the liberalization of foreign exchange policy, including the free flow of capital.

Let us see what has happened in this field over the past decade! It will not be easy to discuss these questions in a logical order because things are closely interrelated: the management of foreign exchange debts with the policy of external trade; that interrelates with privatization and foreign exchange liberalization; that with the development of the Hungarian money and capital markets; that with the consolidation of the banking system and, that with the adjustment of the Budget... In spite of this close interrelationship, I shall try to study the elements of this chain one by one for a better understanding.

2.2.3. Debt management and external trade

The first government of the change of regime, the Antall administration, was aware of the fact that it could not afford the luxury of non-payment although it was demanded by several political forces. 'We have nothing to do with the debts raised by the dictatorship' - they said. Regrettably, there is no room for this argumentation in international capital markets. At most, some assistance and rescheduling can be forced by the threat or, perhaps, the fact of non-payment. But the price of this step would have been the shaking of the confidence of the capital markets and it is interesting that first among the socialist countries and for long alone Hungary financed itself through the capital markets even in the former system. It is interesting, indeed, because it was a positive phenomenon; it provided cheap sources to the country from abroad - had they been utilized more properly! It is absurd that those that financed themselves by bank credits and state loans fared better. These countries - I think of Poland, primarily - had better negotiating positions with their partners since banks had already written off a part of their losses and in other parts of them political motivation could be better asserted. It is true that, in addition to this, considerable immigrant masses with a strong American lobbying force were also required. But I managed to talk to absolutely authentic economic politicians and I have learnt from them what a great role good tactics of domestic policy and the confidence between the leaders of the country and financial experts played in the rescheduling of Polish debt. Regrettably, this situation was not characteristic of Hungary and I would not like to go deeply into its reasons. We did not find acceptable the offer to sell Hungarian debts to an investor of an extraordinarily high capital strength or to swap them for participation in ownership because we intended to avert overwhelming one-way economic influence. The route was left for us to perform due debt-servicing at the sacrifice of great restrictions and the IMF promised to lend a hand to this if we met its conditions. (Conditionality.)

In 1990 we balanced the Budget and continued to liberalize several economic fields. In 1992 under the stimulation of the IMF, we introduced one of the strictest bankruptcy laws which was too strict according to later evaluations. It led to the collapse of more companies and businesses and, eventually, to a greater degree of state intervention and a greater loss of the national wealth than necessary. The 'ruinous' companies could be purchased rather cheaply by domestic investors who obtained good information over privatization and by foreigners as well. But non-payment appeared in the balance of banks and generated banking consolidation - again, it can be said at a greater cost than was justified. The Hungarian economy, that restored its credibility abroad, raised more loans than necessary through the National Bank of Hungary (NBH), refilling its foreign exchange reserves. As a consequence, some growth could commence in the second half of the cycle which was, of course, concomitant with a deficit in the balance of payments but the country had reserves for some years. Undoubtedly, the size of the deficit developed by the end of the first cycle and at the beginning of the second political cycle would have devoured reserves and/or would have increased indebtedness - which had already been critical - compared to the indicators of external trade, so under normal conditions it could not be increased. It is indeed true that there was no time to wait and see as to what impacts on exports the brand new businesses, which realized investment imports, would generate because the Horn administration introduced drastic restrictive measures in 1995. This was called the 'Bokros package' in popular Hungarian parlance which meant the introduction of extra customs duties, drastic depreciation, and budgetary restrictions. Here the dilemma of foreign exchange policy should be mentioned: in the first cycle, the forint was revalued and in the second one it became devalued by crawling peg depreciation that had also been introduced by the Bokros package. In the spring of 2001 the government and the NBH management decided to discontinue the crawling peg depreciation and to introduce broader bands. As a result, the forint has been revalued somewhat in the markets but we cannot speak about an overvaluation since it started from a devalued position. As far as external trade is concerned, of course, the slight under-valuation favours exporters but it considerably increases inflation. This is why the first administration did not implement a more drastic devaluation. When remarkable devaluation had to be done, it pushed inflation up ten percentage points. A more stable arrangement of the foreign exchange situation was achieved by the launching of massive privatization which was also part of the package of measures in 1995. The rapid large-scale privatization resulted in the inflow of several billion dollars that was spent, basically, on the accumlation of reserves and debt servicing by the government. Some economists thought that a part of the incoming amounts had to be spent on domestic developments and the stimulation of domestic economic life but this conception was realized only by the third government of the change of regime, i.e. by the Orbán administration.

The commodity structure of exports, 1963-2000

Commodity group	1963	1965	1970	1980	1990	2000
Foods, beverages and tobacco	21,4	20,7	22,3	21,8	21,2	6,9
Raw materials	4,5	3,9	4,7	4,7	5,9	2,4
Energy	2,0	1,4	1,1	2,5	3,1	1,8
Manufactured products	37,5	39,2	37,7	36,9	44,2	29,1
Machinery and means of transport	34,6	34,8	34,2	34,1	25,6	59,8
Total	100,0	100,0	100,0	100,0	100,0	100,0

Source: Statistics of centuries (Statistical curios in the Hungarian history) Budapest, Hungarian Central Statistical Office, 2002, p. 162.

Hungary's largest trading partners 1938-2000 (share of total exports and imports)

Country	1938	1950	1960	1970	1980	1990	2000
Exports							
Soviet Union	-	28,9	30,8	35,8	31,1	20,2	1,6*
GDR	-	7,4	12,0	10,3	7,2	3,1	-
FDR	27,4**	7,4	5,2	5,9	10,0	17,1	37,2**
Czechoslovakia	4,1	10,6	11,3	9,0	6,4	4,1	1,7***
Poland		8,2	5,5	5,6	4,1	1,7	2,1
Austria	18,3	5,1	3,4	2,8	4,2	7,5	8,7
Italy	8,5	3,4	2,4	5,8	4,6	5,9	5,9
Romania	4,0	-	-	-	-	-	-
Imports							
Soviet Union	-	24,5	31,6	34,4	28,9	19,1	8,1*
GDR	-	2,6	11,0	11,0	7,2	5,9	-
FDR	30,1**	9,9	5,2	5,3	12,2	17,4	25,5**
Czechoslovakia	6,6	10,3	11,9	8,3	5,4	4,7	2,0***
Poland		9,9	5,4	5,8	3,8	2,4	2,0
Austria	11,5	5,7	3,6	3,4	5,5	10,0	7,4
Italy	6,2	2,9	2,5	3,8	3,3	4,1	7,5
Romania	9,8	-	-	-	-	-	-

* Russia
** Germany
*** Figures for the Czech Republic. Slovakia took 1,0% of exports and supplied 1,8% of imports.

Source: Statistics of centuries (Statistical curios in the Hungarian history) Budapest, Hungarian Central Statistical Office, 2002, p. 163-164.

The state of foreign exchange may be hardly understood without an overview of external trade relations. First, it can be said that the Hungarian trade balance is steadily negative. It had been like that over the past 50, 60 and 70 years in convertible relations. We were in active balance when we were in clearing relations, be those German-Hungarian clearings or bilateral ones between the CMEA countries and Hungary. These outstanding debts have not been cleared at all or, if they have been, they have been done slowly and at a much lower price. (Even recently in May 2002 the sale of Soviet debts occurred which stirred up a hornets' nest in domestic policy.) Services, primarily, tourism, show an active balance, improving the balance of payments. Therefore, it was a rare phenomenon in 1990-91 when the trade balance became active. The reason for that was the already mentioned reorientation of exports to solvent markets but also the fact that imports were limited because of recession and stagnant companies used up their reserves. As far as the structure of exports is concerned, there were great changes in this field. The most remarkable change is that of exports of the agriculture and food industry, previously making up one-fifth of exports, had decreased to about 6% by the turn of the century.

The cause of this is complex. On the one hand, the Soviet market has been lost. The Soviet partner became insolvent and, in addition, they were given assistance in the form of food aid by Western countries. Here the EU got rid of its surplus and make a positive political gesture to maintain public peace in a poverty-stricken nuclear power. However, we were unable to sell in our traditional market as we had done before. Who would buy things for money when he is given them free of charge? Never and nobody has ever compensated the Hungarian economy for the losses caused in this way! It is sure nobody wanted to damage Hungary on purpose but, actually, this happened owing to internal and external motivations. On the other hand, it is also true that the forms of production organization of agriculture, existing before the change of regime disintegrated. Formerly, agriculture was in a special position: it was conceived as a strategic branch in the Kádár era. In Hungary it belonged to political consolidation that meat should always be available in shops. A very effective model emerged between the large-scale/co-operative estates and the so-called private household farming plots

- based on the self-exploitation of peasants - which provided a significant portion of agricultural exports. With the introduction of the so-called compensation privatisation, this organizational form and system of relations ceased. Numerous and ineffective small farms have emerged, and cultivation on farming leases has become widespread. In addition, food-processing enterprises and shop chains were purchased first and foremost by foreign investors. The latter often bought only a market and brought in their own goods or, if they made a real purchase, they set the prices and dictated compulsory credit relations and deferred payment from a monopolistic stand. The profitability of agriculture declined dramatically which led to the loss of market.

Trade in several former export goods decreased. Hungary had been the greatest bus exporter before. Nowadays Ikarus sells only a fraction of its former volume. At the same time, motor car construction was launched in the first cycle by the investment of Suzuki the Japanese multinational which provides one fifth of the Hungarian market. That was followed by several other investments, thus, Hungary is now also renowned for the manufacture of Opels. Having been restructured in this way, vehicle exports continue to be a fairly great and, in practice, a decisive part of Hungarian exports. That means it is moving with international booms which actually strengthens the dependence of the Hungarian economy on external trade.

2.2.4. Privatization and economic growth

The first years of change can be called 'crisis' if the degree of the decline of production and the concomitant social problems are considered. True enough, this crisis differed from other ones in history to the extent that it did not result in a totally hopeless morale. Although a great many people got into difficult situations owing to the termination of their jobs, political changes freed much positive energy into Hungarian society. This, too, had some precedents. Over the economic reform attempts, the Hungarian economy also tried to do much that had been 'invented' to increase efficiency by the Western world. Such 'innovations' were the GMK and the VGMK (the Economic Working Community and the Company Economic Working Community, respectively) as well as the household farming plots which had previously been established in agriculture. From them, one million small businesses emerged as soon as a proper legal framework had been formulated; in addition, the loss of work places forced people to find solutions. Proof of Hungarian vitality is the operation of the micro-businesses which exist at the boundaries of the grey economy and implement self-employment with minimum capital. Of course, their effectiveness is low. The structure of the Hungarian economy has been divided into two extremes, namely, into advanced large companies with in practice foreign capital and micro-businesses deficient in funds. Small and medium-sized businesses, which are the basis of middle-class development in our interpretation, are 'goods in short supply.' Certainly, the bulk of employment is guaranteed by Hungarian-owned companies which produce a smaller part of GDP while a negligible part of the population are employed by export-oriented multinational and other foreign-owned companies. It has not come off either what we have expected from the inflow of capital, i.e. the latter will bind small businesses to itself and let 'the motor effect' operate. Actually, we have an export-oriented - mostly foreign-owned - economy and a stagnant one. This means that, in the items of the balance of payments, the dividend transfer appeared in the second half of the decade. Having taken into account interest service as well, it is a considerable burden in the current account. The coverage of the external trade deficit and the current transfers in connection with foreign capital, should be assured by the inflow of foreign capital investments which are not determined, fundamentally, by the possibilities of privatization any more but <u>the ability to attract capital to the economy.</u> To assure this, favourable per capita wage costs, qualified manpower, proper infrastructure as well as low-income burdens are necessary. This is given since, in Central Europe, corporate tax is the lowest in Hungary and significant investment incentives stimulate inflow.

Thus, the economic indicators for the past decade demonstrate such a growth curve which, after a 12% decline in production occurring in two years during the early 1990s, crept from the negative domain into the positive one again by the mid-90s. Thus, it indeed took a decade for economic performance to exceed the one prior to the change of regime. The first government aimed at crisis management, the second one wanted to initiate export-oriented growth and the third one's target was the stimulation of domestic businesses, strengthening the middle class and the growth of consumption. The question has frequently been raised: Why could not programmes for the stimulation of business be launched during the first government? The answer is that ruins had to be removed; losses had to be cleared away; new owners with vision had to be 'created' and production had to be restructured. The assurance of the necessary resources for this was made possible only after the solution of the debt crisis. An economy cannot be pushed either by cheap credit or state capital allocations while the financial system is not at a level where it could trace the utilization of injected capital and assess the creditworthiness of businesses. A great many of bad loans have been accumulated, the working out of which caused serious problems and became a great burden on the Budget. Just like the other transition countries, the reorganization of the banking system had indeed to be carried on the shoulders of future generations.

However, part of the losses were spread immediately. Consequently, money in circulation grew which was concomitant with the increase in prices. Inflation spread the burden of the losses of transition across society because, it should not be forgotten, the government of the change of regime showed determination in pulling down the barriers to the market economy. (It had no alternative either, since even on the verge of bankruptcy, the IMF recommendations had to be met to the greatest extent.) Businesses which had already lost their markets became stagnant for a long time, while their better parts were organized into limited companies and later, bought by smart managers. During that time, the bank loans and public debts of businesses had been accumulated. Those were settled in the losses of wealth, the winding up of companies, their privatization at a very low value, and the undertaking of the consolidation of banking debts.

The first administration represented some continuance in the reform efforts preceding the change of regime, since the concept of partial privatization had been elaborated before 1990. Privatization between 1990 and 1994 was rather slow, not without problems. Privatization, implemented without proper care, sold what could be sold from the lesser items, i.e. commercial networks. Thus, it determined the fate of the Hungarian food industry and agriculture since purchasers who were mostly foreigners preferred suppliers who belonged to their scope of interest to Hungarians and, even if they bought domestic products, they did it at an unfavourable price. The broadening of the agrarian scissor, which became so wide as nowhere else in Western Europe, is the greatest proof of this fact.

Terms of trade in agriculture

Denomination	1996	1997	1998	1999	2000	2001	2002	2003
Producer price index of agricultural products	133,7	146,0	150,1	154,0	188,7	200,0	196,6	208,6
Agricultural input price indices	134,3	156,5	168,8	184,9	214,7	239,8	242,2	257,0
Terms of date[1]	99,5	93,3	88,9	83,3	87,9	83,4	81,2	81,2

[1] Terms of trade are calculated by dividing teh output price index by the input price index.
Source: Statistical Yearbook of agriculture KSH, 2003, p.32.

Even if, during the Kádár era, agricultural production had a priority to some extent, this came to end after the change of regime. The great losers of this change are Hungarian peasants and pensioners, who are less able to enforce their interests. That became particularly obvious during the second cycle which was that of the left-liberal coalition when the real value of pensions decreased radically.

The decision of economic policy characteristic of the second administration is attached to the package accepted by Mr. Bokros, the then Minister of Finance, which proclaimed a privatization campaign with massive foreign capital for the improvement and stabilization of the external balance of payments. This era induced a 'take-off', i.e. export-oriented growth. As has already been referred to in the study of the structure of exports, the latter made the Hungarian economy highly dependent on external booms and bound it very tightly to the EU. Economic policy preferred not only export-oriented investments but, through privatization, it attracted capital to infrastructural territories which basically also produced for domestic consumption. The privatization of telecommunications and the energy sector has raised serious problems of regulation unresolved even today, and it opened up the possibility for the repatriation of income which is exclusively earned in the forint zone. This is a great burden to the balance of payments. It generates an almost infinite chain of the inflow of capital since the foreign exchange reserves to the repatriation of profits can be raised only by ever newer inflow. This chain would be broken only if there were capital exports the repatriated incomes of which would result in a better equilibrium in the balance of payments. Naturally, the 'price' of this would be the assurance of foreign exchange reserves to capital exports. As far as the most eligible sector is concerned, that has been the consolidated banking sector. There is no banking sector in Western Europe - and, probably, anywhere in the world - which would be owned by foreigners to such an extent as the Hungarian banking sector. This creates a strange situation that, over the forthcoming decades, probably indefinitely, the transfer of Hungarian tax forints in exchange for the consolidation vouchers will make up the bulk of the profits of the foreign-owned banking sphere. (Just to remember: The reorganization of banks after World War II occurred in a similar way. But there, at that time a) non-market interest was paid, b) the bonds had been repurchased in proportion to the profits of the amount of money issued by the *Bundesbank.*

Taking all this into consideration, the third cycle projected a growth curve the basis of which would be, basically, the domestic economy and internal consumption. The larger proportion of GDP was aimed at consumption, so a more rapid growth could also be achieved only by the rise of consumption. Naturally, that would come off only if consumption were met by domestic supplies, fundamentally. That is, the third - liberal/conservative - administration - sought to combine the export-oriented growth with that generated by the domestic market. Therefore, it proclaimed an institutional state support of the domestic small and medium-sized businesses. For the realization of this approach, a more favourable international economic environment would have been needed. Since there was again an oil price explosion in the world and the struggle against terrorism, too, this had a double effect on economic growth, namely, it affected some branches negatively and caused a boom in others, the development in Europe slowed down. The subsequent waves of energy prices did not help to stir stagnant Japan either. The improving indices of the USA emerging out of recession did not assist us much at that time. However, the mobilization of internal demand was inevitably concomitant with the deterioration of external trade. The left-liberal coalition which won the elections in 2002 tried to implement a combined policy again, parallel to the privatization of the extant state property.

2.2.5. Protection of the value of money

The inevitability of the depreciation of money in Hungary need not be proven. The explanations above obviously demonstrate that the losses affecting the whole of society appeared in the fact that money fell in value, inflation increased and the depreciation of money, together with its economic environment, was to lead to the devaluation of forint.

Since there were foreign exchange restrictions in the former regime, devaluation was carried out by the state. Although the new Act on the NBH, passed in 1991, provided that the protection of the value of money is the greatest task of the Central Bank, it also put down the necessity of supporting government policy. In practice, that resulted in controlled devaluation, i.e. exchange rate policy was subordinated to anti-inflation efforts. The forint was rather revalued in the first cycle but after an initial price leap, inflation reduced almost by half. Of course, the revalued rate of exchange attracted imports and interest in exports was not satisfactory.

The drastic devaluation in the second cycle, which was an important element of the policy based on export-oriented growth, was concomitant with the practice of the crawling peg depreciation. Out of several disinflationary methods, financial experts chose the former, emphasizing that credibility and calculability are the means for the reduction of additional charges and that of inflationary expectations. (Disinflationary policy is the decrease of the rate of inflation.) It is unquestionable that the reduction of inflation had come off again by the end of the cycle. Since, over the period of the third administration, the NBH maintained its crawling peg depreciation policy for quite a long time, inflation reached the critical point of a double figure. As it became evident that, in compliance with the Maastricht requirements, a further radical reduction of inflation was to come, it was reconsidered whether the impact of the crawling peg depreciation would not reverse in the meantime, i.e. through devaluation, it would actually increase inflation. Since in the third cycle profit repatriation took place, this reconsideration did not violate to a great extent either the interests of foreign capital settled in Hungary, although exporting sectors complained about the decline of exports stimulation. In the first year of the new century the NBH, the autonomy of which had been strengthened considerably in compliance with EU requirements, ended the crawling peg depreciation and broadened the bands in the expected way but with unexpected rapidity. That meant the revaluation of the exchange rate bound to the euro. This change had a beneficial impact on inflation although the latter did not continue to decrease considerably due to several reasons. On the one hand, with conscious income policy the government increased the level of minimum wages; on the other hand, the budgetary consequences of the growth based on quickening domestic demand may also have generated inflation. Undoubtedly, it is difficult to follow a disinflationary policy parallel to the stimulation of demand. The former is also hard because the government will be deprived of a part of the seniorage incomes owing to inflation. To avoid this, the administration estimated the expectable decrease of inflation higher than it was in reality which resulted in a decline in the expenditure side of the Budget in real terms. This step in economic policy reduced general and proportionate sharing of taxation in a selective way; made the interested parties invest private incomes in the operation of public institutions (hospitals, schools) in a spontaneous way. It reverted a part of the costs of services to the user; i.e. the principle of solidarity was violated. The patient himself took the necessary medicines to the hospital, the parents of pupils painted and renovated schools. The sources liberated like this - since the income side did not alter unfavourably due to the higher than expected inflation - could be used for the stimulation of businesses and put into the service of demand-booming state policy beside partial compensation of problems.

As has been pointed out, the winners of the fourth cycle intend to continue the latter policy by other and more normative methods. The means of the stimulation of businesses will be the reduction of tax burdens. They would like to avoid <u>the revaluation of the forint</u> in order that exports and further inflow of capital should be stimulated. They want to fight against inflation through the reduction of public expenditure and further decentralization what will jeopardize the sources of the so-called Széchenyi Plan (the support scheme of small businesses), which the winning coalition has promised to continue.

2.2.6. Challenges for the future

The greatest event of the recent past has been be our accession to the EU. Till 2010 we intend to join to the Euro-area as well. In this respect we have to face some factors of uncertainty: Will domestic policy be able to meet the conditions of joining? Will the other new member countries be able to do so? and Will the internal tensions in the EU not increase in the coming period?

One of the most important tasks of Hungary's economic policy will be the reduction of inflation. Without this, there is no possibility to take over the Euro. We have seen in the past that inflation will be 'stuck' if the rate of growth is emphasized. Since over the past two decades in Hungary stagnation has been typical while Europe has made progress even if not a rapid one, catching up with the EU average requires Hungary to have a rate of growth much higher than that. The acceleration of the rate of growth has started over the past 4-5 years but has not reached the one according to which the catching up would be possible in the foreseeable future. The planned in the earlier years rate of growth of 5-7% could only be realized under exceptionally favourable external circumstances and the boom in the domestic economy would require a long-term and very consistent economic policy. Actually, this is hindered by the frequent changes of conceptions and the adjacent institutional frameworks as well as the unresolved tensions.

<u>The management of foreign indebtedness of the state has been resolved</u>, and external debts partially turned out to be internal state debts. In the market of state bonds there is a significant amount of (foreign) capital, so the management of state debt is not problematic but rather fragile. Economic and financial policy may not deviate from the path to which investors' profit expectations have forced it. It would be good and desirable to finance the greater part of

state debts out of domestic sources, however, this would necessitate a greater amount of more dynamic domestic savings. (The latter would be needed for the financing of small and medium-sized businesses as well.) This is not assisted by the growth policy which stimulates consumption. (The net savings of the population is in the middle of our decade near to zero.)

Another problem is me of the rule of agriculture. The profitability and interest enforcement of this sector is catastrophic; the rise of producer prices will be inevitable. Over twelve years, no competitive economic and property structure has emerged either in the form of co-operative large-scale estates, or competitive family farms. Actually, we can witness the struggle of the two conceptions but, regrettably, we can see they extinguish each other in practice. In this process of the question of land ownership is playing a part, too. The representatives of the national/conservative as well as the national/liberal political forces want to postpone the acquisition of land by foreigners, regarding it as the sell-out of a factor of production which is absolutely limited, to the remote future. But in the absence of this, the shortage of capital in agriculture will be more outstanding and the price of land will remain low. However, the left-liberal coalition claims that efficient operation has a priority even at the price of the participation of foreigners. In this question there is a strong confrontation in the society. Regional policy cannot be regarded as consistent; to this, in addition to the Ministry of Agriculture and that of Finance the co-operation of at least three more ministries (agrarian, water, environment) would be needed. To this end, the division of power between the coalition parties has never been favourable.

By the way, over the twelve years the question of land has been determined critically by the law of compensation. Over this step, the original property relations have not been restored but so-called compensation vouchers could be exchanged for land. However, the significant part of the ageing population could do nothing with the newly-emerging small holdings parallel to the shortage of capital and declining physical strength, although at the beginning they wanted to cultivate land or rather, they had dreamt about doing so. They would have liked or would like to sell their property and use up the monetary value of the compensation. The solution found in the third cycle, i.e. eventually, the repurchase by the National Land Fund would lead to implementation of a delayed monetary compensation. Illegitimacy could not be remedied by a plain redistribution of national wealth; the aggrieved persons had/would have a demand on profits lost, or a proportion of them. Now state incomes have been spent on repurchase - if you like it: on renationalization -, so a kind of income redistribution has been taking place. Obviously, if using up is aimed at, it will have an inflationary impact as well.

The restoration of profitability can be achieved not only by the rationalization of production and costs savings. The rise of agricultural produce will be a general cost/inflationary challenge.

Another danger to bringing down inflation is the steady increase in public expenditure. Therefore, the administration will regard further privatization and the reorganization of great welfare systems as being of fundamental importance. In the past decade, we have spoken more than it has been necessary but there were only some reforms implemented. The cancellation of socio-political benefits would arouse great social resistance, however, the privatization of the health care system may be attempted by the government, although the impact of this on current expenses would result only in slight savings: the salaries in health care are so low that a genuine change would cause a pressure on expenses inevitably but capital injection may save some central expenditure.

Further on, the government cannot afford to discontinue the development of infrastructure. Here there is an exciting question whether consequent public acquisitions and tenders will not knock domestic firms out of the market. In this case, the implementation of a project may be and, probably, is cheaper but obviously, the possibilities of income acquisition of Hungarian small and medium-sized businesses will not be improved. Also, it should be pointed out that on our way to fulfilling EU obligations, external to the Budget debts, have to be incorporated into the balance of public finances if it is undertaken by a state-owned company and at the same time the current of the budget balances should also be kept within definite percentages.

Inthelion, balence of payment delerionalion, public debt management, reform of the “big redistributive systems” in the budget and social security, identifiny the role of the agrobusiness – alla these are monuting chaellenges for the presend and future Hungarian goverments. In any case, the playing field of economic policy is rather small.

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2.3. KATALIN BOTOS: BANK PRIVATIZATION

If we wish to make a comparison with medicine, the banking system is an organ to assure the 'circulation of the blood' of the economy. It covers the whole organism with a network and only a single thrombosis is enough to paralyse everything. We can live without hands, moreover, without feet, however, without the circulation of the blood, we definitely cannot survive.

Therefore, the banking system is of special importance in a country's economy. Although it does not produce real goods, its service is one of the most important products; the share of 'banking industry' in GDP is very significant. If its balance sheet total is compared to GDP, there is a value of over 100% in developed countries; in Hungary it is over 70%, i.e. there are still objectives to be achieved.

The group that introduced socialism into Hungary was aware of this fact. This is why banks were nationalized and then, in compliance with the prevailing ideology, the system of commercial banks was terminated.

2.3.1. From one-tier to two-tier banking system

True enough, the need to restore the former banking system had been ripened by the years preceding of the change of regime but the newly- established system hardly differed from the one-tier banking system. Practically, certain directorates of the National Bank of Hungary (NBH), together with clients and staff, were transferred to commercial banks. The dowry was the building and the intellectual capital of those working there. If the clients were monotonous, the future of the newly-established banks was also dependent on that of the given sector and on the group of enterprises. Since it was obvious that, in addition to the state, other owners ought to have existed, as there were no others, the sphere of companies were also included. This resulted in such an overlap between owners and clientele which greatly hindered the effective intermediary activities of banks towards which Hungarian banking regulation - seeking to comply with international regulation - also tried to direct the banking system. It cannot be expected from my own bank to drive me to bankruptcy in the case of financial troubles. (This is not an aim of a bank either because it kills the sheep when it would like to shear it in the future, too. But if the client is the owner, this is totally out of the question: my own credit application must be the most attractive to me...)

With the emergence of the two-tier banking system, banks with mixed ownership could be also set up and, thus, the structure of ownership in the banks operating as joint stock companies evolved like this: state ownership, corporate (private) ownership - but the latter, too, were state enterprises and/or co-operatives - and genuine private property that was held by a foreign owner.

By the time of the change of regime, the group which supervised banks had been set up in the Ministry of Finance. It intended to harmonize regulations with international practice. International financial institutions were ready to extend credit for 'x-raying' the sector that had indeed brought its own sad experiences by the time of the change of regime, namely: owing to the portfolio of bad loans as well as to the accounting practices different from international one, the profitability of banks was only illusive and it turned out that there was a serious shortage of capital. However, this fact was strictly confidential; the team of supervision consisting of Dr. Klára Csoór and Dr. Tamás Rusznák dared not reveal the great many banking and business secrets even to the Minister who was responsible for their work. This is why the public continued to regard banks as 'rich' and even politicians, who could be considered as experts, advised banks 'to swallow hard' their losses which, in the absence of capital, would have meant losing depositors' money and the collapse of the banking system - and that was entirely impossible at the threshold of the change of regime.

The government and the public understood that there were burdens inherited as a consequence of some bad political decisions forced on the banking sector. However, the traceable extent of the burdens was far below the volume that originated from the forced track taken by the clients - often, the owners at the same time - of the banks and, for subjective and objective reasons, they were unable to adjust to the rapidly changing conditions of the internal and external economies. The trouble was not (only) the fact that there were unprofitable transactions financed on the instructions of the centre of the Communist Party but even that there were no alternatives when they made their own decisions. Out of the credits, too, which were extended on the basis of 'banking considerations', many indeed turned out to be bad ones. How much inertia played a role in this or to what extent opportunities were taken advantage of was not clear either in those days - at least, at the level of the authorities. A solution to the problem would have been as rapid a settlement as could be in order to avoid the accumulation of 'more bad loans' than necessary - and, of course, a highly professional supervision. However, there are not so many examples of the latter in international practice either, otherwise, no scandal of Crédit Lyonnais or that of Barings Bank would have occurred. This is all the more so in Hungary where everybody was a 'driver with an L-plate' both in the management of banks and the offices of the civil service. Nobody had long enough experience in banking which would have assisted the supervision of banks.

However, during the first months the government did not - did not want to - undertake greater constraint caused by the consolidation because it thought that step would increase the burden on the Budget. And we must see, those months/years were passed by the bargain with IMF where the most critical question was the volume of budgetary deficit.

The government would not have been willing to force through legislation either, i.e. to establish the financial conditions of consolidation under a separate law instead of 'hiding' them in the actual Appropriations Bill as it had been done. This attitude was the direct consequence of the aforesaid, i.e. there was an illusive picture about banks in the public perception. They thought the saying, 'Thou shalt not muzzle the mouth of the ox that treads out the corn' was true and deficits in banks could be attributed to the 'bankers' caste' that defrauded people. It seemed to be impossible to accept the proposition - even within the coalition majority - that banks had 'to be assisted'. To gain the support of the opposition could have been unrealistic not only for the absurdity of the idea but also due to the appearance of counter-interests on their part. Since there were opinions - they originated from the left-liberal circles, primarily - that the government had to acknowledge losses and hand over the banks for 1 forint to possible investors to restructure them through recapitalization. This approach supposed that 'only' capital was missing from the banks and, perhaps, in the absence of proper information, they did not count on the actual high volume of deficits and their consequences. However, all experts and politicians were reluctant to discuss in depth the seriousness of the problem before a broader public, being afraid of unfavourable international reception and domestic panic, i.e. a probable run on the banks.

Similarly, we were unable to make the government understand that the chain of indebtedness among enterprises emerged not because of the hard-heartedness of 'evil banks' that had rejected newer credit applications. Rather, it demonstrated the absence of liquidity which could not be assured by banks because there was no guarantee for the refund of their money lent. And that was true. Here shortage of revenues was in question. A considerable amount of money would have been required to terminate the chain of indebtedness, which was like a cancer. After all, money substitutes necessary for circulation had been created somehow but a rather strange situation evolved where credit was not granted but bought. The solution was a forced credit extension. To excuse the government, it can be said that in a tense budgetary situation pulled to the extremes, together with the total absence of reserves, the government could hardly have presented the growth of deficit acceptable to international organizations. Thus a proposal to create a deficit then at the sacrifice of public funds for the avoidance of greater trouble would hardly have won approval. International financial institutions wanted to compel the adjustment of economy and society to the changed situation through a radical decline of living standards. (Shock-therapy.) In no case, they would have accepted any deficit in the budget which exceeded the one justified by them. (I state it definitively because I myself was a participant in the negotiations. Moreover, it is also a fact that significant revenues having previously been taken from the banks were planned when making the Budget although I called attention to the fact that they would indeed only be 'paper profits'.)

Eventually, the loss of income appearing as an absence of liquidity led to the loss of capital when accounting started to reflect real values. This could not be hidden anymore in 1992 due to the enacted banking law, although the accounting rules had not shown an entirely true picture even at that time. The loss of capital became a threat to the balance of payments of banks where the value of credits to the bankrupt enterprises, which were threatened by winding up, were reduced to the minimum. (Even as a consequence of the law of bankruptcy because, during the days of grace, debt servicing was discontinued. Incidentally, the law of bankruptcy the suspension of which was urged by the Banking Supervisory Body revealed Hungarian economy as being in a much more unfavourable state than it really was since, it bankrupted the whole network of enterprises if the end product - oriented to the CMEA market - had not been sold, although the competitiveness of Hungarian industry and 'within this, that of manufacturing industry, was much better in the international markets as any of the CMEA countries. This is supported by the analyses of the industrial economy which measured the external competitiveness of Hungarian manufacturing industry based on the comparison of price levels. (Botos J., 1985). This development definitely contributed to the fact that the enterprises were undervalued during privatization and thus foreign investors were able to acquire Hungarian capacities at a low price.)

Since in this way banks, too, were compelled to show a considerable shortage of capital, the effort to find private owners as soon as possible was aggravated. The heap of losses to fall on the shoulders of the new owners ought to have been substituted through capital injection by them which would have made the purchase of a bank too expensive. Thus, the outlook for us was that we must pay somebody to buy a bank ...

That was just contrary to the government's intention to have a considerable income from privatization and from that the government did not want to deviate at all in the case of banks either. The question was especially exciting as to how many and what kind of foreign investors could be counted upon, since this would have alleviated the government's problem in the respect that there was the inherited foreign exchange debt as a burden and the servicing of which was an almost insoluble problem for it. If foreign capital comes in, obviously, it will be interested in enterprises and sectors whose prospects are profitable. It seemed almost unbelievable that the Hungarian banking system - at least, the majority of banks - should not belong to the undertakings which would have a market and be profitable in the future. Thus, one question was to settle the heritage of the past and another one was that the would-be purchaser of a bank was likely to buy an undertaking profitable in the future, therefore, foreseeably, he would pay a considerable amount of cash for it.

The long discussion of consolidation is not the subject of this study. This has been treated from many aspects by a series of studies (by Péter Mihályi, Éva Várhegyi, Ákos Balassa, Katalin Botos *et al*.) and in the material of a parliamentary *ad hoc* committee. I think I will not enter into the field of overgeneralization when stating that consolidation had been inevitable. Opinions differ as to whether the concrete method and, primarily, the point of time were the proper ones. Because, in this way, there had been plenty of opportunities for not so prudent operations and the process was much more expensive than it might have been if, at the beginning, the chain of indebtedness and the direct losses owing to the transition to the market economy and the collapse of CMEA had been settled. The debate is rather academic because the settlements which require public money cannot be exempted from the direct influence of politics and, as has been mentioned before, the latter did not favour professionally correct solutions.

Then this fact may be interpreted according to the approach of one's own party policy.

From the aspect of our topic, bank consolidation is of high importance because if the person who is buying the bank after consolidation will be the owner of the yields of a great heap of state bonds that

- will not be a barrier to a recourse to further assets since they are weighted 0 as far as the capital adequacy ratio is concerned,
- for the acquisition of this income - be it however low - no permanent expenditures are required, i.e. it is jut a clear profit as we say it,
- it is a guaranteed income that will maintain the banking infrastructure until better times come and, the intermediary activities may be realized more dynamically.

To put it in another way, he who buys a consolidated bank and will secure himself to avert unexpected surprises - the probably unpleasant inheritance in the portfolio - will make a very good bargain since one of the most important questions of privatization on the part of the buyer is whether the factory, plant or economic venture will have a market; whether he will be able to sell his products. However, a consolidated bank has secured itself for 20 years ahead. All other increases in activity are just a present! **This would have been expedient to be paid for by the buyers.** And this is what has been missed during the bulk of privatization.

Consolidation is important from the aspect of privatization, too, because its established method, finally, led to re-nationalization, i.e. the post-consolidation proportion of state ownership was higher in banks than previously. But we must be honest, the spontaneous privatization, which started with the handing-over of company-owned bank shares to private individuals in this sector as well - and what was halted by a 1992 decision to transfer the banking shares to the State Property Agency (SPA) - would not have been desirable, either. Each state known by me where the privatization of state banks was decided worked out a very serious conception which dealt with the desirable owners, the proportion of private ownership to the foreign-owned one, the method and schedule of sale and the utilization of income. Naturally, the banking sector is a strategic one, it is quite another question what conception has been followed by strategy-makers with privatization.

Having reviewed the process of privatization after the change of regime, the process can be divided into several phases. It is worth studying the strategic approach of the governments of different political composition because, parallel to the basic consent to the necessity of privatization, there is a political difference concerning the preference of domestic ownership, a greater state intervention and the pace of privatization which is not independent of the former. It should be seen, however, that the Polish saying - 'Three Poles have four opinions' - is also true for our small country. Three Hungarian economists have four approaches to bank privatization. And as I have claimed this is not only for effect but may be supported by the fact that Lajos Bokros the current leading expert of the World Bank, the one-time minister of the Horn administration (1994-98), who became notorious for his package of measures, had a quite different opinion on bank privatization just after the change of regime from that of later times. There was not a common and mature stand within the individual political forces either in harmony with the broad political palette which embraced the national/liberal and Christian/conservative forces of the first government.

Notions have changed on the other side as well: while Lajos Bokros preferred privatization with Hungarian ownership in the Council of the SPA in the early 1990s, he later sold Budapest Bank to a foreign investor, the GE, by means of a not very advantageous contract.

We may scrutinize the series of individual actions from the aspect when the conception to invite strategic investors played a role, or to rely on portfolio investors came to the fore. The privatization of the Hungarian Foreign Trade Bank Ltd. is a typical example of the former, while that of OTP is characteristic of the latter.

Phases can be separated according to what changes the acceptance of banking law induced in the process, for this law created a constraint on reducing state ownership with the stipulation that even the state might not have more than 25% share in a bank after a while, as had also been valid for other owners of banks. Looking back from the present into the past, I myself do not understand how the knowledge on the banking system and its capital state could be reconciled with the requirements of the forced process of privatization. Since they who knew - and among those there were the staff members of the Banking Supervisory Body that had played a key role in the preparation of the law - how deficient banks were in capital, could hardly believe that in such states buyers would be found for them in a short space of time. There is only one acceptable explanation, i.e. they wanted to enforce the decision on consolidation as soon as possible in that way. It has already been mentioned, the earlier the restructuring would have occurred, the better it would have been. At least, it might have cost less. The Banking Supervisory Body was always the advocate of legal consolidation. That would have been the right, expedient and professionally correct solution over a not so hasty implementation from which personal conclusions could also have been drawn.

Let us make a little detour to assess consolidation! If we start out with the fact that the German economy faced a similar problem in 1990 owing to unification, it is worth studying the solution there. According to the German practice of privatisation, the *Treuhand* (similar to the Hungarian SPA) took on a guarantee for business debts to banks. Thus, the loans of the banks were not classified as bad ones and the problem of the recapitalization of banks lessened. Naturally, that solution used up the resources of the *Treuhand* which would not have been celebrated by the *Treuhand*'s Hungarian counterpart, i.e. the SPA. Hungarian administrations needed cash for several reasons, including the elimination of several budgetary deficits. (Certainly, the government would not have faced the problem of gaining parliamentary authorization to assist the banks. Of course, there is no good solution because the deficit of the SPA would have been looked at with consternation in the Parliament, too: 'Where has the privatization income disappeared?')

Eventually, consolidation was a disguised raising of state loans because the interest service of consolidation bonds had to be financed to the detriment of tax revenues and other state income. This means that we are re-grouping, permanently, the financial resources collected by state power towards the private sphere since the majority of consolidated banks have become private ones after privatization. Besides the form of consolidation selected, the government was allowed to make a free decision on how the income from privatization would be spent (or, in the case of foreign exchange incomes, they would be placed in the NBH reserves).

If you like, it can be said that consolidation was the means for the settlement of the Hungarian external state debt. Since it had not consumed privatization incomes - beyond some current consumption of them - it made possible their use, namely, the settlement of our foreign exchange debts and/or their placing in NBH reserves and through this, the reduction of our net debts. Actually, consolidation transformed our former external debt into a long-term domestic debt that would have been utterly impossible with other forms of loan-raising. The market would hardly have purchased Hungarian forint state bonds with a maturity of 20 years.

However, the German *Treuhand* also ended consolidation with a deficit the estimated amount of which was almost DM 400 billion, and this, too, increased the state debt. <u>Incidentally, the</u>

German consolidation bonds have a 40-year period for maturity but are charged at market interest rates as well. (It should be noted that German bank consolidation after World War II took place through similar methods. Then the bonds were not charged at market interest rates and their repurchase was planned for 100 years' time. During personal consultations with the representatives of the *Bundesbank,* I have been informed of the fact that, eventually, repurchase from the net income of the *Bundesbank* occurred over 54 years.) Similar to us, today's German economy carries the interest burdens of this consolidation with some difficulties which is indicated by the leap of the German budgetary deficit after unification. Only for the sake of order, I note here that not only was the weakness of the portfolio of placements included in the expenses but also the fact that German reserves were converted one-to-one into the former West German currency. Thus, the Kohl administration gave a very great present to East German citizens (which was not appreciated by them so positively according to later political events.) Unification and the transition to the market economy led to the massive job losses in the Eastern *Länder* and increased the basis for the election of the left. The fact that at least bank deposits had not lost their values was not, in the long run, impressive enough for the masses.

Hungary could not rely on such a protective umbrella that would have helped the population endure the difficulties. (They were mitigated by Hungarian economic policy through another subsystem of the state finances that undertook the burdens by making large-scale retirement possible. I note it here that parallel to the one-to-one conversion of savings the inclusion of East German citizens in the earlier West German pension system was a great - and expensive - political gesture for them, too, i.e. the German economy applied the umbrella for the moderation of the burdens of transition.) In Hungary concerning the banking system only the minimum objectives that banking deposits should not be lost because of bad placements could be and were to be set. (After all, their value was eroded by the soaring inflation and their net values were reduced to the minimum by the favourable instalments of OTP housing loans.)

This is why banks had to be consolidated. It is quite another question that if the government wanted to have a cash income even from the sale of the banks themselves, not only the assets - deposits, current accounts - had to be covered but with consolidation, recapitalization should be raised above zero-level, otherwise, what capital could have been sold by the existing Hungarian institute of privatization, the SPA or State Holding Company?

But it should be seen that from the whole of privatization, including the selling of other sectors as well, the state was able to receive a considerable amount of cash because the burden of consolidation was not put on the shoulders of the SPA or State Holding Company through netting.

Coming back to the impact of banking law, which urged privatization, we may see the victory of the generally-spread liberal notion - nonetheless, to the stimulation of the World Bank and the IMF as well - that the performance of state property is weaker, therefore by the force of legislation a deadline had to be determined for the hand-over of bank shares to private individuals. The thesis according to which the worst private owner is better than the state one is not well founded at all. The message of this has not been supported by recent research (thus, by an ECB paper published recently), either. Profitability is neutral as to the form of property in the EU, too, even if there are examples of large state banks near to failure and it is also a fact that Brussels opposes the state's rescue operations oriented to them... Rather, the question is that every political force would like to deprive its opposition from the advantage that is made possible through the influence exerted by the ruling party on state-owned banks. And it is hardly debated that such a phenomenon could be experienced all the time. For example that was the reason for the Central Corporation of Banking Companies becoming involved in the business of Postabank during the Horn government when the target in that case was, obviously, just to cover losses. This type of investment would not have been made by any sound private banks at all! But financing actions with high risk and, probably, concomitant with losses (high-risk e-credit, students' loans under market interest rates) can only be conceived under the stimulation of a state owner and, in addition, to his promise to cover the losses.

The theoretical debate of whether or not a strategic investor would be needed, had mostly been decided in favour of the former in Hungarian bank privatization. Thus, the Hungarian banking system turned out to be the branch network of interested strategic bank owners *de facto*, even if not *de jure***.**

Whether or not this is a problem has been the subject of much debate even till today. Although strategic investors brought some expertise in addition to capital, at the same time, they lacked local knowledge; they also brought assets, if needed, but they did not force lending; they did it only with regard to solvent foreign-owned large companies in a rather limited circle. (However, they wanted to win over these companies to their credits through a suicidal competition since the acquisition of good customers was a strategic question.) The analyses demonstrated that the expertise of imported specialists was no deeper than that of domestic ones. The expertise of some talented managers who had also been concerned before with foreign transactions or extending credits in the NBH did not lag behind that of their Western colleagues. At least, the difference is in the fact that, in order to meet the rigorous control of the private owners, it can no longer be substituted by any political merits.

Subsidiaries of banks operated by or established with foreign participation in Hungary entirely fitted into the business policy of the parent banks. It may also occur with banks which have large international networks that the centre of various business branches is in another foreign city, i.e. the Hungarian subsidiary reports in two directions. In the subsidiaries, the freedom of the decision-making of managers is very restricted. Decisions are adjusted to the international standards of banks and have a minimum regard to domestic conditions. Actually, banks with strategic owners function as branches even if this is not the case according to current regulations in force. After joining the EU, many of the domestic banks owned by EU banks are expected to turn into branches in the legal sense as well. The developments of the internal banking system in the EU indicated this trend when the EU converted to the rules of the single European market. Thus, to expect the conveyance of the goals of the national economy and those of politics from private banking sector - e.g. the financing of small businesses with high risk; the development of medium-sized businesses with capital participation - will be very restricted. This can be implemented insofar as and when they coincide with banking interests.

Let us examine the impacts on Hungarian bank management from the aspect of the extent to which the banking system, that has emerged, is consumer-friendly. The complaints are as follows: customers feel themselves defenceless; services are expensive; and there is competition for customers only at the level of advertisement.

As far as the credit lines are concerned, it became quite obvious that the only chance for the development of domestic small and medium-sized businesses is the growth of domestic savings. And now the cardinal question is what possibilities the development of Hungarian small and medium-sized businesses that are in the forefront of establishing jobs have since multinationals will not solve one of the greatest problems of our age - and probably the most urgent one in the country - i.e. employment.

Taking all this into consideration, it is hardly understandable why this strategic branch, almost the whole of the banking sector, had to be handed over to foreigners. International comparison shows that out of European countries, a high proportion similar to us can be found in Greece (77%) while Germany, Austria and Spain keep this proportion between 25% and 30%; and in Sweden, Norway and Italy the presence of foreign owners is not typical at all.

2.3.2. Case studies

Let us study some concrete questions interrelated with bank privatization. Here I do not strive at completeness, only at commenting, on the one hand, on some cases which were focussed upon by the public and, on the other, the professional community thought their conditions were rather obscure.

2.3.2.l. The case of General Entrepreneurial Bank

Similarly to Ybl Bank, the privatization of General Entrepreneurial Bank took place as a routine step of the SPA, preceding the elaboration of a general conception that was not a too-detailed one, either. At that time, in 1991 the setting-up of the not-so-effective Committee on Bank Privatization was under way and in connection with those sales, the question was raised as to who else might intervene in privatization with respect to the special character of the sector, i.e. privatization might not be the only result of a decision of the SPA management.

At the highest state levels the German West-LB expressed its intent to make a 'bridge-head' in our country; therefore it would purchase some shares of a small and well-operating bank. Since General Entrepreneurial Bank was previously qualified as a well-managed, small bank, the purchase was licensed - indeed, at that time, its manager was appointed as top manager of OTP where he spent only a short span of time but later, too, he was a banker and/or an influential person of financial policy.

At the beginning, WLB did not wish to buy more than 25% and wanted to examine the books of the bank more thoroughly as an owner. Who would have thought that over that short period there would be an essential deterioration in the bank's state? But that happened. The Banking Supervisory Body began to collect the banking data services, based on banking law. Relying on this information and only out of intuition, without any special signal, the management of the Supervisory Body had a look at the ownership structure of small banks where there was already some variety, as compared to state ownership. It was striking that there were overlaps between the owners, managers and clients of some small banks, and the Managing Director of one of the banks controlled an ownership interest in the businesses financed by him. A more thorough examination launched was strengthened by the liquidity problem of a bank that had been indicated by the apparatus and data service of NBH as sound. Eventually, that bank had been wound up and their managers and owners were put on trial. Our bank - having a very complicated contact with the former - accepted bills at a discount guaranteed by the bank but for such a short period of time that it was shorter than the legal enforcement time, thus, the guarantee was zero. The amounts were so high that they shook the state of the small bank to the foundations. Revealing the problem, the foreign purchaser protested to the selling body (SPA), the State Banking Supervisory Body and all the possible fora, asking why it had been given 'a defective product'. It was proved that the radical deterioration of the situation had occurred during the time it had been the owner, although not a majority one. As the foreign owner preferred not to stand in front of the public as an owner of a failing bank, he was willing to make a sacrifice. Thus, the consolidation of the bank was carried out in a way that the SPA undertook a considerable proportion of the losses but the minority owner, too, participated in the settlement. Then, the reorganized bank was in practice taken over by the latter. Since that time it has been one of our successful small to medium-sized banks.

2.3.2.2. The privatization of Hungarian Foreign Trade Bank Ltd.

At the end of the cycle of the first government, bank privatization was considerably prolonged because of the conceptual debates and consolidation. The government which 'had worn out' its third minister of finance by that time and the Minister himself would have liked 'to produce success' in the field of bank privatization, they put the privatization of Hungarian Foreign Trade Bank Ltd on the agenda, which had long been prepared by the Director General, together with one of the strategic partners the Bayerische Landesbank the head of which was also one of his good acquaintances. The sale 'having been frozen' for one-and-a-half to two years took place in 1994. The purchaser greatly immersed himself in the contract of sale and was willing to pay for the bank just as much as the registered capital and the reserves above par in the bank. That is, he did not want to pay a penny more than that for the clients thereby acquired. The bank's total balance sheet was not among the biggest and, therefore, according to some analyses its sale was marginal. However, it should be noted that, owing to the properly controlled relations between partners and the nature of the transactions, the foreign trade transactions financed by this bank resulted in the most favourable portfolio for the bank – in any case, much more favourable than those of the others. (And even if there was a 'deficient component' in it, with a master-stroke, they sold it to another bank with state ownership; which was, eventually, a kind of consolidation.) Since there was no problem with the portfolio, the bank could be sold without an 'official' public state consolidation - at a rather low price. The Banking Supervisory Body could not intervene in it because the sale did not belong to its scope of authority. An ironical contradiction of privatization is that Hungarian privatization strengthened the position of the Bavarian *state* bank as a strategic investor...

In the first phase among the owners there were also EBRD as an institutional investor and also the Hungarian state (SPA) with 25%, but after two years, the latter proportion, too, was bought by the strategic investor.

The new owner soon replaced the Director General but it employs in this position an 'old motorist', a leading banker who had been an active top manager even before the change of regime.

2.3.2.3. The case of OTP

Although the privatization of OTP had not been hindered by the volume of bad portfolio, there were some problems to be solved concerning the bank. Before the change of regime, international financial institutions exerted pressure on OTP to change from a savings bank into a commercial one and also undertake corporate financing since it was the one organization which had considerable assets from the savings of the population. But it had neither experience nor a professional personnel in corporate finance. (Indeed, none of the other banks had either but, at least, they had been concerned with some corporate finance according to the practice of the former regime.) Incidentally, the informatics system of the bank did not meet the modern requirements of retail banking services, either. In addition the capital of the bank was not enough according to the regulations in force. All this would have definitely been a barrier to sale. However, a solution of regulation and a genuine financial step assisted in settling the problem. The former could be eliminated by classifying credits lent on mortgage in the 50% category; that step considerably improved the capital adequacy ratio, then the coverage for IT was created by the separation of some billions from the framework of consolidation bonds to spend them on recapitalization. Moreover, this whole amount was returned out of the income from privatization and, what is more, in cash!

Liquidity was not a problem, owing to abundant savings of the population which started to accumulate rapidly after the change of regime.

Actually, the government had a problem with OTP because of the interest rate support of housing loans since the latter generated such a great volume of budgetary expenditure that they had to be reduced. Therefore, a programme had to be introduced for the reimbursement of the housing loans under the following conditions: for those who repaid the half of the existing debt, the other half was released. If somebody was unable to do so, he had to pay a higher interest rate. (It was rather an unlawful measure because it was one-sided. Contracts should be changed only on the agreement of both parties.) That series of operations belonged not to the consolidation of OTP but to that of the Budget.

The decisive steps of privatization took place during the Horn government but the swap of compensation vouchers for shares, which had occurred over the preceding two years, could be considered as part of privatization. That was followed by a series of actions that did not bring money to the government but corresponded to the principles of privatization, i.e. domestic institutional investors - local governments and the social security system - were granted banking ownership. Further on, foreign investors, domestic institutional and private investors as well as the management, acquired a significant proportion of ownership not in open sale. Finally, the proportion of state ownership left was sold as well.

OTP relied mostly on **portfolio investors** of national ownership. As there is influential participation but none of the owners has dominant ownership, **the role of management** is of decisive importance in the bank's profitable and prudent guidance. Although the structure of ownership compels the management to run the bank profitably, strategic development is dependent on the inventive ideas of the management. Unquestionably, the basis of successful operation of OTP is that it has been run by a rather permanent team of Hungarian banking specialists for more than ten years. With an intelligent policy, the management had a hold on the process of privatization; it always had its own initiatives; it managed to avert the attempts at the change in management; here it was the bank's privatization strategy that played a great role. The shares of state ownership were held by several state organs, i.e. the compulsory social security organizations, the SPA and the Ministry of Finance, which acquired ownership rights for privatization bonds. They were all considered as the representatives of the state. **Thus, with proper tactics, they could be persuaded to make votes against each other in the question of personnel that would not do much to the co-ordination of central organs but continuity benefited the management.**

2.3.2.4. The BB story

The sale of Budapest Bank (BB) is the most expressive - perhaps, negative - example of how **a bank should not be sold.** I would like to point out some elements of it: it is not expedient to set short deadlines for the sale publicly since it results in unfavourable bargaining positions for potential customers. It is not right to give generous guarantees in the contract of sale stating that bad loans coming to light later will be taken over by the state. Let the customer have a closer look as to what he will buy. It is not reasonable to sell a bank to a multinational company, one large company which has just settled in Hungary. That is, BB was sold, actually, to one large company General Electric although, formally, the provision of the law according to which only a financial institution may even own 100% of a bank had been met because an investment company classified as a financial institution owned by GE (GE Capital) appeared as a buyer. However, this purchase is hardly independent of the presence of an enormous corporate investor in Hungary. Also, it has often been said that this sale has been 'necessary' because it has warranted the credibility of the government's intents - but *at too great a price.* With consolidation, it would have been better to examine more thoroughly what there was in the bank and discover the losses - the management of the bank had been boasting before that, eventually, they did not want to participate in state consolidation; 'the problems would be solved on their own'. Finally, this happened in a different way due to realization of state guarantees. Here, too, we may refer to the German example since consolidation there was not a single action but recapitalization was put on a Sonderkonto and that was corrected by permanent analyses. Obviously, we are witness to such a thing in the case of BB as well but, in the meantime, the change of the owner had taken place. In any case, it was untrue that the bank recapitalized itself without state assistance, as was said in the advertisement of the sale.

2.3.2.5. Privatization of other banks

Hungarian Credit Bank sold in 1997 and the Commercial and Credit Bank Ltd. (merging with Ibusz Bank) were sold even later and were acquired by strategic investors. Similarly, the smaller Bank of Hungarian Savings Co-operatives with its network and Mezõbank Co. Ltd. - amalgamating with Agrobank - also received foreign owners. The sale prices were much more favourable than in the abovementioned cases. Concerning the sale prices, that of the Bank of Hungarian Savings Co-operatives was outstanding. Here it was reflected to some extent that the banking licence and market presence themselves are of a value. This wave of bank privatization has implemented the presence of banks of various European nationalities - Irish, Dutch, Austrian, German - in Hungary and mitigated the dominance of foreign ownership, at least, with its greater variety.

2.3.2.6. The - unrealized - privatization of Postabank

Postabank was established after the emergence of the two-tier banking system, also having foreign owners from the outset. The objective of the bank was to break the monopoly of OTP in the retail market. After the change of regime, similar to OTP, institutional investors and social security self-governments, were granted shares in ownership. Since the bank might not refer to inherited debts and, presumably, did not intend to give a significant participation to the central government, it 'did not apply' for consolidation bonds. However, its capital adequacy ratio was continuously under the level required and that could not be remedied by any regulatory tricks because it did not have a considerable stock of housing loans lent on mortgage (which had provided a solution for OTP). Since *it did not apply* for - later the management said it had not been given - the opportunities of consolidation, bad loans remained unsecured. However, the case of Postabank differed from those of all other banks, even from that of Agrobank with which it had some similarities in the solution followed. Agrobank's shortage of capital derived mostly from inherited bad agrarian loans that the seller did not want or was not able to admit to the buyer and would have liked to manage without a state co-owner - but Postabank itself made all of its placements. Here there is nothing or nobody to be pointed at. This whole situation originated, entirely, from management decisions, the placement constraints of its aggressive expansion policy and business policy. Why indeed should it have been consolidated?

It is really incomprehensible why **the personal consequences** of the constraints of consolidation have not been concluded much sooner by the authority concerned. It is also incomprehensible that a state-owned bank was compelled to intervene with capital to cover losses and other public monies were sacrificed in restructuring - and the management was not changed. (It is not an easy task but there was no attempt even to do so as far as it is known.)

It can be said in favour of the Supervisory Body that, eventually, it stopped unknown owners - hidden behind offshore firms - from increasing capital in the bank and acquiring a bank of considerable total balance sheet the collapse of which would not be permitted by the state, evidently, because it would be 'too big to fail' and, thus, somehow it would continue to operate. And through this rather unfair way, the owners would have had the privilege of earning money with taking a risk with other people's money since the ownership of a bank means 'my adventure with your money'.

Regrettably, 'playing the fox' for a long time - let us call what has happened like this although a more thorough investigation must make the wording more exact since risk-taking points at moral hazard, too - required a terrible price: such a huge amount of money that had gone beyond all other previous scales; a larger amount of money than those appeared with any other bank's consolidation which had been justified by somewhat more objective economic circumstances than those of the Postabank. Here, indisputably, subjective factors, i.e. the decisions of the management played a role and consolidation was justified rather by the size of the bank and the immense amount of public savings. Thus, it conveys a really unfavourable message to society, namely, *taking risks is worth doing only on a large scale.* The bank was returned to state ownership again and stayed there by the end of the third cycle. In compliance with its privatization philosophy, the new left-liberal coalition is likely to privatize this bank as well. It is only to be hoped that they will learn from the experiences of former privatizations. Over consolidation the management, having been operating for a long time was fired and criminal procedures against the top managers were commenced by several organs. **From the public report of the parliamentary committee of inquiry, the State Audit Office revealed** that the bank management had been skilfully balancing on the edge of legality, 'dodging' the alertness of the supervisory organs by creating non-transparent ownership relations with the establishment of a complicated holding structure and spicing it with the approach so that it presented different ownership structure through forward option deals by a given point of time. By this step, it averted the collision with prudential capital requirements that could have been revealed only by a very thorough on-site examination. The question can be raised why such an examination had not taken place! The reply may be that politics intervened in the process of affairs - who knows for what reasons but, probably, for enough justifications - and prolonged their solution. And with this our discussion has come to an end.

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2.4. KATALIN BOTOS: PREISE, WECHSELKURSE, WETTBEWERBSFÄHIGKEIT

Die Wettbewerbsfähigkeit ist eine wissenschaftlich schwer definierbare Kategorie (Török Á., 1999). Es ist darüber eine riesig grosse Literatur vorhanden, und es gibt beinahe unzählige Teilindikatoren der breit interpretierten Wettbewerbsfähigkeit. Heute bedeutet die Wettbewerbsfähigkeit in der Praxis internationale Wettbewerbsfähigkeit. Wir können sie auf Mikro- und Makroebene interpretieren , obwohl es Manche gibt, die die Letztere für uninterpretierbar halten (Krugman, P., 1994).

Im Jahre 1999 haben es mehrere Versuche internationaler Institutionen versucht, sie zu definieren, die eindeutig dafür Stellung genommen haben, dass der Begriff vorhanden ist. Die Wettbewerbsfähigkeit bedeutet die Sicherung eines dauerhaft aufrecht erhaltbaren Faktoreneinkommens, bei einer relativ hohen Beschäftigung, bei einer angemessen hohen Grades der Liberalisierung, d.h. bei einem internationalen Wettbewerb. (Lengyel, I., 1999, Botos, J., 2000).

Wir können die Erhaltung des Marktanteils auf den ausländischen Märkten für eine gute, annähernd richtige Evaluiierung betrachten, - trotz aller Kritik, - wenn sie mit der Verbesserung der Handels- und Leistungsbilanz und der Verbesserung der Warenaustauschverhältnissen einhergeht (Botos, J., 2000). Wir wollen es natürlich damit ergänzen, dass es wichtig ist, zu welchem Preis dies zu erreichen ist, und dazu, wiederum als eine gute Annäherung lohnt es sich, die Entwicklung der Devisenwechselkurse unter die Lupe zu nehmen.

Dieser ausserordentlich komplexe Indikator verändert sich bei einer angemessenen Liberalisierung natürlich nicht nur aufgrund der Veränderung der aktuellen aussenwirtschaflichen Lage, sondern er wird im hohen Masse auch dadurch beeinflusst, was für eine Möglichkeit die Investoren sehen, in der investierten Wirtschaft Einkommen zu erzielen. Die Wettbewerbsfähigkeit bedeutet in diesem Sinne die Fähigkeit, Kapital anzuziehen, da Kapital deshalb kommt, weil es gute Perspektiven der Wettbewerbsfähigkeit auf dem betreffenden Gebiet für vorhanden sieht. Das widerspiegelt sich in den Wechselkursen so, dass die Nachfrage nach der Devise die Auswirkungen der eventuellen

Abwertung mildert, die die möglicherweise ungünstige aussenwirtschaftliche Lage, bzw. die Entwicklung der Inflation verursacht.

Die Entwicklung der Wechselkurse spiegelt einerseits den Unterschied in den Inflationsraten wider, andrererseits ist die Inflation selbst ein Wirkungsfaktor. So soll man manchmal nachdenken, was früher da gewesen sein soll: die Henne oder das Ei? Die Abwertung der Devise, d. h. das Absinken des Wechselkurses ergibt sich nur als eine Folge der aus anderen verschiedenen Gründen sich ergebenden Inflationsraten, oder trägt dazu die Wechselkurspolitik selbst, vielleicht im breiteren Sinne auch die monetäre Politik bei.

Bei der Erörterung unserer Gedankenreihe können wir die geschichtliche Analyse nicht entbehren. Selbst dann nicht, wann ein jeder seine Aufmerksamkeit jetzt endlich, auf die Zukunft lenken möchte. Das Gleis, auf dem die Bahn unserer Wirtschaft im höheren oder langsameren Tempo rollen kann, um sich den entwickelten Marktwirtschaften anzunähern (?), ist festgelegt, d. h. der Weg stark determiniert.

Diese Determiniertheit hat geschichtliche Wurzeln. Die ungarische Wirtschaft hat beim Systemwechsel eine so schwierige aussenwirtschaftliche Lage geerbt, die aus ihr, wie so viele Male in der Geschichte einen Zwangs-Herkules gemacht hat. Sie war gezwungen, ihre aussenwirtschaftliche Wettbewerbsposition um jeden Preis zu verbessern, da sie konvertible Devisen unbedingt brauchte. Ich formuliere es etwas zugespitzt, aber er war so.

Das Mass der Bruttoverschuldung, die immense Last des Schuldendienstes haben erforderlich gemacht, vom Preis der Verbesserung der aussenwirtschaftlichen Lage für eine kurze Zeit abzusehen, da die Verbesserung der Handels- und Leitungsbilanz die erstrangige Frage war. Alles, was wir nur konnten, haben wir von den zusammengebrochenen Märkten auf die Zahlungsfähigen umgelenkt, aber die Verbesserung der Leistungsbilanz war in nicht geringem Masse dem Rückfall selbst zu verdanken, nämlich viele Importe sind dadurch entfallen. Der Wechselkurs hat trotz der nominellen Abwertungen die ungarische Devise im aufgewerteten Zustand erhalten. Dieser Zustand wurde oft auch kritisiert. Die Kritiker wiesen darauf hin, dass diese Lage die Exportorientierung nicht gefördert hat. Wir sollen aber auch in Betracht nehmen, dass die sich ausbreitenden Kosten des Systemwechsels einen drastischen Verfall des Geldwertes zur Folge hatten, den ein noch höheres Mass der nominellen Abwertung durch die Erhöhung der Importkosten noch verstärkt hätte.

Es ist wohlbekannt, dass die ungarische Wirtschafspolitik in Jahre 1990 sofort zahlreiche restriktive Massnahmen in der Fiskalpolitik getroffen und zugleich eine Liberalisierung vollzogen hat, da die Hilfeleistung des Internationalen Währungsfonds (IWF) sie erforderlich gemacht hat. Erinnern wir uns daran, dass der ungarische Fiskus 1990 den Haushalt, unter meiner damaligen Leitung, mit einer fast völlig ausgeglichenen Bilanz abgeschlossen hat. Die Verbraucherpreise sind viel schneller gestigen, als der Preiszuwachs in der Produktionsphäre (Tarafás, I., 2001). Dabei spielten auch die Schritte in Richtung der Steuerreform eine Rolle, und auch die ungedeckten Mehreinkommen, die auf den Verbrauchermarkt strömten. Sie sind aufgrund des schnellen Erhöhung der Anzahl der Rentner und Pensionisten, sowie des Anstiegs der Zahl der Arbeitslosen entstanden, obwohl es für die Betroffenen oft nur ein soziales Minimum gesichert hat. Dieses Problem hätte man nicht radikaler behandeln können, aber diese Ausgaben haben zu einer radikalen Erhöhung der Inflationsrate beigetragen.

Die Regierung hatte nicht die Absicht, die Inflation mit einer noch radikaleren Abwertung noch mehr in die Höhe zu treiben, insbesondere so lange nicht, bis ein exportfähiges Produktionspotenzial des Landes unter den neuen Umständen entsteht. Das was in jeden Fall vom Entstehen der neuen Eigentümerstruktur abhängig. Es ist eine andere Frage, warum die Privatisierung auf solche Weise, in solchem Tempo vorangetrieben wurde, wie sie der Fall war. Auch dafür gibt es mehrere Erklärungen. Es ist ziemlich offensichtlich, dass jede vernünftige Regierung seine Bürger zu Eigentümern machen will, aber die Möglichkeit der Verwirklichung dieser Bestrebung hängt in hohem Masse vom Anteil der Ersparnissen und von den Zwängen der Devisenlage ab. Wenn es nicht möglich ist, durch das Wachstum der laufenden Produktion und damit durch die Erhöhung der Exporte die Verschuldungslage zu verbessern, ist es nur durch den Verkauf vom nationalen Vermögen an die Ausländer möglich. Die Nation wird zweifellos ärmer an Eigentum, aber das hineinströmende Kapital bringt auch viele positive Effekte mit. Diese sind vor allem: exportfähige Technologie, Vertriebsnetz, Führungsfachkenntnisse, strenge Kontrolle durch die Eigentümer. Dazu braucht man sicher eine entsprehende angemessene Wechselkurspolitik, weil die Wirtschaft eines Landes auf dem Weltmarkt mit einer überbewerteten Devise schwer wettbewerbsfähig sein kann. Dafür gibt es auch Beispiele, aber dazu muss man in der Technologie Spitzenreiter sein. So das man Preisbestimmer wird, aber diese Rolle hätten wir kaum vom in unser Land gekommenen Kapital erwarten können. Dieses Kapital wollte eher die günstigen Lohnkostenbedingungen nutzen, hinter denen aber doch nicht ungebildete Arbeit stand, und die Vorteile auf dem Gebiet der Abgaben (günstige Steuerbedingungen, vorhandene oder vorbereitete Insfrastruktur usw.) realisieren. Deshalb wurde 1995 die gleitende Abwertung eingeführt. Sie hat, gepaart mit der massiven Privatisierung, die grundsätzlich Auslandskapital mobilisiert, die weitere Verschlechterung der Zahlungsbilanzlage verhindert. Danach hat sich die ungarische Wirtschaft auf eine Bahn eingestellt, die bei einem angemessen stabilen Niveau der Einströmung des Kapitals eine Entwicklung sichert, aber dieses Niveau muss kontinuierlich sein, denn sonst können wir die aufrecht erhaltbare Entwicklung vergessen.

Das nach Ungarn hineinströmende Kapital hat durch seine Investitionen eine gewisse Zahl von Arbeitsplätzen geschaffen, aber es hat in der heimischen Beschäftigung keine entscheidende Rolle gespielt. Dies mussten die heimischen Unternehmen, die aber relativ niedrige Kapitalkraft hatten, erfüllen. Die ausländischen Direktinvestitionen haben eine hohe Produktivität, und sie haben schon fast die Hälfte des ungarischen Unternehmenssektors in ihrem Eigentum (Pitti, Z., 2002). So entstammt das Wachstum des Beitrags dieses Sektors zum BSP nicht von den Löhnen, sondern grundsätzlich von den Profiten, und wir sollen nicht vergessen, bei sehr vorteilhaften Steuerkonditionen.

Blicken wir auf die am Anfang unseres Beitrages erwähnten Indikatoren der internationalen Wettbewerbsfähigkeit! Was zeigt die Aussenhandelsstatistik?

Der Systemwechsel hat den Anteil Ungarns am internationalen Handel auf seinen richtigen Platz gestellt. Nach dem Zweiten Weltkrieg hat der Anteil Ungarns auf dem Weltmarkt 0,3% betragen, durch die Ausweitung des RGW (COMECON)- Handels wurde er auf 0,8% erhöht, aber dies ist nach 1990 wieder auf das Nachkriegsniveau gesunken. Das "Fährenland" Ungarn hat leider still gestanden. Diese Lage des Stagnierens hat sich trotz aller exportstimulierenden Anstrengungen lange nicht verändert, nur in den letzten Jahren hat sich eine markantere Verbesserung gezeigt, deren Aufrechterhaltbarkeit die Frage der Zukunft ist.

Und die Export-Importpreisverhältnisse? Die ungarische Wirtschaft schaltete sich in den letzten 30 Jahren unter den Bedingungen sich immer mehr verschlechternder Export-Importpreisverhältnissen in die internationale Arbeitsteilung ein. Wenn wir die unit value Statistik der UNO als Basis nehmen, können wir feststellen, dass es in den 1960-er Jahren eine ruhige Periode der internationalen Preisentwicklung gab, deren Stillpunkt das Jahr 1963 war. Dies als Basis nehmend, können wir die kontinuierliche Verschlechterung feststellen.

Natürlich haben die Auswirkungen der "Pferdestosse", der Ölpreisexplosionen auch Ungarn, wie die anderen energieimportierenden Länder sehr unvorteilhaft betroffen, und zwar aus zwei Richtungen, aber lange haben wir nicht angemessen reagieren können.

Die ungarischen Importpreise enthielten sowohl den Preisanstieg der Energieträger, als auch jene Preiserhöhungen, mit denen die entwickelten Länder darauf mit der Erhöhung ihrer eigenen Exportpreise geantwortet haben (Botos, J., 1981, 2001). Es ist ein offensichtliches Zeichen der Schwäche der Wettbewerbsfähigkeit Ungarns, das es weder langsam, noch schnell seinen Preisverlust ausgleichen kann. Während Italien in 17 Jahren, die Schweiz in 11 Jahren durch die Veränderung der internationalen Preisverhältnisse den Wert einer ganzjährigen BSP-Produktion gewinnt, Ungarn verliert ihn in 7 Jahren. Auch Deutschland und Japan gleichen in längerer Zeit die Verschlechterung ihrer Export-Importpreisverhältnisse aus, obwohl sie stark auf Energieimporte angewiesen sind.

Es ist schwer zu quantifizieren, ob und inwiefern in der Verschlechterung der Export-Importpreisverhältnissen und im Tempo der Inflation das höhere als das begründete Mass der Abwertung eine Rolle gespielt hat. Ich bin der Meinung, dass die Abwertung notwendig war, auch deren Technik als zeitgemäss bewertet werden kann, aber die langsame Senkung ihre Rate hat die Inflation genährt (Tarafás, I., 2002). Es ist zu erwähnen, dass die Anwendung der gleitenden Wechselkurse für die monetäre Politik zwei weitere Folgen hat. Die Eine ist, dass das Niveau der Inflationsrate das Zinsniveau determiniert hat, das relativ hoch festgelegt wurde, um den Investoren eine minimale Anreize zum Sparen zu sichern, und dies hat zur kontinuierlichen Kapitaleinströmung geführt. Die Interventionspraxis der Ungarischen Nationalbank hat es nicht durch eine "fruchtbare Unsicherheit" hinsichtlich des Zeitpunktes der Intervention gemildert. Das hat die Spekulation begünstigt (Tarafás, I., 2002). Selbst schon die Notwendigkeit der Intervention hat die Sterilisierung zur Folge, die letztendlich wieder Gemeinschaftskosten verursachen, der eine nicht zu unterschätzende Höhe erreicht hat. Die Ungarische Nationalbank musste die Wirkung der hinausströmenden Forint-Geldmenge neutralisieren.

Die Wechselkurspolitik, die früher auf dem Prinzip des "Wechselkurs-Ankers" beruhte, wurde 2001 verändert. Die Schwankungsbreiten wurden auf +/-15% erweitert und die Senkung der Inflation wurde zum Hauptziel. Die Veränderung der Wechselkurspolitik um 2001 war begründet und zeitgemäss, auch wenn die Aufwertung infolge der Liberalisierung und Ausweitung der Schwankungsbreite gerade den Export der kleineren ungarischen Unternehmen erschwert hat. Die ausländischen Grossunternehmen, insbesondere die Multinationalen haben die Aufwertung des Forints wegen ihrer bedeutenden Importe relative gut ertragen, selbst wenn sie auch für sie eine gewisse Last bedeutet hat, da was sie an Fährgeld bezahlt haben (Verluste beim Export), holten sie beim Zoll wieder ein (verbilligte Importe). Die Tendenz der Entwicklung der Export- Importpreisverhältnisse hat sich auch in den letzten 10 Jahren nicht verändert, von den Daten in 1-2 Jahren abgesehen. Die ungünstigen Export-Importpreisverhältnisse belasten auch weiterhin die ungarische Zahlungsbilanz. Das bedeutet, dass die makroökonomische Wettbewerbsfähigkeit Ungarns sich trotz der Hoffnungen nicht verbessert. Ungarn ist auch nach dem Systemwechsel ein "Zwangskraftmann", ein "Zwangs-Herkules" geblieben.

Die monetäre Politik Ungarns, die die Senkung der Inflation in den Vordergrund gestellt hat, hat sich leider 2002-2003 nicht erfolgreich erwiesen. Die ausschlaggebenden Ursachen dafür sollen mit hoher Wahrscheinlichkeit die Unkoordiniertheit der ungarischen fiskalen und monetären Politik, der Ausgabenüberhang und dessen inflationäre Wirkung gewesen sein.
Alldas stellt hohe Herausvorderungen für die ungarische Wirtschafts- und Finanzpolitik in der Periode des sich nähernden EU-Beitrittes dar.

(Text closed in 2003)

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2.5. JÓZSEF BOTOS AND KATALIN BOTOS: WHAT CAN BE EXPECTED AFTER JOINING THE EU? (Lisbon targets and Hungary)

In connection with the EU accession, we need to study to what direction the EU itself intends to move. According to the Lisbon targets, the Community aims at becoming a region in the world which will establish a dynamically developing and science-based society with social cohesion and high employment.

Let us see how Hungary approaches these targets.

2.5.1. A small country with many people

Hungary's territory and population comprise 2.6 % of the whole of the EU. Thus, our geographical and demographic conditions are similar to the EU's. (If the territory of the latter were as large as that of Hungary, practically speaking, the size of its population would be the same as that of today's Hungary.)

Area, Population 2001

Country	Area 1000 km^2	Population millions	Area/Population
Hungary	93,00	10,11	10,19
Austria	83,90	8,08	8,96
Belgium	30,50	10,26	31,28
Denmark	13,10	5,33	11,51
Finland	338,10	5,19	1,43
France	551,50	59,19	9,98
Greece	132,00	10,62	7,48
Netherland	40,80	16,04	36,54
Luxemburg	2,60	0,44	15,71
Great Britain	244,10	59,76	22,77
Germany	357,00	82,36	21,45
Italy	301,30	57,95	17,88
Portugal	92,40	10,02	10,66
Spain	506,00	39,93	7,34
Sweden	450,00	8,83	1,82
EU=15	3497,20	378,51	10,07
World	135600,00	6134,01	4,20
Russia	17075,40	144,40	0,79
China	9597,00	1285,00	12,45
India	3287,60	1017,54	28,79
United States	9363,50	284,80	2,83

Source: Monthly Bulletin of Statistics, 2002/6 (ONU, New York)

If a few the EU countries had a territory as large as Hungary's, their population would be twice or three times the size of Hungary's today. To put it differently, countries much smaller than Hungary maintain the same or a larger population with higher living standards. In these countries, the per capita GDP is much greater than that in Hungary. Thus, theoretically, our territory would be able to maintain a much larger population with higher living standards.

Consequently, we are not 'too many'. Even if we cannot be called large regarding our territory and the size of our population, we are not small either. If the question is approached from an economic point of view and the medium state of development of the country is taken into account, the Hungarian market is remarkable: it ranks among the first 30 countries in the world.

GDP / Capita

	2001	**2003**
	euro PPP	
Hungary	11920	14629
Austria	25610	29591
Belgium	24610	28484
Denmark	28020	29905
Finland	23540	27205
France	23320	27866
Netherland	26430	29282
Great Britain	23650	29080
Germany	24170	26396
Italy	23750	26170
Portugal	17110	18321
Spain	19320	23264
Sweden	23400	28163
EU=15	23170	…
Bulgária	7110	7274
Czechia	13970	16124
Poland	9090	11461
Romania	5670	6974
Slovakia	11620	13005
United States	-	37756

Source: EUROSTAT OECD in Figures, 2002
(OECD Paris)

The size of Hungary's market equals those of Ireland, Denmark and Norway. Although Ukraine's territory is six times the area of Hungary and has a population five times the size of Hungary's, its consumer market is smaller than the Hungarian one.

Up till now, our rate of growth has been twice the EU average. Since our state of development - per capita GDP - is half that of the EU average, with this rate of growth, we hardly come close to the average level of development in the EU. We need almost 30 years to catch up with the EU, if the present rates are maintained. However, history has shown that nobody has been able to keep such a high rate of growth over 30 years. (It can be maintained for a shorter period of time but not for long.)

2.5.2. Agriculture - Are we welcome or unwelcome in the EU?

Joining the EU two things come to everybody's mind, namely: intensive foreign attention to Hungarian land and the fact that our farmers will get much less support than those of the existing EU Member States. Are we welcome or unwelcome in the EU? Both may be right.

Agricultured area / 10 millions inhabitants

Country	Agricultural area 1000 hectares		Agricultural area/ area of the country %		Cultivated land/ agricultural area %	
	1999.	2002.	1999.	2002.	1999.	2002.
Hungary	6065	5867	66,5	63,1	81,5	81,8
Austria	4274	4199	40,8	40,5	43,1	43,0
Belgium	1521	1463	45,9	45,9	54,9	55,3
Denmark	5288	4946	61,4	61,9	87,0	85,6
Finland	4544	4276	6,7	6,6	95,5	98,5
France	5068	4946	54,2	54,0	65,3	65,7
Greece	9020	7657	68,4	64,0	42,8	45,5
Netherland	1229	1201	47,4	46,9	48,3	48,8
Irland	11045	11048	62,9	62,7	24,5	25,5
Great Britain	2870	2851	70,9	69,8	34,7	34,2
Germany	2074	2056	47,7	47,5	70,6	70,7
Italy	2805	2690	54,0	51,2	70,2	71,7
Portugal	4142	3966	45,0	45,0	65,3	65,3
Spain	7495	7395	59,3	59,7	61,7	62,0
EU=15	3829	-	44,1	-	60,0	-
World average	8269	-	37,0	-	30,3	-
Russia	15083	14920	12,7	12,7	58,3	57,5
China	4166	4248	55,8	57,7	25,3	27,7
India	1776	1696	55,0	55,1	93,8	93,8
United States	14681	14007	43,4	42,8	42,1	43,2

Source: Calculations of the authors, basen on: FAO data (Roma), Nemzetközi Statisztikai Évkönyv (International Statistical Yearbook), KSH, 2004. Tables: 14.5., 1.3.

Ploughable land in Hungary is 50% larger than the EU average, so we are well supplied with arable soil. This is exploited to a great extent because more than 80% of ploughable land is cultivated, although nowadays large patches of uncultivated land can be seen all over the country...The corresponding figure in the EU is 60%. Taking into account the whole area, it can be said that 50% of Hungary's territory is cultivated, while the corresponding figure in the EU is only 25%. On a greater part of the cultivated land, cereals are grown. The per capita corn production in Hungary is among the top group in the world, approximately, at the US level; 771kg and 825kg, respectively.

Main crops production / capita

(kg)

Country	**Wheat**		**Maize**		**Vegetables**		**Fruits**	
	2001	2003	2001	2003	2001	2003	2001	2003
Hungary	505	288	771	448	182	190	170	132
Austria	187	147	196	180	76	64	132	139
Belgium	153	158	35	-	168	161	69	45
Finland	96	130	-	-	46	-	4	-
France	542	512	278	199	132	145	190	163
Greece	141	148	174	200	396	350	374	374
Germany	277	234	44	41	33	30	53	54
Italy	273	109	14	156	89	264	190	274
Portugal	14	22	80	64	236	214	173	174
Spain	137	154	117	105	301	290	409	418
EU=15	242	-	107	-	141	-	155	-
World average	92	88	98	101	110	134	77	76
Russia	273	235	14	15	89	105	19	25
China	73	66	86	88	223	315	56	55
India	67	61	12	14	60	77	44	43
United States	189	216	825	873	132	126	108	99

Sources: Calculations of the authors basen on International Statistical Yearbook, KSH, 2004, Tables: 14.7., 14.13.; QUARTERLY Bulletin of Statistics 2001/2 (Roma)

This level is approached by none of the EU countries where the highest figure is 35% (278 kg in France) but the EU average is 107kg. In wheat production (505 kg) Hungary ranks first, while the EU average is only half of it (242 kg). In vegetables and fruit production, Hungary exceeds the average but in this field there are countries with better results, mostly in the southern part of the EU.

Meat production and consumption per capita

Country	Production kg/capita		Consumption kg/captia	
	2001.	2003.	1998.	2003.
Hungary	116	115	62	68
Austria	105	105	95	98
Belgium	158	168	98	94
Denmark	388	394	89	114
Finland	64	72	69	69
France	107	109	109	107
Greece	47	44	84	91
Netherland	176	149	85	87
Great Britain	55	55	78	83
Germany	79	80	93	88
Italy	72	74	88	90
Portugal	74	69	94	103
Spain	126	133	123	130
EU=15	95		93,7	
World	39	40	39	40
Russia	31	34	48	47
China	51	54	19	24
India	5	6	3	5
United States	133	132	88	88

Sources: Calculations of the authors basen on International Statistical Yearbook, KSH, 2004, Tables: 14.21., 14.28., 3.10.; FAO data

As far as meat production is concerned, Hungary's output exceeds consumption to a greater extent than that in the large the EU countries (only Denmark and the Netherlands exceed the Hungarian surplus in this field.) Data indicate that the EU has always considered agriculture a strategic branch and sought to guarantee self-sufficiency in agricultural produce - at least, at the Community level - and it is a considerable exporter of farm produce. But it can be seen that Hungary's export-orientation is more intensive than that of the EU. For us it is vital since the agriculture and food industry is the sector which shows a significant foreign exchange surplus in exports. It is true that the share of Hungarian agriculture in exports was only 7.5% in 2001 (a decade before it had been 20%), while manufacturing exports made up 60%. These two branches are responsible for surpluses but agriculture has the lion's share in them. While manufacturing exports result only in a 1% export surplus (210 m euro), the agrarian sector produces a nearly 60% surplus out of its exports (1.5 billion euro), and the imports of the agriculture and food industry make up only 43%. (By the way, this proportion might be smaller if the large food sales networks did not prefer the products of their the EU parent countries...)

External trade by main commodity groups

Main commodity groups	Imports				Exports				Balance			
	2001		2003		2001		2003		2001		2003	
	Billion HUF	%	Billion HUF	%	Billion HUF	%	Billion HUF	%	Billion HUF	%	Billion HUF	%
Food, beverages, tobacco	281,4	2,9	327,1	3,1	656,2	7,5	630,3	6,5	+374,8	+133,2	+303,2	+82,7
Crude materials	195,1	2,0	211,3	2,0	173,7	2,0	188,8	2,1	-21,4	-10,9	-12,5	-5,9
Fuels electric energy	792,2	8,2	825,0	7,7	169,4	1,9	157,1	1,6	-622,8	-78,6	-667,9	-80,1
Manufactured goods	3413,7	35,3	3811,1	35,8	2712,8	31,0	2762,0	28,6	-700,9	-20,5	-1049,1	-27,5
Machinery and transport equipment	4982,6	51,6	5520,9	51,8	5036,0	57,6	5895,5	61,1	+53,4	+1,1	+374,6	+6,8
Total	9665,1	100,0	10695,4	100,0	8748,2	100,0	8643,7	100,0	-916,9	-9,5	-1051,7	-9,5

Source: Statistical Yearbook of foreign trade, Table: 1.3.

We must draw the following conclusion: if the agrarian sector is important for the EU, it is all the more so for us. Consequently, Hungarian economic policy should handle this question in compliance with the aforesaid. This is not the voice of the farmers' lobby but it is of vital importance for the Hungarian economy.

2.5.3. Let us see how we stand with science-based society

Kuno Klebelsberg, the one-time prominent Minister of Culture in Hungary, said in Parliament: I request a great support for national defence... His reply to the question as to what a Minister of Culture had to do with national defence was that without a dramatic increase in the cultural and knowledge level, national defence would become hopeless...
The situation is the same today as well! Let us see where this strategic branch stands, compared to the EU. How much do we spend on elementary (i.e. basic), secondary and higher education? How much is spent on research? Are there enough human resources at our disposal?

Full expenditures / studendts of Σ years of education in PPP (in euro)

	1998	2001	1998	2001	1998	2001	1998	2001
Hungary	16224	20736	8560	10532	25361	35610	50153	66878
Austria	48520	52568	32652	34248	56395	56370	137567	
Denmark	53704	60576	28800	32492	47810	71400	130314	
France	30016	38216	26420	32428	36130	44185	92566	
Netherland	30360	38886	21216	25612	53785	64870	105361	
Great Britain	26632	35320	20920	23732	48495	53705	96047	
Germany	28248	33896	24836	26480	47405	52520	100489	
Italy	45224	54264	25832	33032	31475	69672	102531	
Portugal	24968	33448	18544	23904	25000	25995	68512	
Japan	26136	33344	17096	21768	25190	37275	68422	
United States	40600	46168	23560	26136	49355	55820	113515	
	48344	60480	31056	35116	99010	111170	178410	
Average EU expenditures / Hungarian expenditures	~2x		~3x		~1,6x		~2x	
Primary:	8 years	Secondary:	4 years		Tertiary education:	5 years		

Source: Authors' calculations based on: International Statistical Yearbook, KSH, 2004. Table 8.1., and OECD in Figures, 2002 (OECD, Paris)

It should be noted that, concerning the GDP ratio spent on the aforesaid, we are where the EU stands. Is it enough? And what do the average data cover?

If we calculate with purchasing power parities, which are more suitable for such comparisons than those made at official exchange rates, it can be claimed that expenditure per student in Hungary is at half the EU average. Obviously, with this proportion we cannot increase our competitiveness either inside or outside the EU. It is informative to analyse the breakdown of figures as well. In primary education, EU expenditure is nearly twice and in secondary education it is approximately three times that of Hungarian expenditure. In higher education the EU spends 60% more than Hungary does. Let us see the most important item of expenditure, i.e. that of teachers/professors.

Number of teachers per 10 millions inhabitants

(thousands)

Country	Primary school 1999	Primary school 2001	Secondary school 1999	Secondary school 2001	Tertiary education 1999	Tertiary education 2001
Hungary	47	46	100	92	21	24
Austria	36	36	91	91	32	33
Denmark	74	74	88	81		
Finland	44	48	79	74	31	33
France	35	34	83	85	20	21
Netherland	78	81	58			27
Great Britain	41	43	78	79	15	15
Germany	28	29	67	71	34	34
Italy	42	46	70	77	12	14
Spain	43	44	69	100	27	33
Sweden	69	76	69	78	32	38
Swiss	56	54	72	65	37	
Japan	29	29	50	49	37	38
United States	58	56	54	52	36	38
Average of 13 countries	49	50	71	68	29	30

Source: Authors calculations based on: OECD Education Database (OECD, Paris) and International Statistical Yearbook, KSH, 2004

In primary education, we have the same number of teachers as the EU; in the secondary education of the EU countries, the number of students is 25% fewer than in Hungary. But this also means that the salaries of Hungarian teachers are much lower than the EU level. In EU higher education, the number of professors is 15-20 higher than in Hungary. Perhaps here 'tutoring' is the most important thing since elite education may not be guaranteed by 'mass production'. (On making comparisons, data of all countries were calculated per 10m persons.) It should be noted that - taking into account the reduction in the number of children - per capita financing of education will be concomitant with the decline of the level of higher educational institutions and the reduction in the number of professors, which will be unfavourable from the aspect of competitiveness.

But let us study what degrees/diplomas are awarded. According to OECD data, in Hungary the number of teaching diplomas are the highest. Teachers are employed, primarily, in secondary schools and, as has been pointed out, their number is higher than that in the EU. But if nowadays the number of teachers is already too high in Hungary - and since teaching may also be a life-long career -, where will the great number of degree-holders who better meet the requirements of modern times, probably, due to their age, find a job? What can be expected? Obviously, there will be a tension between generations and unemployment (changing career, further training, seeking to acquire new qualifications and further degrees) may be expected as well.

Ratio of certificats

Country	Technical 1999	Technical 2002	Liberal arts, teachers 1999	Liberal arts, teachers 2002	Medical 1999	Medical 2002	Total (%)
Hungary	14	9	25	22	7	9	100
Austria	17	18	12	12	9	8	100
Denmark	10	7	1	17	5	40	100
Finland	24	22	10	7	17	21	100
France	13		8		2		
Netherland	11	11	16	15	20	20	100
Great Britain	12	11	12	5	12	14	100
Germany	20	19	8	9	15	13	100
Norway	8	9	19	23	27	31	100
Italy	16	18	5	4	16	12	100
Spain	12	15	13	15	11	12	100
Swiss	16		9		13		
Sweden	19	22	21	18	24	22	100
Japan	21	19	7	6	5	5	100
United States	7	6	13	8	10	7	100

Source: Authors' calculation, based on: International Statistical Yearbook, KSH, 2004. Table: 8.5. and OECD Éducation Database (OECD, Paris) 2001.

In several EU countries (Germany, Sweden, Finland) there are more degrees awarded in technology than in Hungary and, in most of the EU Member States, the number of degree-holders in health care is above that of Hungary's. (In Germany, Italy and Great Britain the relevant figures are twice as much or higher.) The proportion of arts degree-holders in Hungary is low - perceptibly, we cannot afford the luxury of beauty... In social sciences we are roughly at the same level, probably, somewhat below the average.

As far as research is concerned, it is known that the proportion of research expenditure to GDP (2000) is well below 1% (at 0,8%).

The EU average in this field is twice the figure. In the EU countries approximately the same amount is spent on defence and research while in Hungary the amount spent on national defence is twice the sum spent on research. (The Hungarian figures refer to 2000; the research data of the EU countries are from 1993. Source: *International Statistical Yearbook 2001*, Central Statistical Office. The defence data are from 1999.)

In Hungary, every 360th person is in an R & D job; every 210th person is employed in defence, so in Hungary there are two soldiers for every researcher.

In the EU, disregarding the southern countries where there are even fewer people employed in research than in Hungary, the average figure is around 200. In Scandinavia every 130th and in Germany every 180th works in research. As far as defence is concerned, the EU average is close to the Hungarian figure but some data should be highlighted: in Germany every 248th, in Great Britain every 269th and in the Netherlands every 293rd is employed in defence. Typically, more soldiers per capita are employed in small countries - in the highly advanced North and the less developed South. However, in the small, advanced countries in the North there are proportionately more people in research,. Thus, the EU gives equal preference to both fields in employment policy, not to mention the fact that a high technological level is an essential element of modern warfare. Perhaps, it is vain to draw conclusions but if the above-mentioned figures do not change, we can hardly catch up with the science-based the EU economy. Obviously, the relationship with the per capita GDP ratio is not one-sided. By all means, the state of development is the highest where most people are concerned with research...

2.5.4. Social cohesion and competitiveness

Solidarity is the token of social peace, not only between the poor of the same level (this is an ancient form of solidarity) but between the poor and the rich in modern society through the realization of a compulsory system of redistribution (taxes, social security etc.) Even under full employment, the question of the just distribution of incomes is raised. It is all the more so when there is a high unemployment. It is not surprising that in the EU, that, up till now, has proclaimed itself the champion of social market economy based on solidarity, the high rate of unemployment is Problem No 1.

The other one is lack of competitiveness in the world market and the recession concomitant with it. How will the Lisbon target be met?

Recently, parallel to comparatively low unemployment, Hungary's growth rates have been relatively high. (The respective figures for the EU: 7.6, and for Hungary: 5.7, in 2001.) But it should be added that the Hungarian activity rate is significantly lower than that in the EU. Disregarding Greek and Italian data, the proportion of the active Hungarian population is the smallest among the EU countries. This fact lays heavier burdens of solidarity on the Hungarian economy.

It is a question whether the relatively low unemployment rate will persist in the Hungarian economy after joining the EU. Now let us turn to compare the data on corporate structures in Hungary and the EU!

Source: EUROSTAT (Luxemburg, 2001)

Active enterprises per 10 million inhabitants (in thousends)

Country	Manufacturing	Construction	Trade, hotels, restaurants	Real estate, renting and business activities
Hungary	82	79	240	246
Austria	31	22	123	49
Belgium	37	53	185	80
Denmark	41	53	127	123
Finland	52	57	121	81
France	42	51	138	82
Netherland	29	39	128	
Great Britain	30	35	87	83
Germany	30	34	82	92
Italy	93	62	196	94
Portugal	78	73	286	51
Spain	56		258	102
Average of 11 countries	47	48	157	84
Average of 11 countries/Hungarian data	~1/2	~2/3	~2/3	~1/3

In Hungary the proportion of small businesses is relatively high. In 2001 out of 372,000 operating businesses, 342,000 were micro ones, i.e. almost 92% of all undertakings belonged to this category. To this are added the so-called 'individual entrepreneurs' who make out bills, although they are not legal entities. In total, 800,000 small entrepreneurs employ themselves, pay little into the common 'purse', the Budget, - but, at least, they do not require a share of it. They do not queue for unemployment benefits but try somehow to earn their living. 'The individual entrepreneur' is not an accepted category in the EU. Here the level of minimum capital requirement of businesses is higher than that of the majority of existing small businesses in Hungary, therefore the vitality of this category after joining the EU is highly dubious. Data may be analysed from another aspect as well. The number of operating businesses are grouped by sector in statistics. In order to compare data, we have given the number of the EU businesses projected to 10m persons.

In the EU countries, too, trade and tourism are leading ones among businesses. But in Hungary in this field the number of undertakings is twice the average. Only Spanish and Portuguese figures are of a similar magnitude owing to the great number of tourist establishments in these countries. (Hungarian data: 240,000; Italy: 196,000; Portugal: 285,000; Spain: 258,000. It is interesting that in Austria the relevant figure is only 123,000; the role of tourism is of great importance there though.)

Tourism in GDP (%)

	1999	2001
Hungary	7,1	8
Austria	6	5,2
Finnország	1,2	1,2
France	2,2	2,2
Greece	7	7,3
Netherland	1,8	1,7
Germany	0,8	0,9
Italy	2,4	2,3
Portugal	4,5	5
Spain	5,4	4,7

Forrás: Compedium of Tourisme Statistics 2001., 2003 (WTO, Madrid)

But in the field of real estate business (!) and other economic services, we are at the top of the list. Compared to our 246,000 businesses, the other countries are lagging far behind (Austria 49,000; Germany 82,000; France 89,000). Although in the processing and construction industries there are far fewer businesses (82,000 or 73,000, respectively), they are twice/three times the number in the comparable data of most the EU countries. From this we can draw nothing but the conclusion that a significant part of our businesses will fail to operate after joining. Consequently, the unemployment rate is likely to increase. This may be averted only if the dynamic growth of the economy is able to absorb the legions of those who lose their jobs. There might not be a great chance for this since the motors of economic growth are the multinationals whose share in the employment of people is small. Eighty per cent of the employed work is in Hungarian-owned businesses although more than half of the companies are foreign owned. This also demonstrates how important the role of domestic-owned (self-) employment plays in keeping a low level of unemployment. To put it differently, the inflow of foreign capital only marginally helped employment. Naturally, this statement may be formulated positively, too, i.e. productivity is high in foreign-owned companies. Consequently, per capita costs are lower, therefore the international productivity of these businesses is ensured. However, as has been mentioned, the main sector of exports has played a relatively small part in Hungary's foreign exchange surplus. Analyses have also revealed that the per capita capital in the globalized multinationals in Hungary is not too high either, i.e. the inflow of FDI, the foreign venture capital, has not resulted either in the emergence of large companies with a considerable capital strength but in the appearance of rather unstable businesses with remarkable amount of foreign sources. This fact may be explained by several causes. What is the use of the establishment of these enterprises if the expenses of their operation are increased by the costs of credit, i.e. their profits are relatively low?

The reply is simple: the assessable income is also small. And nowadays, in a globalized world, external financing may be assured by a financial affiliate, too, which belongs to a holding company registered in a tax haven. Eventually, the owners of the global holding are able to benefit from the aforesaid undertaking. If the logical reasoning of ours is right, it will be evident that the analysis of macroeconomic data is not enough to assess whether economic policy proceeds in a good direction, and it is not enough to forecast what Hungarian society and the competitiveness of its economy will be like after joining the EU.

3. MORAL, PSYCHOLOGY, AND ECONOMICS

3.1. KATALIN BOTOS: ECONOMIC ETHICS OF CATHOLIC SOCIAL MESSAGE IN HISTORIC PERSPECTIVES

3.1.1. Introduction

In the early development of the modern economy, the Catholic Church was shocked to experience its consequences: proletarianization, social tensions, the disintegration of traditional social structures, first and foremost, that of the family, the corruption of morals and the spread of materialistic thinking. It considered the currents of thoughts which caused the given situation utterly wrong; at the same time, it deemed the trends of ideas for the cure of the former rather harmful. Primarily, it rejected socialism which wanted to turn the social order upside down, but it was against anticlerical and liberal ideas, too.

It took a long time to reveal that, eventually, liberalism fighting for modern human rights - when it was stripped off its anticlericalism - would find its theoretical basis in the essence of the Christian message, i.e. in the dignity and freedom of the individual. At the beginnings, Rev. Félicité Lamennais, the representative of the liberal trend of French Catholicism, whose slogan was 'God and liberty' and whose ideas were also close to those of the socialists, was rejected by the Church.

However, two things became obvious even for Catholic philosophers: on the one hand, if the emerging social tensions were not be treated on the basis of ideological commitments but efficiently, the Church would completely lose its influence over the masses who were falling under the influence of the ideas which proclaimed new and earthly redemption and paradise; on the other hand, it had to be realized that, parallel to the problems, the unfolding capitalist economic order resulted in irreversible progress, too. The unquestionable impacts of development reflected in the increase of average consumption, the lengthening of the span of life and the growth of population indicated the fact that the new bourgeois system entailed not only difficulties but it might be able to cure the latter with the elaboration of a proper system of distribution due to the growth of productivity. The developments that ensued changed the legal and economic circumstances to the extent that the restoration of traditional forms became totally anachronistic.

The Catholic social message had to open two frontlines: it had to reject the communist ideas which were hostile to private property but, at the same time, it later had to disapprove of 'wild capitalism' as well, which was denoted as 'bare capitalism', 'unsociable capitalism' and 'pure economism'.

Beside anti-modernism, new scholastic and socio-romantic notions appeared, which tried to heal social troubles not against the ensuing processes but through their correction. Although the new scholasticism critically approached the progressive achievements of modernity, human rights as well as the phenomena of democracy and market economy, it is very important to note that it returned to the concept of the human being as an individual. It stresses that an individual as a physical, spiritual and intellectual unity has dignity and an inalienable and inborn right to possess private property.

However, based on the argumentations of St. Thomas Aquinas new scholasticism obliges people to use property, taking into account the benefit of the community, too. The promotion of common good - *bonum communae* - is the owner's responsibility and the basic task of politics. The socio-romantic trends are open to other directions: they became the forerunners of the ideas which urged social reforms going beyond capitalism and a corporative social system.

The socio-realistic trends which sought not to surpass capitalism but to reform and regulate it, seemed to be the most viable ones. It can be stated that the emergence of the European market economies later relied on these principles.

The Catholic Society of Social and Economic Studies made up of the thinkers around G. Mermillod, Bishop of Fribourg, was the most influential intellectual circle. It laid down the foundations of the Encyclical entitled *Rerum Novarum* (*RN*) issued by Pope Leo XIII (1891) and called the *Magna Carta* of the social message of the Church by Pope John XXIII. [1]

3.1.2. The first forty years

Indeed, the change was of great significance. The Encyclical uses a system of new scholastic argumentations: it attributes '*private property'* to the nature of human existence. What has not been focused on up till now is perhaps the fact that Pope Leo XIII emphasized private property as the basis of the subsistence of the *family.* He considered the work of a labourer as *a sole (!) source of state economy* and he claimed that a wage should be considered worthy only if it were high enough for the subsistence of a family since in his opinion - not without any basis - the most destructive phenomenon of the changes was the disintegration of the natural basic unit of society, i.e. the family. In the field of the state's role-taking, he thought that laws on *workers' protection* (e.g. the restriction of female and child labour, measures of health and safety at work) should be framed.

The acquisition of properties by workers was to be assisted and it was just and proper for the workers to combine to safeguard their interests.

As far as the realization of the principles in practice was concerned, at the beginning, the Church urged the establishment of entirely Catholic organizations and this approach only later became ecumenical. The overall support of secular organizations for the safeguarding of workers' interests only appeared under the influence of Pope John XXIII. For example in Germany after the repeal of the so-called 'Socialist Act' the number of workers' mutual funds and associations increased and one-third of Catholic workers gathered in them. The development of welfare legislation was demonstrated by the introduction of the compulsory social security system first in Germany, then in Austria and Hungary. (By the way, in Hungary the Act on Social Security was passed in the year of the issue of the Encyclical, i.e. in 1891.) In Germany, Christian trade unions, too, began to emerge and even if they were not so numerous as the socialist organizations, their proportion was considerable.

The author of one of the most comprehensive Catholic and Christian economics book was Heinrich Petsch, a Jesuit who characterized the message of the Church as *a system of solidarity* in his five-volume work. Regrettably, this interesting phrase has not become deeply rooted either in public knowledge or the terminology of the Church in spite of the fact that it indeed properly expresses the essence of the Catholic/Christian economic ethics.

The principle of solidarity is summarized by the author as follows: 'In general, solidarity is a social system which represents/enforces both interpersonal solidarity relations and those between the members of the natural communities of the family and the state in a proper way, i.e. according to the essence of the community of the age... The system of solidarity can be called a community principle which is free of exaggerations; respects the rights of the individual and those of the society as a whole as well as freedom and social responsibility, too. [2] It should also be noted that, at the same time, Pesch incorporated the ideas of the organization by vocation represented by the socio-romantic predecessors into his system of notions, too. This is why the otherwise thorough work was later pushed into the background. Although he was for the reformation of capitalism through regulation and not for its rejection, the Great Depression hardly favoured his ideas. In Europe the distressing failure of capitalism led to more radical experimentations as a reaction to the practical challenges of Soviet reality.

The Encyclical *Quadragesimo Anno* (*QA*) issued by Pope Pius XI for the 40th anniversary of *RN* tried to reconcile the radical notions with those of the reformers with little success. A part of the Christian sociologists and economists considered it was much and the other part of them thought it was little included in *QA*. The so-called 'Vienna School,' whose mentality was close to that of the socialists, rejected it as a capitalist Encyclical while, for others, the recognition of the righteousness of a properly conceived class struggle was too socialistic. In addition, after national socialism came to power - despite the Pope's rejection of Mussolini's corporative state - the approach to *QA* became unfavourable: some said it was pro-fascist.

Although *QA* strengthened the right to private property, it expressed down that out of the common good the state was allowed to regulate its use. It expounded the idea that capital grabbed too large a share out of the total output of production despite the fact that labour and capital were *interdependent*. It pointed out that labour was *a primary force of property generation*, so acquisition of property had to be made possible for workers, including *co-ownership* in the factory where they worked. Worthy payment which had already been mentioned in *RN*, too, had to enforce three aspects: the subsistence of the worker and his family, the vitality of the factory, and the requirements of common good. It should be pointed out that the factors of a necessary compromise determined by these principles are still valid. *QA* emphasized that the workers' right to combination and co-operation was unquestionable. In connection with the state's role-taking it points out that *subsidiarity* is the principle which is considered even nowadays one of the most characteristic features of the Catholic social message.

The essence of this is that the problems raised should be solved at all levels and only the ones which cannot be settled at a lower level or by individuals should be passed on to higher authorities. *QA* actually calls the tendency a sin when problems solvable through individual actions are pushed to the provident state. It is also unable to get rid of the notion of the corporate integrations attached to trades, and the idea of the co-operation based on vocations that will later prove to be unrealisable.

However, it is a very important statement that *the market cannot be a sufficient controller of the economy* because, due to its automatic operation, it comes into a 'power-like state'. By the time of the publication of the Encyclical, it could be seen that the market economy spontaneously established monopolies and oligopolistic markets which, in the absence of

regulation, realized profits not through meeting the needs of consumers to the greatest extent and this problem could only be solved by the community's regulation.
The murder of Chancellor Dollfuss in 1934 discouraged politicians from making social experiments with the establishment of a form of government based on the order of vocation; at the same time, there were many progressive events in the world economy.
As a consequence of the Great Depression, state interference and income redistribution increased significantly in all developed countries. The scope of social security widened and provision for pensions, too, appeared beside health insurance and the organized access to social allowances/benefits. Capital markets and banking supervisory bodies were reorganized; bank control was strengthened since the operation of the banking sector was considered to be responsible for the crisis and in the Crash many people lost their savings. All over Central Europe a wide network of savings co-operatives of the Raiffeisen type was established and provided financial and sales services; and a remarkable network of savings and loan associations were organized in the USA as well. In the framework of New Deal, new state companies were set up in the home of free enterprise. Crédit Agricole established a broad network of co-operatives for financing the French agriculture and the mutual pension and health care funds ('mutuelles') still exist in France. Laws which regulated competition and labour legislation were enacted. One of the most urgent and insoluble institutional problems was the disintegration of the international monetary system. [3][4]

International trade, too, declined because of the Great Depression but it was also unable to develop because, due to the competition in devaluation and the absence of the gold standard, entrepreneurs of various countries were not able to calculate in the long term and settle their business in international relations. World War II brought change in the stagnation of economies with a war boom and the acceptance of the Bretton Woods system was a significant progress in 1944. Then international settlements became smoother and external trade grew dynamically.

3.1.3. The age of social market economy

After the collapse of the Third Reich, there was also a revival of Catholic public life in Germany and Austria. Concerning national frameworks, 'the German model', the social market economy emerged as a result of the co-operation between Ludwig Erhard and Konrad

Adenauer. Consequently, the Catholic social message seemed to draw closer to its implementation.

In this the fact that during the former regime the Catholic Church was the least compromised institution since it had been also persecuted, played a role. [5] The role of the Church in education and its impact on social policy were great. In addition, at the international level an exceptional situation came about in Europe: in three countries (Federal Republic of Germany, France and Italy) committed politicians (the trinity of Europe's Catholic founding fathers: Adenauer, Schuman, de Gasperi) who were able and willing to arrive at a compromise of historic importance came to power. [6] H. Young [7] describes Schuman as living ‘in a monastic chastity, a bachelor and a scholar, expert in philosophy and theology and he adds that the three men [Adenauer, Schuman, de Gasperi] ‘were more than routine Catholics. Church was important to their project’. Indeed, they all attended Mass together and spoke to each other in German! The reconciliation between the Germans and the French, and the establishment of European Economic Community was the result of this exceptional co-operation.

Life seemed to legitimize the theoretical concept of the social market economy which had proper answers to the questions of all the fields in practice. The evolved system adequately embraced the requirements of economic and social subsystems. The liberal market economy was functioning but the socially sensitive state took care of the welfare of its citizens... The so-called Golden Fifties and Silver Sixties generated an extraordinarily swift development all over the world, at the same time, the collapse of colonial empires rearranged the world map: Asia, particularly the Far East turned out to be a new centre. (Japan's share in external trade had grown from 0% to 7% over a few decades) but from other aspects, too, the division of the positions of the great powers in the world in fact strengthened, along the lines of radically different ideologies. The emerging COMECON (CMEA) dominated over one sixth of the world. In the countries of 'existing' socialism, the anticlerical and atheistic state introduced planned economy and 'showed' what economic achievements would come about if the incentive and allocating role of the market were discarded. The role of money became rudimentary and, at the international level, trade by barter appeared. [8]

From time to time, social tensions came to the surface owing to political and economic causes. The most important one of these was the outbreak of the Hungarian Revolution in 1956. Later, too, greater or smaller crises evolved in Central and East European countries.

However, for an outsider, the forcible (i.e. drastic) social transformation brought forth spectacular achievements and important results from military aspects. In the field of nuclear and space research, the Soviet Union cornered its one-time ally and actual adversary or, rather, its enemy, since propaganda permanently proclaimed the threat of the Cold War. The competition for colonies on the part of the countries striving for world power recruited many supporters to the socialist-planned economy in the newly-liberated colonies and, over relatively peaceful years, the two world systems 'contended with each other' there. Soviet and American 'experts' replaced each other in Egypt; Soviet and American armaments competed in the Arab/Israeli war. Some countries of Central and South America turned out to be the market for US capital exports. On both continents the activities of the Catholic Church increased and the ideological and real conflicts made fairly numerous martyrs. In the socialist 'camp', too, there were great tensions between the big communist countries of Asia and the Soviet Union. At the same time, in individual economies social mobility grew; there was a forced industrialization and the share of agriculture increased as compared to its pre-war one. Towns sprang up; health care improved and education became widespread. It is quite another question *what* was taught. Again, it is quite another question *what social destruction* was caused by rapid urbanization. It is difficult to assess *the scale of waste* in investments at the social level. Also, it is difficult to assess how high unemployment was and *what harmful environmental effects* had appeared due to so-called development. Just one of the Hungarian examples was that drinking water was available in all settlements but in half of them there was no drainage. The price of apparent achievement is environmental pollution. Actually, all this could not be seen from the outside and the existing socialism seemed to be much 'rosier' than it was. Although the world was aware of the persecution of the Church, the militant atheism, the existence of nuclear armaments and the socialist colonialization, peace was given priority. Another world war had to be averted at any means! All the more so because new problems also emerged within the capitalist world system. The expansion of the multinationals began and in the redistribution of the world market, Western players, too, ruthlessly competed with each other.

All the aforesaid phenomena meant a new challenge for the social message of the Catholic Church.

3.1.4. Mater et magistra

The Church searched for answers by the convocations of the Second Vatican Council. The most concise summary of the social message is contained by the Encyclical entitled *Mater et Magistra* (*MM*) issued in 1961.

In this, the Pope discusses the lasting statements of *RN* and *QA* and supplements them in the spirit of the age. Practicality is one of the most important characteristics of the message. This approach is supported by a passage of the Gospel. It cites the words of Jesus addressed to his Father: 'I do not ask you to take them out of the world but to save them from the Evil.'

The common message of the previous two important Encyclical letters was that *the norms of economic life should be based on ethical foundations.* But the 19th century capitalism of free competition, which relied on profit-motivation itself in a highly arguable way, was replaced by ever more aggressive forms. As it is claimed in *QA*: 'Chase after profits was replaced by unrestrained rivalry for economic power.' (109) *The world of economy became awfully barbarous.*

Undoubtedly - at least, in Western Europe - this was changed by the implementation of the social market economy but in the international arena, cut-throat competition started and in international relations, too, several open questions cropped up. With appalling far-sightedness, the Pope pointed out that stronger state interference carries newer dangers. Modern man deprived of his autonomy increasingly becomes used to the fact that every important question is decided by other people, which amounts to the hotbed of *manipulation.* The Pope poses the question *whether in the network of the increasingly complicated system of social relations people grow more and more stupid and their inner independence ceases. This is something to be refused.* (*MM* 62)

The structure of human coexistence is very important. The Encyclical reaffirms the idea of subsidiarity and the importance of the fact that people should actively participate in the settlement of their own affairs.

What is surprisingly new in the formulation of this Encyclical is that it contains very concrete guidelines for economic policy. *MM* is not content with the statement of general principles either according to which workers are worthy of a worthy wage but it expounds that it is expedient for them to set up organizations which safeguard their interests as well as the fact that they are entitled to have a share in ownership. Small and medium-sized businesses must be protected and supported; vital co-operations had to be established. These organizations had to be assisted by the state in the fields of education, taxation, credit conditions, security system and social policy. Attention was to be directed to the separation of the manager and the owner, and to the fact that the interests of large companies might clash with the public weal. (This practicality would be characteristic of the Encyclical '*Pacem in Terris*' issued by Pope John XXIII in 1963. Here, he expounds that measures for the provision of roads, drinking water and health care should be framed by the state. If we have it in mind that Galbraith's book on a new industrial state was published in 1961, it must be stated that the Church was able to take into consideration the requirements of modern times. While confirming the right to private property as this is the guarantee to human rights, the Pope perceives the characteristics of the age, i.e. the growth of state ownership. (This is all the more so in the East!) He directs attention to the fact how important is the personal quality of the management of these bodies. With considerable idealism Keynes assumes that on part of the interfering state there are absolutely fair people who just represent public weal. The worry expressed by the Church is remarkable, namely, economic power within the state administration should not be grabbed by a narrow social stratum because it is utterly against the basic interests of the people. (*MM* 118). Again, it should be pointed out that this was unambiguously the case on the one sixth of the world and the impacts have not yet disappeared at all.

With the establishment of the industrial society the global phenomenon of urbanization raises several problems as well. The deterioration of the means of earning a livelihood in the country caused the Pope to take a definite stand in holding *the peasants' work* on high esteem. He formulated the expectations from the society as follows: the state should guarantee the same level of public services, a special agrarian economic policy - regulation of the market, capital allocation, necessity to develop an insurance system - the elaboration of fair conditions of taxation and the improvement of vocational education. The position taken up covered special questions like the gap between prices of agricultural produce and those of industrial products, the need for compensation for losses and the interrelationship between agricultural price incomes. There are excellent socio-economic observations in the Encyclical since it aims to reduce migration, to create worthy living and working conditions for this important social stratum which preserves traditions and values. It is thought provoking that the text of the Encyclical arrives at the far-fetched conclusion that *agricultural work is of the highest order because it is done in nature.* (*MM* 144). Agricultural work is also a model for others to reach the level of true humanity (*MM* 149). It also warns us how important co-operation and setting up proper organizations are since interests may be enforced only in this way because 'one voice is lost in the roaring of the wind as wise man says!' (*MM* 146) With the knowledge of

W. Röpke's work who is considered as the propagator of the third way in the history of economic policy, it can be seen that these thoughts reflect in many of his statements. (It was also noted by Röpke that after one of his lectures he was asked if he was a Catholic. The Protestant author replied that one did not need to be a Catholic to agree with the essence of the message of the Pope. [9]

The other far-reaching statement of *MM* is that *basic problems became global.* Amongst them the demographic question, neo-colonialism and military confrontation provoked fear. Although the approach of the Encyclical to the progress of science is positive, - it assumes that science will make possible a life worthy of man in spite of the growth of population - but, referring to Pope Pius XII, it advises us not to turn to be *a giant* in science while we remain *a dwarf* in spiritual and moral questions. (*MM* 242)

According to the Encyclical the humanization of the formidably barbaric world is the most important social objective and the element of economic ethics included in this process is of special importance.

3.1.5. After Vatican II

Out of the documents of the Council, the constitution *Gaudium et Spes* may be regarded as the summary of the Catholic social message which expounds the socio-ethical questions from the overall definition of the human mind. [10] The passage at 63-72 contains the summary of the statements of the ethics of economy. The documents of the Council terminate the former anti-modernist approach and urges a dialogue with the world.

By the late sixties, the abovementioned achievements of the economic miracle and the socialist practice resulted in a *transitory strengthening* of ideology of both dialogue-partners. The modernization impetus concomitant with the 1968 movements pushed a considerable part of the intelligentsia to the left. And the representatives of liberal economic policy realized that, probably, market economy fares better without state interference. Stagflation, that meant the failure of Keynesianism, came about. It could not be claimed anymore that employment might be assured at the price of a little budgetary deficit and inflation because both inflation and unemployment lingered on. Still, in 1971 President Nixon said that they all were Keynesians, but it was that year when the dollar was devaluated against gold. Convertibility of dollar to gold was suspended and the first devaluation was soon followed by a second one in 1973. The Bretton Woods monetary system collapsed and the economic struggle between the system of currencies detached from gold once and for all and that of the floating ones began. The leading politicians of the world - Reagan and Thatcher - became Friedmanist... The ideas of monetarism which preferred global free competition took over the leading role. Economic life followed these ideas and soon a price and interest explosion swept over the world. The indebted developing countries - but also the Hungarian economy - were stuck in the debt trap and, fighting against economic restrictions they regrouped an increasingly greater part of their incomes to the developed countries, well provided with capital. A renowned economist Robert Triffin, who had already pointed out the absurdities of the international monetary system based on US-dollar dominance, characterized the situation like this: the seriously incapacitated transfuse blood to those with exuberant health. He called this situation a scandal and urged the reform of the international monetary system.

There were high-level and intensive debates over economy and society, raising *economic questions.* Latin American poverty and inhumanity evoked the ideological current turning into one of the most significant movements within the Church, i.e. the liberation theology concluding that definite actions to change society were wanted. The proximity of the notions of this theology to Marxism gave rise to critical remarks but the rightfulness of the problems was recognized by the Church (*Libertatis conscientia*, 1986). At that time, the leftist academic intellectuals in the Western world raised the question whether socialist ideas proved to be wrong only in practice or their theoretical bases also had to be thrown away. [11] What is better: a transitory deficit or a prolonged inflation? It should be pointed out that posing a question like that was wrong. Deficit became almost a permanent phenomenon in socialism (where this was not reflected in the shortage of goods, soon high indebtedness appeared.) And inflation was kept well in hand by several developed countries.

By all means, life overstepped philosophy because it proved clearly, still in the year of the publication of the book cited, that *the system of socialism, which proclaimed egalitarianism but, in practice, deviated from this notion, was the loser in the competition with capitalism,* not only in relative but absolute terms as well. *It failed because it was unable to feed people.* This system was not realistic; it did not comprehend, or only just latterly and sporadically, that human fallibility necessitated material stimulation, including the possibility of the acquisition of property. *Little* cannot be distributed well if there is a real alternative of *more*.

The Catholic social message had not drawn a markedly new image over these years; the conception of labour, the rejection of unemployment as well as the appreciation and protection of natural resources, and the emphasis laid on the double nature of property enriched and deepened though. (*Laborem excersens*, 1981, *Sollicitudo Rei Socialis* (*SRS*), 1987). However, what could be seen as seeds even in the 1960s germinated into harsh reality today, i.e. *the world became globalized.* The international trade and monetary system had to be revised because its functioning was widening the gap between the developed world and the countries in the debt trap. But how can it be done? Regrettably, there are no detailed replies to this in the Encyclicals, only it is uttered as a 'bitter truth' that the organizations set up for the international promotion of the common good have been monopolized by political forces to their own benefit. In order to overcome this situation, the organization of international life at a higher level would be needed. (*SRS* 43)

But what does it mean? Who should organize this multi-facet world?
By the centenary of the publication of *RN* this question seemed to be solved. At the birth of *Centesimus Annus* (1991) the socialist/communist system had practically already collapsed. With renewed efforts, on reasonable grounds, the Encyclical directed attention to the other notion, i.e. to the criticism of global liberalism, because for the transition countries the rejection of the former regime was typical. However, socialism was replaced not by the market economy but by 'wild capitalism'. The rapid privatization of nationalized wealth was performed by various methods, but eventually, with similar results: *foreign capital penetrated deeply into these countries.* And backing out of the dead-end as well as the transition to the market economy were concomitant with the rapid differentiation of incomes and it creation not of societies with a strong middle class similar to the Central European ones but rather drew the East European economies towards the social structures of the Latin American countries. In addition, the end of the millennium was shaken by serious financial crises all over the world. Competition between the centres of power grew increasingly aggressive. International financial institutions had no means to resolve the crises; they were confined to symptomatic treatment. Our colleagues in several important positions (Korten, Stiglitz) revealed to the public, in their critical papers, the inefficient activities of the aforementioned institutions - and sometimes bringing about results contrary to those intended.

3.1.6. Iustitia contributiva

Contributory justice

To formulate the ethical norms of the new world order which is beginning to take shape is very difficult.

The message on *the structures of sin* in the Encyclical *SRS* issued by Pope John Paul II is an important element. In human behaviour not only the desire for power and profits *at any price* - that is a sin itself - must be seen but the institutionalization of structures which push the man of our age onto a fixed path. Although one intends to do good, but one is almost forced to do ill. Of course, the individual's responsibility may not be reduced. Every person must decide if he/she accepts the rules of the game. However, weighing the pros and cons becomes more and more difficult.

If, contrary to the liberal thinkers like the Nobel Prize winners Buchanan and Friedman, we accept the notion - the representative of which is Rawls - that we can speak about social justice, we have to define several kinds of justice. [12]

Iustitia commutativa is the justice of **exchange,** the typical territory of which is the framing of fair conditions of competition and worthy wages.

Iustitia distributiva means distributive justice, **the protection of the poor.**

Iustitia legalis assumes the justice of **procedural law** and the presumption of innocence and the principle to 'give both parties a hearing'.

In addition, *iustitia contributiva*, **contributory justice** is important. By this it is meant that *everybody may have the possibility to participate in the formation of the common good.* Human rights and civil rights are real only if we can make use of them. *Social rights* create the conditions for it. But to this consensus, which does not permit pushing liberty either in the direction of collective egalitarianism or of individuality that lacks solidarity. *Iustitia contributiva* is a hard responsibility because it needs to make constant efforts. Citizens have to participate, continually, in the formulation of the legislative framework which makes decisions on the conditions of competition and probable redistribution. Let us see whether we have exercised our rights to vote and called our elected representative to give account of the public weal, at least, their promises; we have accepted the moral weaknesses of the politicians, and finally, whether we have made the same mistakes. Let us study whether we have made use of our right of combination and participated in the ideological struggles and political fights for a better and righteous world. If we have not done so, we have not met the minimum requirements of a Christian society or the ethics of economy. Then, we expect justice to be realized in economic practice in vain.

What should one do if in a *globalized world*, let us say, *'the rules of the game'* force one to be ruthless, to reduce quality, to defraud the Inland Revenue and to exploit his partners? Let us take an example! If, in international competition, the costs of the entrepreneur who provides for their workers with responsibility are higher than those of an Asian counterpart of his - who produces goods at the level of starvation wages or the one who lives under different natural and social conditions - indeed, he has hardly any choice under current circumstances but either to reduce the wages which he has considered worthy according to bargain or to face winding up his venture. In a worthy wage community allowances are also included. The denial or defrauding of the financial sources of the aforementioned is a rather hidden violation of the social contract since the social consequence of it, i.e. the deficit in the Budget is revealed only later. May the average of the minimum subsistence level of an employee in Lapland and that of the one around the Equator be calculated? May the common good in a state framework interpreted at the international level where there is no or just a minimum level of redistribution?

The case of the state of global environmental protection is a similar ethical problem. Modern economic thinking arrived at a stage where methods radically different from reasonable solutions are considered economically rational. For example, according to the 'pollute pays' principle the manufacturer who caused the environmental damage should compensate for it. However, the consumer, too, may estimate how much a clean environment is worth for him. Let him pay for it if he wants. (If there is one who has enough money for it!) [13] For the manufacturer environmental-friendly production would mean additional expenses, so would the fines imposed on him: both would reduce his competitiveness. From an economic point of view the solution, too, that for the elimination of pollution the consumer should pay if he wants to live in a healthy way seems to be viable. Thus, the entrepreneur may continue to operate his venture and environmental protection also acquires its own resources. Of course, this solution is not good since it means that, in practice, production with a polluting technology may be continued in many places, owing to the fact that on the other side of our globe restrictions are not so strict. As for a solution, on such imported goods, a countervailing duty should be imposed but it would be difficult to establish the legal basis of this. The case is similar with labour-intensive products which pour into the advanced countries from states with low social security costs. However, nowadays the rights to health and social security of the citizens in developed countries would be clashing not only with the employees of the poverty-stricken Third World but also with the layers of the capital exporters and capitalists of their own countries since it is just the financial means of these capitalists that makes the inexpensive factories of the Third World produce their products! They moved there because production is cheaper in this part of the world. Will there be enough democratic will to redress this problem? In addition, it would also mean that the exports of the developing countries to solvent developed ones would be aggravated ... What can the advanced world offer to the poor Fourth World in exchange? Zero percentage transfer?... Is it sure that the right of the citizens of the developed countries were framed at a proper level? Since the products imported in this way would also be more expensive for the consumers, although on the basis of common law they may think that they are entitled to cheap bananas, cheap energy carriers and raw materials. They are entitled to claim the credits with interest that were extended by them voluntarily to the countries which fell into a debt trap... They are entitled to take in capital and withdraw it from where they invested it if they think it right. Well, the leading powers of the world extended the four principles of liberty on a global scale, however, they think this seriously *only in the case of the flow of capital.* The migration of manpower on a world scale is limited by strict immigration rules.

These questions will remain open only if we have no idea of a *minimum world state* in mind. Some thoughts cropped up that following the general deregulation at the beginning of the 21st century some kind of *re-regulation* would be needed which would guarantee 'the common denominator' or the equalizing mechanism which will meet group interests. However, the question may be posed only if the interest relations established in the world economy make this possible since the keeping of expanding integration together is questionable; there are also severe objections against the federative notion.

Within the national framework, the regulation of spontaneous capitalism came about when it turned out that the unregulated operation of it was no longer profitable for anybody... The world economy after the Great Depression learnt from this bitter lesson. And the War induced the strong technological impetus which increased profitability to a great extent and assured a 'larger cake' for redistribution. This was sweated out by the existential fear of mankind. Will progressive ideas be borne only at this price? May mankind realize the necessity of a joint regulation only when some kind of world cataclysm comes about?

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3.2. KATALIN BOTOS: SOME QUESTIONS OF CATHOLIC ECONOMIC ETHICS

Motto:
'....It would be a mistake to regard the economic order and the ethical one as independent of and alien to each other as if they had no relationship to each other at all' (*Quadragesimo Anno* 42).

'Economic ethics as a discipline, concerned with the moral behaviour of people who pursue economic activities, is part of the Christian social message in a stricter sense...' [1]

Obviously, the roots of the message of Christian economic ethics can be traced back to the Bible; its all-embracing historic interpretation is a great task. [2] [3] In any event, it can be stated that modern times with unprecedented economic development created a radically different situation. Ethical guidelines wanted a permanent reformulation. Social changes emerging due to the currents of thoughts in the Industrial Revolution and the Enlightenment induced not only several positive results but economic differences as well which seemed to be deeper, compared to the former ones and which could hardly be acceptable as being of heavenly origin. Although economics itself, aged more than two centuries, sought to become an independent and exact discipline separated from moral theology, ethical questions still cropped up time and again. The man, who transforms the earthly world to an ever greater extent, will shape his own environment himself. The question is raised in a more stark manner: Have we created a more righteous and brotherly world than existed during earlier ages having been more backward from an economic point of view? (Here I consciously refer to the title of the Encyclical of the Hungarian Bishops’ Conference.) And if we have not done so, because social inequalities became more widely spread and appeared as striking contrasts, what position does the Church take on this question? Is the situation, which has emerged, righteous and just? Or, is the requirement rightful on the elaboration of more detailed ethical norms which *include positive actions* and refer to human-created economic relations? This question has become all the more important because the representatives of utopian ideas proposed solutions promising an earthly paradise which were - and still are - contradictory to the message of the Church but the influence of which, at the same time, were and are still far-reaching.

In 1891 *Rerum Novarum* was issued and the fortieth anniversary of its publication was commemorated by *Quadragesimo Anno*. More papal documents followed with *Mater et Magistra* and the documents of the Second Vatican Council, *Gaudium et Spes, Populorum Progressio, Laborem Excersens, Sollicitudo Rei Socialis* and *Centesimus Annus*, marking the centenary of the issue of *Rerum Novarum*. Further, the message of the economic ethics of the Church has been treated by several additional papal proclamations as well as the standpoints and letters of various episcopacies. All of them have tried to answer the burning questions of the age. Parallel to the confirmation of lasting theses, emphasis was laid on the typical problems of the given age. While proclaiming the necessity of right and proper wages and rightful possession, *Rerum Novarum* sought to find the middle course between liberal 'wild' capitalism and the socialist and communist ideas which claimed nationalization, *Quadragesimo Anno* addressed the economic problems of the Great Depression, the issues of corporations and the necessity of safeguarding workers' interests. In the sixties, the Vatican pointed at the contrast of the poor and the rich in the world economy and the negative impacts of the social phenomena of the consumer society. In the first decades of his papacy - during the co-existence of the two world systems - John Paul II emphasised the criticism against the social practice of socialist/communist countries since it totally contradicted the economic message of the Church. *Centesimus Annus* which may be regarded the most significant further development of this message, directed attention to the liberal capitalist tendencies after the change of regime, especially to those which threatened the socialist countries trying to return to the market economy. In this Encyclical, the Church formulated a definite position: there are not only two alternatives, namely, socialism and capitalism. There is a system which is called the 'social market economy', even if the Encyclical does not use this expression. In recent statements, the problems of global debt and the *responsibility for the environment*, that is of extraordinary importance in our times, have also been stressed.

However, several solutions which have been worked out on the principles of economic ethics of the Christian message and seemed to be applicable to the ethical questions raised, have been increasingly questioned by globalization. The cause of this is that *state sovereignty*, which was able to keep private greed within ethically acceptable boundaries (through the regulation of competitiveness, antitrust laws, wage regulations, minimum wages, social security contributions, social benefits) was, *by the turn of the century, considerably weakened due to economic reasons. Under the conditions of globalization* several institutions of the modern market economy are unable to operate according to the way accepted by the message

of Catholic economic ethics. A new situation has emerged in which adequate answers to the issues of economic ethics must be found.
Let us study the truth of this statement in detail. Without a demand on completeness, we must investigate the applicability of some theses of economic ethics of the Catholic social message today.

3.2.1. On private property

There were quite a number of debates over the question whether it was justified to incorporate private property into a social message on the basis of natural law. Is it not common property that is closer to the essence of Catholic message? Does the recognition of private property justified on the basis of natural law not mean the legitimation of *all kinds* of property acquisition and *the existing relations of property distribution?* Does this strong confirmation of private property (based on natural law) not show favour, merely, to the liberalism of modern times?
It is a fact that neo-liberal notions are indeed not very far from the message of the Church. However, the concept of the word 'neo-liberal' should be clarified because this is used by economists, too, who are the followers of 'paleo-liberalism' as Cardinal Höffner puts it. The essence of liberalism is that *the state should provide economy with a constitution* in order that its probable intervention should conform to the market. But the message of the Church does not accept that the supra-empiric regularities of the economy are paramount. Also, it is out of the question that a given property distribution can or should be regarded as final. On the contrary, an ownership structure much more deconcentrated than the present one is highly desirable.
The necessity of private property is derived not from the ideas of the liberal thinkers of the Enlightenment by means of the Catholic message. In fact the authority cited is St Thomas Aquinas according to whom possession is *a law of Paradise* but after the Fall it is a *necessary obligation* at the same time, since in the absence of this the fallible human being would lose a significant part of his stimulating and motivating forces and, finally, he would work neither for his good nor for that of the country - at least, not that much which could be done. The pros and cons of private property were expounded by Leo XIII, Pius XI and Pius XII in detail. Cardinal Höffner enumerates the arguments as follows: Property is a condition of human rights, the determinant of competency, an instrument for the maintenance of a family, a chain between people through trade and the source of charity. Without it the individual would not

be stimulated to be active; the disorders of the scope of activity caused by the absence of private property - i.e. by common property - 'would be solved' by an expensive and despotic bureaucracy through pushing people into slavery – the prophetic St Thomas Aquinas! - 'everything common' would become the source of turbulence and managers would enjoy unpredictable power concentration. If the state is the only employer, a new serfdom may emerge. (We have experienced it, indeed. It is not accidental that the slogan of the winning party which changed the regime in 1990 was: 'Liberty and property...')

Undoubtedly, *Rerum Novarum* states that possession as one's own is a man's innate right'. (RNS). But *Quadragesimo Anno* claims that 'similarly to other factors of social life the form of property is not permanent either.' (QA 49). And *Populorum Progressio* states that 'one must not use property to the detriment of the common good.' If necessary, 'it is the *task of the state administration* to find a solution of the problem, together with the active co-operation of individuals and social groups' (PP23) (Cited by the author), i.e. the regulation of the use of property is unambiguously assigned to the state by the Catholic economic message. The question is that nowadays when there are international agreements on the free flow of production factors, which guarantee, primarily, the free flow of capital, how can the state intervene if it sees that owners of capital, who neglect the interests of the citizens of a given state, only follow their own profit-seeking. Practically, in no way, primarily, due to the fact that several emerging, developing and indebted countries are in need of the inflow of capital to an extent that without it they would be unable to function. They are forced to accept the dictates of capital without any defence.

Indeed, what kind of property do we speak about? Property has several forms. The majority of modern societies in developed countries consist of those earning wages or salaries. The latter spend a great part of their income on their subsistence but also acquire some wealth through the purchase of consumer durables. They keep their savings - because they already have such - in deposits or securities. The right to social welfare may also be regarded as wealth to some extent since it is the result of a special pre-saving and, an apartment is also a property element of great importance for a family. Only after having taken all this into consideration, are we able to think of the employees' participation in the means of production; they may have securities which embody proprietary rights.

The wage-earner citizens in modern societies are no more the workers of the Age of *Rerum Novarum* about whom the poet said in a touching way in his poem 'Misery is dreaming': He is dreaming about a clean bed and a pure woman; he is dreaming of a slightly higher wage, a dish of good food, clean clothes, more respect and some humane words; less blood when coughing and more strength to work, hoping he need not appear in front of the Lord for another ten or twenty years... (Ady)

Incidentally, for people the right to respect and humane words is as important as their well-being. This is supported by another poet's words. (See the poem 'Mama' by Attila József: She wore a clean apron in her dream and the postman greeted her sometimes...)

It is not accidental that one of the keywords of the Catholic message is human dignity. The fact is that in developed countries a strong middle class, whose layers of wage earners possess several different forms of properties, has emerged does not annul the theses which had been previously formulated by the Church. Even nowadays, there are millions of defenceless people with starvation wages who have a hand-to-mouth existence. It is impossible to generalize about the whole world since it would be ridiculous to warn starving Africans against over-consumption.

However, in the developed world, the abovementioned forms of property are made widely accessible by the evolution and application of the principles of social market economy. Wage-earner citizens of modern times possess many things. Can it be said that, at least, for them the problem of property and freedom have been solved once for all? Not to mention the situation of the one-time socialist countries which have returned to the market economy! This is even a more complicated issue. Many of them are the members of the club of advanced countries (i.e. those in the OECD) but their societies keep still carry the signs of the half-a-century or more experiment of the socialist system, and their social structures after the change of regime and the transition resemble that of the developing countries rather than that of their fellow club members. Can it be said that the privatization of the formerly nationalized property has resulted in an approvable property structure?

Let us focus on the issues of the proprietary rights of the means of production, partly, because the past one-and-a-half centuries has not been able to get rid of the ghost, i.e. the ghost of communism walking about among us. Various liberal or Christian ideologies often seem to answer the questions of Marxist social analysis. Vulgar materialism penetrating Marxism - 'raving' materialism as Péter Veress puts it - explains social progress by the interaction between the economic basis and the superstructure, the development of *the ownership of the means of production.* Experts in economic ethics have been permanently concerned with the question of the socialization of the means of production. Is it just that the worker whose work is also a basic source of value-making according to the Christian message and *that which has a priority to capital* according to the Church (LE 5l), will not have a share in the property which is the result of his work?

Is it rightful that the worker like a 'talking tool' is to be the executor of the orders of the owner and his deputy through the implementation of working processes?
The documents of Vatican II clearly state that modern production is also a joint venture, so it is justified for the workers to participate in company management. It was widely-debated that participation should mean a share in ownership or only its profits.
Here it is interesting to refer to a fact of economic history: in Hungary, where socialism had practically ended the private ownership of the means of production, the endeavours of economic reform in the 1960s concentrated on developing the sense of ownership in employees by the introduction of a share in profits, i.e. a 'quasi-dividend' from the profits was paid to the workers. And in the Yugoslav socialist experiment, the employees' quasi-ownership ties to the company were one of the essential elements in the 1960s. The drawbacks of this have come out clearly after the change of regime since no workers' collective could be expected to enforce the steps of rationalization which were directed against them. Thus, the model acted as the brakes on the transition to a market economy. In Western world, too, it became widespread to let the employees acquire shares in companies although in this way, primarily, the interests of managers attempted to come close to those of the owners. However, there were serious theoretical arguments against the solution that only those who brought about profits for the company should be entitled to proprietary rights. After the post-war boom companies earned high profits mostly due to prices paid by consumers and tax allowances - states Höffner -, thus, if you like it, others, too, would have been entitled to acquire ownership. [4]
The concentration of property which could be realized with respect to the already-existing stock of wealth through privatization appeared in a most noticeable manner both in the Western practice of the 1990s and in the transition of the one-time socialist countries. In the latter, this was due to the fact that everything was owned by the state, so market operation was almost out of the question. In developed countries, too, the redistribution not of private properties but of considerable common ones was on the agenda. In those instances, it was not distribution but rather purchases in cash which occurred. The cause of this was that besides the narrow means of the budget, financing and development became an ever more acute problem. Among the various privatization techniques of the socialist countries there was purchase in cash but also privatization by voucher which actually distributed national wealth according to the rights of citizens and, having changed its owners several times - that time at its real exchange value - it became concentrated in the hands of its final owner. Eventually, partial proprietary rights of the means of production and ventures mean more than an

investment alternative only for those who, through the acquisition of an influential participation, can have a say in company management.

This must be faced in the economy of developed countries. Large-scale private savings play an increasingly greater role in corporate financing either as credits extended through banks or in the form of securities embodying proprietary rights in capital markets. This could be regarded as the realization of a deconcentrated ownership structure that is considered to correspond better to justice than to the concentrated ownership structures expressed by the Catholic social message. But the character of joint venture of a modern company is weakening. The shares/bonds representing proprietary rights are only instruments of financing and, practically, smallholders are unable to interfere in company affairs.

Moreover, here we have come to the most critical point of ownership from the aspect of economic ethics. Paying into investment and pension funds becomes an increasingly frequent form of savings. Even in the 1980s Cardinal Höffner saw clearly that institutional investors would become decisive in our age [5]. He also saw that the unscrupulous use of the funds - brought together in this way to serve individual interests - might occur if management were morally inadequate. However, it was shown only in the 1990s what huge investment funds were able to do in the global capital markets that had in the meantime been losing their ties. The fact that with modern technology the funds handled by employees and dealers interested in profitable management, were able to transfer immense amounts of money from one part of the world to another in minutes made it possible to ruin booming businesses as well as to shake the financial balance of national economies. But effects more indirect than this may also appear. Let us say, an employee of a company saves money, makes payments in a private pension fund which puts the fund's monies in the papers of the ventures which are concerned with innovative techniques in emerging markets. The financial facilities provided will lead to the development of the venture and strong exports offensive and, let us say, it is just our man's company that is coming close to bankruptcy because of the fierce international competition. The company's responses to this situation are rationalization and maximum economy. Our man is fired. Instead of securing his future, even his present has become uncertain. The example which I have depicted is an extreme one but realistic. It is hard to arrive at the conclusion with the frequently cited economic rule that competition is like this... *There is no international regulation which provides a fair solution to the problem.* Economists who are for order suggest that the state should give 'an economic constitution' to the business sector. This suggestion - otherwise close to the Catholic economic message - is useless *if it is not imposed on all economies.*

3.2.2. On labour

The Catholic social message treats work as joining God's creative activity. In all documents, the Church speaks up for human dignity, proper working conditions and fair wages. Setting wages has to be done in compliance with the common good. Wage demands which cannot be borne by an entrepreneur are considered unlawful. (QA 72). However, in the case of minimum wages, the Catholic economic message states that companies owe something to workers who they have to thank for their profits and this should somehow be recognized. (MM 75). Thus granting some part of the proprietary income or a share in ownership may be considered - see the previous section of this paper. As far as the 'still bearable' wage burden for the entrepreneur is concerned, it may not be interpreted by *individual companies* since it would mean restricting the impact of the selection of competition. The right to wage fights of trade unions that is recognized by the Catholic social message, too, may be regarded as antisocial and outworn by Cardinal Höffner if there is proper law and order in a society since the 'aspect of the most successful serving of the common good' includes both a proper level of employment and the stability of the value of money. This is jeopardized by wage fights which resort to desperate means. It is true that the individual employee's perseverance to enforce his interests well in a contract is much weaker than desired but the growing intensity of strike movements is dangerous and may be concomitant with socially harmful consequences. In Hungary, it can be seen clearly that strikes which are mostly in the civil service affect the relationship between the citizens and the state and the general justice of distribution rather than that between the capitalist employer and the employees. Moreover, we may claim that in this sector the powerful means available to workers, *the strike,* is going *to be ineffective.* Consequently, in Hungary strikes are rare in the private sector which can be explained by *the relations established by globalization.* Nowadays, in the countries of the world economy where development may be attributed to the inflow of foreign capital significantly, there are not many strikes because capital will flee from the territory in question.

While Höffner emphasizes that there is no need to throw in such a 'weapon' when there is a proper economic constitution available [6], we may state that under the present conditions in Hungary *recourse to this means may be desired but there is no possibility to do so.*

Namely, the indebted developing and emerging countries have no other choice because of the growing internationalization of the economic system and the freedom of capital flow. They are badly in need of direct capital imports since they cannot indefinitely substitute their shortage of capital through taking out loans. They are forced to stimulate capital inflow which - so to say - does not generate indebtedness. This may not be 'threatened' by strikes... and this is understood not only by governments but by the people who are employed. As a matter of fact, in multinationals organizations safeguarding workers' interests are often absent.

The employee of modern times finds himself working under defenceless circumstances. Again, I cite Höffner who pointed out: the employee may not enter into a contract with the employer freely in a sense because several laws influence the probable content of it [7]. But this, too, is circumvented by modern globalization. The phenomenon of contractual employment, where the employee steps out of the regulated circle of labour codes and laws, is increasing. He works in the world of ventures where the content of contracts is less - or not at all - restricted by state regulations. Here, too, free competition prevails, moreover, in an ever broader geographical circle. Cheap workers from India perform labour of great value to American companies - the distance is not an obstacle. In Hungarian practice, too, so-called 'forced' ventures are spreading, partly for the above-mentioned reasons and, partly, due to the fact that a significant part of the population have chosen this method of self-employment because of the shortage of jobs. Here, too, the aim is to avoid the payment of public burdens since in this way it is easier to find a job. Evidently, besides the high Hungarian public burdens both the employer and the employee are interested in this - at least, in the short run. It seems to me, there are too many who share Keynes' notion: in the long run, we are all dead...

As far as the amount of wage is concerned, from the beginning the message of the Church emphasizes that it should be enough to support the worker and his family at a level which is compatible with human dignity. This approach assumed the existence of families with children, what is more, families with several children. The proportion of childless couples and single households is increasing although this phenomenon may not be regarded desirable at all. Taking all this into consideration, the aforementioned requirement could not actually be met only by giving a wage proportionate to performance but it seems to be unreal to expect an employer to pay more to families with several children. This task becomes increasingly that of the state's social policy. And, in the one-time socialist countries, women's involvement in work had been a conscious objective of economic policy for decades. Here, to live on one salary in a family was, practically, impossible. We can agree with the statement that the foundation of the society is the family and its strengthening is a public interest. In spite of this, we can experience that employees with many children - especially women – do not find jobs so easily. The disinclination in employing persons with more children ought to be compensated through granting allowances to entrepreneurs, be it a reduction of the degree of social security contributions paid by the entrepreneur or other financial means in the Budget. The aim should be *the restoration of the equality of chances* but the solution should rely on the market to decide who is best suited and for what. Besides this, of course, the support of large families is necessary by other means as well - especially if they cover the costs of the education of their children.

Further, the issue of the wage is interrelated to the topic of *social security.* The costs of live labour for an entrepreneur are the wage plus public burdens and it should be seen that the burdens of social welfare are not the same in all countries. Again, we have arrived at the topic which presents itself at a degree blown up by globalization: free-moving capital seeks to find an environment where wages are not too high, there are no strong trade unions and *the public burdens on wages are low.* Not only the countries where the population is ageing will lag behind in competition - there it certainly occurs -, but those, too, that want to provide higher services for old people or health care at a higher level through social security.

Where, owing to the change of age structure, payments of contributions lessen, compared to the number of those provided for or there is a demand on extra services, burdens of contributions ought to be increased. However, this would mean *a disadvantage in competition* in the world market. Therefore, although we agree with the notion that social security systems cannot be regarded as some paternal degeneration [8], the possibilities of the reform of the systems should be studied both from the aspect of financing and that of economic ethics as well. To this attention was directed even in the 1980s, namely, 'large groups of the masses conspicuously sought to have access to state provision...'; the large process of redistribution lent, increasingly, some economic character to the state what would nearly hurt the state interest' [9]. A difficult and uncongenial task falls on politicians who rarely have a long-term view to enforcing unpopular restrictions in regulation. In this issue an all-society consensus ought to be found but, generally, the topic is of some service for a political party to push another aside, using the social unrest of the masses. In a liberal democracy, where people can protest against restrictions dictated by economic rationality with strikes and movements of civil disobedience, politics is in a difficult situation. Undoubtedly, politicians should be honest. People should be told, whatever political party be in power, that the supervision of a too generous system may not be avoided... With this statement we would agree with Keynes' opinion on civil servants, i.e. they are governed not by their own interests but *by the public weal.* And although this would be highly desirable, today's society will not fall on such ethical values but believe those who promise more [10]. In Hungarian relations, the question is more problematic. The image of Hungarian society approaches to that of West European countries, only that its standard of living lags behind. Thus, what is theoretically feasible in the Western world, in spite of strong social resistance, in Hungary it may be concomitant with further serious reductions in the living standard. This is why they tried to reform the pension system by strengthening the element of insurance in it but deficiencies in the basic system of solidarity caused by the savings transferred to private pension funds has been made *the problem of the future.* That is, deficiencies are covered by the Budget which, obviously, increases state indebtedness. The so-called compulsory private pension funds invest their clients' money in safe state bonds, i.e. they finance the *deficiencies* caused by the reform. By the way, this solution puts the burden back onto the shoulders of the employees, those of the taxpayers since it is they and not the companies that pay the bulk of the tax burdens. Thus, the Hungarian 'solution' can be regarded rather as an effort to meet the challenges of the competitiveness of globalization which alleviate the *burden of employers* to some extent because it was concomitant with the reduction of contributions paid by the latter. Here the ethical problem is that the abovementioned impacts of changes are entirely unknown in society.

3.2.3. Financial system and sustainable development

Sustainable development has several interpretations. In the Hungarian economy, sustainability means *external financeability* in some sense [11]. It is true because for long there has been no equilibrium between the import-intensiveness and export-abilities of the Hungarian economy and that can be guaranteed only by permanent capital imports. Our possibilities for growth have to be adjusted to this factor on an *ad hoc* basis and a reverse situation is only limited.

However, generally, sustainable development is interpreted as one determined by environmental possibilities. It is well known that development has accelerated since the Industrial Revolution. This was assisted by the exploitation of fossil energy and, later, the application of nuclear energy. But the raw materials and energy sources of nature seem to be inexhaustible only in the short run. Actually, they are exhaustible which is well demonstrated by the fact of how quickly the great expansion of the aluminium industry in Hungary exploited our bauxite sites and several formerly functioning oil wells of ours have now been exhausted. Scientists, amongst them the Club of Rome, have directed the world's attention to this problem for more than 30 years. The capitalist and socialist economists were at one on this topic: they simply threw away the message of the study 'Limits to Growth'. Energy sources have not shrunk as rapidly as it was projected by the Club of Rome, although it became increasingly evident that our resources, which are diminishing through utilization, are not infinite. However, an even greater danger appeared and that is the catastrophe of environmental pollution. The experts of the Club of Rome give us no more than 50 years to solve the problem of environmental pollution which is growing ever more tragic [12].

The Catholic economic message is concerned with the man/nature relationship. As early as the formulation of *Octogesima Advensis,* Pope Paul VI referred to the issues of environmental pollution, and in the messages of John Paul II the need to respect the cosmos and the limited nature of natural resources are mentioned in several places (SRS 34). In his message sent to the Day of World Peace on 1st January 1990, his wording went like this: The ecological crisis is our common responsibility... the man with free will has serious responsibility for the protection of the order in the interest of future generations... *Ecology is a moral question.* (*Békesség a teremtővel, békesség a teremtett világgal* V/l5-l6). He expounds it clearly that human greed and irresponsibility induce such economic processes which neglect the rightful demands of future generations (CA 34). Man may not dispose of the Earth arbitrarily. He may not take the place of God. (CA 37). Extraordinary natural phenomena of our age - the greenhouse effect and the fighting going on, practically, with all means for the control over oil resources - give actuality to the message of economic ethics of the Church. Eventually, the statement of the experts of the Club of Rome saying that *the advanced Western world is overpopulated* ecologically is rather shocking. If the problem of the reduction of the population is raised in Hungary, all people of goodwill began to think of how the inclination to deliver and bring up children could be stimulated. However, it is apparent that per capita consumption and the concomitant waste production will choke our economy, too, although Hungary is still below the consumption level of Europe's 'happier' part, and more particularly that of the USA. On the other hand, it should be recognized that the other parts of the world struggling with real overpopulation try 'to take the European fortress', with repeated waves of migration. Consequently, environmental pollution and the inequality of the geographical distribution of natural resources and the foreseeable worldwide migration urge us to global solutions. The Catholic Church has taken a stand for this thought but today's political reality demonstrates the contrary, i.e. the decay of international institutions. It is only to be hoped that it will not need another world cataclysm to force mankind to co-operate again.

There is a very widely-known and misunderstood thesis of the economic message of the Church which is related to *interest.* Here, this would be treated, primarily, from the aspect of sustainable development, although some words should be devoted to the general content of the message.

In public opinion the notion that the Catholic message refuses interest payment/collection has become widely known. However, this notion has to be clarified to some extent since, undoubtedly, the prohibition of usurious rate of interest referred to the situation when the debtor in financial difficulties basically took out a loan to cover consumption. If consumption is in question, there are no sources of the interest and it may lead to the ruination of the debtors. Loan raising of the Middle Ages was of a social security type [13]. But it was taught by St. Anthony of Florence (c. 1450) that money has the nature of capital, therefore the prices paid in cash are lower than the purchase of goods on credit. In these cases theologians recognized the rightfulness of the rate of interest. In his main work Keynes himself recognized that the interest regulation of scholastics was rational. According to Schumpeter, it was based on a sounder basis than some later works, moreover, on this basis economics could have developed more rapidly and with less effort in the nineteenth century [14].

Modern money which is produced by credits and flexibly accommodates to the dynamic growth of production, is charged with a rate of interest, at least, with a nominal one, inevitably since in the absence of this, inflation would devalue savings which constitute the source of the bulk of credits. It is quite another question how high margins are allowed to be realized by risk surcharges, the costly operating systems and the striving after profits. Although it is true that a bank as a group of undertakings is not completely closed since there is a possibility to establish a bank but, in practice, the market seems to be very divided. Financial mediation and, within this, the activities of financial institutions are, no doubt, a monopoly to some extent which appear in an oligopolistic institutional structure. The debtor (i.e. the loan-taker) feels only his defencelessness as the risk is his because banks try to minimize theirs by asking for securities, claiming that they risk other people's money which is a justifiable reason. However, it is debatable, indeed, that the security asked for is needed only for the aforementioned reason or it is for guaranteeing the bank's profits at any price. And in this case monopolistic effects unambiguously prevail.

The economy of our age is based increasingly on credit. Not only to production and investments but also to consumption, credits are extended. It is enough to refer only to the huge amount of state debts in which the world's leading economic power - that is the USA - is at the forefront. For it the problem is not insoluble, because its own currency is a global one that ensures significant financeability. But after all, it is difficult to step out of the vicious circle because, esp. with consumer credits, sources of interest are hardly created. This is the situation with the foreign loans which have been taken up in convertible currency by developing countries. For the debt service, claims in foreign exchange would be needed and, to them markets and competitive products would be wanted. In most cases, this occurs only in a very restricted way. For these countries the image of an endless debt slavery appears. Hungary, too, was able to reduce its debts only through selling its national wealth mostly to foreign owners. In the social Encyclical *Solicitudo Rei,* the Pope refers to this problem in connection with the hopeless indebtedness of developing countries (SRS 43). He urged debt release in his letter written for the millennium, too, referring to the expectations towards jubilee years in the Old Testament. But the situation is that casual results do not solve the problems globally. The problem is not in the system, the problem is the system itself... The problem is more general. The mechanism pools the income to the mediator layer to an ever greater extent and this leads to the increasing separation of the real economy from the financial sector. This is going to crash with the interests of the economic players of the developed world as well. The modern economy based on compound interest is bound to grow which is not so promising from the aspect of saving resources. *Discounting mathematics is not in favour of the long-term economic approach.* [l5]. Who plants a slow-growing oak if it is ready to be cut down only in 50 years' time?

Now we have arrived at *the boundaries of the economy.*

Although the Catholic social message has always recognized the important role of the economy in effectively creating the conditions of a more humane existence, it has always expounded that not everything can be put on the market. Several human needs cannot be met from the market, and *natural values may not be managed properly only from a market approach*. *Centesimus Annus* finds the solution in the state's role-taking (CA 40), however, it urges socio-economic reforms for the solution of global problems in general. It claims that this message should inspire reforms before it is too late (*Libertatis conscientia* 88).

The experts of the Club of Rome drew similar conclusions: markets make us celebrate all the seven deadly sins, except for laziness, because that reduces turnover... Markets should not be used for what they are not able [16]. Weizsaecker and his co-authors are for solutions through negotiations which is proposed by *Coase* because in this way, too much role-taking by the state, which projects the threatening image of totalitarianism, may be avoided. Indeed, we may agree with this statement but it should be added that the positions of negotiation of the partners are not equal and what is still more worrying is that the interests of future generations have no representatives. If anywhere, an active and conscious role-taking of the members of the Catholic Church is highly important in the field of the social implementation of the proposals which are professionally well elaborated and based on the guidelines of the Church.

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3.3. STEFAN BRUNNHUBER – BERNARD LIETAR – KATALIN BOTOS: ECONOMICS AS AN EVOLUTIONARY SYSTEM: PSYCHOLOGICAL DEVELOPMENT AND ECONOMIC BEHAVIOR

Abstract

Consciousness changes occur in a clearly identifiable sequence that can be described as pre-conventional, conventional, and post-conventional levels. Each one of these levels is characterized by specific patterns of being, feeling and thinking, acting and communicating. When the historical evolution of economic systems and its key organizing institution of money are mapped on that same sequence, interesting insights arise on today's state of economic theory, and on its likely future evolution towards a Knowledge-based economy.

This paper is organized in four sections:

1. Identification of the necessary characteristics of any development, as well as some potential failures in that process;
2. Description of development as empirically verified in the psychological domain, leading to the observation that the consciousness reference point is itself an evolutionary process;
3. The application of the psychological development process to economic behavior, with the conclusion that "economic man" is a valid model only within one particular consciousness level;
4. A synthesis of the implications of all the above for the future evolution of both human society in general and economics in particular.

3.3.1. General Characteristics of a Successful or Pathological Development

All living or evolving systems go through change, via processes of either development or decay. And some general rules about development have been identified that remain valid whether we are dealing with individual systems such as biological or psychological ones; or collective systems such as cultural, social or economic ones.

At this most general level, there are two questions that need to be addressed:

What is genuine development?

Is there a difference between development and mere growth?

Table 1 synthesizes the four necessary conditions for a genuine development to occur.[1] Whenever one of those conditions is missing, a corresponding pathology will tend to manifest, resulting in a failed development and decay.

Table 1: The four necessary characteristics of a genuine development and their potential pathologies

Genuine Development Criteria	Potential Pathologies
1. Differentiation	Fusion
2. Integration and Transcendence	Dissociation
3. Richer Internal Hierarchy	Anarchy, Chaos
4. Overcoming Survival Challenge	Recursive Loops

The first condition is Differentiation. This means that the later condition compared to the earlier one has to maintain or increase the identity of the entity involved, enabling a clear distinction between the inner and the outer. Whenever this doesn't occur, a regressive Fusion occurs instead, and the entity may simply stop existing altogether.

The second necessary characteristic for genuine development is Integration and Transcendence. This means that the later condition not only has to include all the essential parts existing earlier, but that the new whole has to be greater than the sum of those parts. A failure in this condition will lead to a Dissociation, which means the loss of the capacity to apprehend, relate to, or interact with important parts of the system.

The third condition is a Richer Internal Hierarchy, a deepening of the ranking arrangement within the system.[2] All development involves a process where the previous units become parts of a bigger or more encompassing system. For instance, atoms, cells, organs, organisms, societies are one such a sequence. Or letters, words, sentences, paragraphs, chapters, books,

[1] The first three criteria were described by K. Wilber (1995, 1998). The fourth criterion originates from biological and psychological research (L. Kohlberg, 1996; K. Popper, 1957, 1994 (10))

[2] This is the one condition typically lacking in system theory approaches (Bateson, G., 1982; Wiener, N., 1963; Bertalanffy, L., 1985; Prigogine,I., 1992; Maturana H. and Varela, F. J., 1991, Varela, F. J., 1990, Varela et al., 1992) whenever they try to use feedback loops, non-linear connections or autopoesis as a way to make the system become self-sufficient. By negating the role of a richer internal hierarchy, systems analysis risks proposing only reductionist solutions to complex processes (Wilber, K., 1995).

libraries is another. Even if at one point the hierarchy seems to get lost (e.g. cells dissolving back to their constituent atoms), this should only be an intermediary step to enable the manifestation of a new combination at a higher level of complexity. Whenever there is no such deepening of the internal hierarchy, Anarchy and Chaos will result, and future development will fail.

The final condition is Overcoming Survival Challenges, the capacity to deal with and overcome difficulties and adversity. This is the most counterintuitive of the four criteria of development, and requires therefore more explanation. This criterion requires first that a challenge manifests, and second that it is successfully handled. If there is no challenge at all, or if the challenge is systematically refused, we end up with a failure of development that we'll call a "Recursive Loop", a closed loop that repeats itself forever. A metaphor for this type of breakdown is a broken record, stuck on repeating the same segment of a track forever. The easiest way to understand this criterion is by examples in various domains of development.

For instance, in the biological domain, organisms or entire species genuinely develop when they are being tested by the environment or other species, and manage to adapt and survive such challenges. Even normal human birth is about overcoming such a survival challenge, and there is convincing empirical evidence that children born from a Caesarian section have less vital energy and tend to deal less successfully with other tests in life.

In the socio-political domain, free speech and democracy (defined by Habermas as ways to get rid of a leader in a non-violent way, when needed) have evolved as mechanisms to challenge the powers-that-be, and thereby facilitate social development. The alternative is dictatorships that repress any challenge to the status quo. In economic systems, competition between different corporations in a market has proven a useful development stimulus. When this is lacking, monopolies or cartels tend to stifle innovations and the corresponding economic development.[3] Similarly, in science or culture, different ideas or cultural expressions should be able to be challenged by new ones, and get falsified and discarded when appropriate. Whenever such challenges are systematically blocked or avoided, dogmatism manifests. Political dictatorships, economic monopolies, ideological dogmatism have in common the potential failures in development due to recursive loops resulting from missing or suppressed challenges.

[3] Particularly J. Schumpeter's definition of "creative destruction" illustrates this view (1926).

Survival challenges in the biological domain is where the clearest distinction between simple quantitative growth and genuine development show up. For example, imagine an organism or a robot that at death simply replaces itself forever without any change. Such an organism may be able to survive without growth indefinitely, but this would not be development. In a favorable environment without any challenge at all, an organism could even multiply and grow exponentially; but this would only be quantitative growth, not development as defined here.

Finally, in psychological development, going through ontological challenges - the ability to fundamentally challenge and re-assess oneself and one's beliefs - will similarly be shown to be one key condition for genuine development. Given their crucial role in changes of levels of consciousness, we will deal with this aspect of psychological development in more detail in the next section.

All four conditions synthesized in Table 1 must be met for genuine development to occur. Whenever one or more are not met, the corresponding pathological regression(s) occur, leading to decay and potentially death. These four general criteria for authentic development will be relevant to evaluate changes in both individual psychological developments as well as in economic systems.

3.3.2. Evolutionary Psychology

A vast literature originating from the fields of ethnology, anthropology and development psychology shows that consciousness enhancements and personal development occur in clearly identifiable steps or levels.[4] Each level is characterized by specific qualitative psychological differences. The capacities to perceive, to feel, to think and to communicate are therefore all conditioned by the consciousness level at which one operates. Different authors use different labels to describe each level, but they can nevertheless all be regrouped conveniently into three significant categories: pre-conventional, conventional and post-conventional levels.

[4] Commoner B. et al., 1990; Coomaraswami, C., 1943; Lovejoy, K., 1936; Plotin, 1966-1988; Smith, H., 1989; 1992; Wilber, K., 1977, 2000; For development psychology: Baldwin, J., 1906-1915; Erikson, E. H., 1992,

A primary closeness between body and spirit, nature and community psychologically characterizes a Pre-conventional level. These concepts aren't yet sufficiently differentiated. The resulting worldview is magical/mythological, and abstract concepts like laws of nature can't be apprehended. A child at the pre-conventional level of development is unable to use the laws of logic or to alter behavioral roles. For example, a child will perceive the same quantity of liquid shown in vases of different sizes as different volumes. The idea and the object aren't yet differentiated. Everything is taken literally: "Laotze was 700 years old at birth" or "Moses parted the sea". Relationship to the collective doesn't include the possibility to switch roles or to make trade-offs, and rules are enforceable only through rewards and punishments rather than reason (See Table 2).

A failure of development at a pre-conventional level will manifest as a deficit in self-awareness, and in the ability to learn rationality and scientific reality standards.

The passage from a pre-conventional to a conventional level involves a demystification of the world, the loss of faith in the magical/mythological form of experiencing, acting and thinking typical of the pre-conventional consciousness.

Gilligan, C., 1982; Kohlberg, L., 1984, 1996; Loevinger, J., 1977;Maslow, A., 1970; Piaget, J., 1977; Sullivan, H., 1980;

Table 2: Consciousness development levels and characteristics

Development Levels	Emotional/Cognitive Characteristics	Consciousness Reference Point	Relationships with Collective/Social
Preconventional	Fusion object-idea Instinctive, Un-socialized Psycho-biologically determined - Needs - Emotions - Motivations Here/Now priorities	Autism, Primary Narcissism Pre-personal, symbiotic, archaic Collectively determined role identity Cyclical time framework	Belonging, "Particiaption Mystique" Magical/Mythological Worldview Magical/Mythological Determinism Ritualized Praxis
Conventional	concrete Operational Linear, Rational Competitive Short-term priorities	Ego-based/Individualistic Socio- and ethnocentric Causal/analytical Linear time framework	Self-development Science, Legal systems, Nation-State Functional specialization Technocratic development Experimental Praxis
Postconventional	Integration All-perspective embracing, Reciprocal tolerance Cooperative/Altruistic/ Solidarity Sustainability priorities	Transpersonal Multiple Roles & Perspectives Compementarity Universal & Pluralistic Inclusive/Empathic Multiple Time Framework Synchronicities	Self-transcendence Multicultural Human Rights, Universal Fairness Openness, Assimilation Integral Praxis

The **Conventional level** in psychological development starts with the build-up of individuality, with the capability to more clearly distinguish between the interior and exterior, with the faculty to change roles, with higher abstraction and logical capacities, and the emergence of communication skills using complex symbolic and linguistic means. All these characteristics are but visible expressions of an underlying consciousness expansion. The individual Self learns to define itself in terms of its relationships with the immediate community and society, with the result of a growing distinction between the Self and the body, nature or the collective. The cause-and-effect relationships, linear logical deductions, and the understanding of the purpose of different roles grow to become the dominant form of perception.[5]

The breakthrough from the conventional level to a post-conventional one requires a passage through a “Critical Self-Assessment” (“performativen Selbstwiderspruch” in K. O. Apel, 1973; J. Habermas, 1972, 1988). This includes a fundamental re-assessment of the limitations of any purely logical construct that doesn’t take into account the realities of the factual world (J. R., Searle, 1995).

A failure in going through such a Critical Self-Assessment may result in the assumption that “reality is purely subjective” and therefore “everything depends only one’s own interpretation”. This leads to the flawed conclusion that only one particular perspective is valid (i.e. mine), and all others invalid. The final outcomes are different forms of what we called the Recursive Loops in the general development criteria section. The three main ways in which such a “broken record” manifests at this stage of psychological development are predictably different failures of rationality (S. Brunnhuber, 1999):

- “Circular logic” (H. Albert, 1987, 1991), wherein the conclusions are already predetermined by the premises posited at the beginning of a reasoning;
- Dogmatism, which occurs when there is a systematic refusal to deal with criticism, and the defense of the logical coherence of one’s beliefs becomes more important than the external evidence[6];
- And “infinite historical regression” when the criticism is dealt with by going forever further into a historical past without ever resolving it (e.g. “this psychological problem originated when you were five years old, one year old, at birth, from pre-birth, from your great grandfather, …from Adam and Eve.”).

Notice that even the identification of a “rational consciousness level” as a “rational law” creates the danger for such a Recursive Loop. If the argumentation were to remain purely at the rational level, without continuous critical verification through external “real-life” evidence, it would sooner or later lead to a dogmatic circular logic.

[5] In the domain of social sciences one describes the conventional level as one of “differentiating the value domains” in natural sciences, politics, law, religion, art or medicine. (M. Weber, 1921; J. Habermas, 1977; 1988)

[6] The anecdote of the Roman cardinal who refused to look into Galileo’s telescope because “everything that was supposed to be in the Universe was already described in the Bible” is an illustration of this attitude.

Whenever the conventional consciousness level gets stuck in one of those Recursive Loop processes, it degenerates into "hyper-rationality" (J. Gebser, 1992). It is important to distinguish between reason and hyper-rationality. The relevance or need for reasoning or logical rigor is not being questioned here. However, hyper-rationalism arises when reason claims to have the monopoly of legitimate interpretations of reality, when it claims that the only valid thinking is separate from any emotional perception or background. Any input other than itself is simply dismissed as "irrational". This "hyper-rational" structure is a key characteristic of "Economic Man", and we will show later why this psychological construct is valid, but only at this conventional level of consciousness. This will explain also why "Economic Man" loses its explanatory power at both the pre-conventional and the post-conventional levels.

At the **Post-conventional level**, the consciousness reference point shifts again, and therefore also the emotional/cognitive characteristics and the relationships to the social/ collective. However, these new emotional/cognitive standards have to justify themselves in terms of the logical and rational criteria acquired at the conventional level. Indeed, on the basis of the general principles of genuine development, all later stages must not only be different from the previous ones, but also integrate and transcend the realizations of the previous ones. This means that a post-conventional level has to pass the test of conventional criteria such as legitimacy (e.g. democratic processes), respect the laws of nature and biology (e.g. physics and medicine), and integrate the findings of anthropology, sociology or economics (e.g. logic and statistics).

In the social domain, instead of the magical/mythical (from the pre-conventional level) or functionally specialized worldviews (from the conventional level), new standards become important to evaluate reality such as: reciprocal tolerance and pluralism, cooperation, universal fairness, inclusiveness, solidarity, and complementary relationships. These values are internally coherent, and different from what manifested at the conventional level. They change the consciousness reference point, and therefore also the ways of being, thinking, doing, and communicating.

Two aspects of the schema just presented are of particular importance. One is the differences and similarities between the pre- and post-conventional levels; and the other is the difference in Praxis. Each will be dealt with in turn next.

Pre- and post-conventional Similarities and Differences

The pre- and post-conventional levels have some characteristics that superficially are similar, and therefore there is some risk of confusion between them[7]. This can result in errors in categorizing certain states, notwithstanding the totally different realities of the pre- and post-conventional levels. [8]

In both the pre- and post-conventional levels the connections and relationships to nature, community and wholeness are central. So, how can we distinguish between the two?

The answer comes from the presence or absence of specific steps that need to accompany the transition from one level to another. As briefly stated earlier, the transition from the pre-conventional level to the conventional one requires a Demystification step; and the transition from conventional to post-conventional a Critical Self-Assessment step. Both are ontological challenges, fundamental re-assessments of one's being. Such ontological challenges are the form in which the fourth criterion of development – Overcoming

[7] K. Wilber calls such confusion the "Pre- Post- Fallacy". See Wilber 1995, 1998;

[8] For example, children in early pre-conventional states do not experience the ego as being separated from the outer world. Some post-conventional mystical experiences similarly are characterized by the direct experience of non-duality with all that is ("*samadhi*"). S. Freud (1923) automatically classified such post-conventional states as regressions to infantile stages, thereby falling into the trap of the pre- and post-conventional fallacy. C.G. Jung (1958) made the opposite mistake by interpreting all pre-conventional experiences as post-conventional "numinous" states. Finally, cognitive science (Beck, A. T., 1972; Ellis, A., 1962) condemns *both* pre- and post-conventional realities as a lack of adaptation to the conventional reality, implying that the conventional one is the only legitimate one.

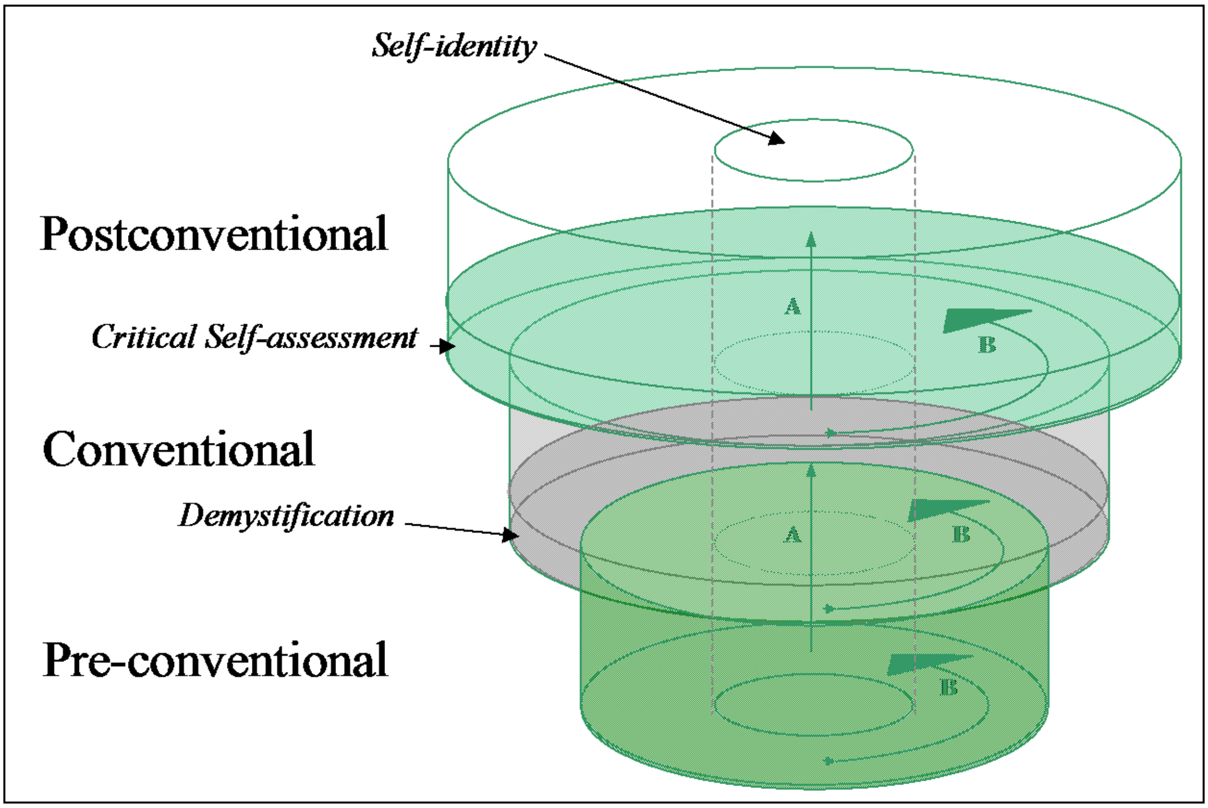

Figure 1: Pre-conventional, conventional, and post-conventional breakthrough

Survival Challenges – manifests in psychological development during transitions from one consciousness level to the next.
Figure 1 presents graphically the relationships between the different consciousness levels and those necessary intermediary steps.

This Figure also illustrates the difference between breakthrough to a different level (A), and additional learning within a specific level (B).

One can assess the nature of a particular psychological state by whether an ontological shift has occurred or not – i.e. through the presence or absence of the corresponding intermediary steps of Demystification and Critical Self-Assessment. Both ontological shifts have in common the use of tools of the new level to challenge the assumptions of the previous one. Demystification uses rationality to question the magical/mythical reality of the pre-conventional level.[9] Similarly, critical self-assessment uses the awareness obtained at the post-conventional level to challenge the monopoly of the rational reality of the conventional level.

Such transitions are often experienced as personal crises, painful re-appraisals of the world and oneself. But they are necessary ingredients in the development process that leads from a biologically and community-determined consciousness (pre-conventional), to an individualistic rational consciousness (conventional), and finally to a transpersonal consciousness (post-conventional).

Figure 1 also shows graphically the continuity of the identity throughout the different consciousness levels, which doesn't exclude changes in the interpretations of the role of the self in the larger worldviews of different levels.

For the purposes of this article, the most important transition to fully understand is the one from the conventional to the post-conventional consciousness levels. We will therefore now pull together synthetically the components of success in such a psychological transition. The starting point is a fully developed individual ego that has learned to use rational thinking, introspection, role-playing, and effective communications to create an integrated value system. This provides the basis on which different sorts of individual experiences and memories can be accumulated. Trans- or post-conventional states can then be assimilated as part of an individual's own biography, and are not confused with primary collective experiences, or with undifferentiated archaic fusion. When the ontological challenge is met – i.e. when one maintains a critical self-assessment operational throughout these experiences - the post-conventional consciousness level is reached.

Differences in Praxis

The second important aspect of the schema with three levels of consciousness is the differences in Praxis, or pragmatic real-life behavior patterns (Kuhn, 1967; Habermas 1972, 1988).

Each level of consciousness involves different worldviews and notions of the Self. So whenever there is a change in consciousness levels, a given inner and outer reality is re-

[9] In a child's development, losing his or her belief in Father Christmas or in St Nicholas is an example of such a demystification.

interpreted differently. For example, at the pre-conventional level the capacity to interpret magical or mythological experiences through the means of scientific laws simply isn't available. In contrast, at the conventional level, scientific interpretations become the dominant ones. But these changes in perception are only half of the story.

It isn't enough to "see reality differently", one must also "act differently" on the basis of that new perception. This is what is meant with the differences in Praxis at the different consciousness levels.

For example, at the pre-conventional level one would ritually worship the sun, while at the conventional level one would measure its astronomical movements with a scientific apparatus to be able to predict its course. But that isn't the end of it. With the change to the post-conventional worldview, one would for instance use solar energy as a way to reduce global ecological stress.
Another example: from primitive agriculture; one can move to chemical-based agro-business; and finally to ecological permaculture. Another illustration that we will elaborate on later: economic systems evolve from using commodity-based currencies; to paper-based fiat currencies; to the simultaneous use of various electronic complementary currency systems.

In each of these cases, a change in perception of reality is a necessary first step, but this move needs to be completed by the second step of a different Praxis. Concrete, real-life changes in upbringing one's children, in political activities, in economic and scientific initiatives, in the way one deals with day-to-day choices, will end up changing fundamentally the relationship between the individual, his or her community, and the environment. The self and the world aren't just interpreted differently; they are also fundamentally changed by what one does.

Notice that when psychological development is successful, the general principles of development identified at the beginning of this article are respected. Specifically:

- Differentiation: each level of consciousness respects the identity of the person involved and builds on it, as shown in Figure 1.
- Integration and transcendence: each level has to survive the acid test of the capacities acquired at the previous levels. In any later stage, both the learning and the Praxis do not exclude those acquired at a previous level, but rather

include and transcend them. The examples of the sun, or of agriculture illustrate this clearly.

- Richer internal hierarchy: here also the later characteristics always include the earlier ones, but as a subset of the new reality instead of being perceived as the whole reality as was the case at the previous level.
- Overcoming Survival Challenge: the necessary presence of ontological shifts - respectively the necessity of a demystification (when shifting to the conventional level) and of a Critical Self-Assessment (when moving to the post-conventional one) - are manifestations of this last criterion.

We will later see that the above principles will also be complied with in evolutionary economics.

To summarize what will be needed for the balance of this article, the following aspects of the psychological development process are important. Each level of consciousness is internally coherent, but each is actually better comprehensible when seen from the next level up.
Each one of the levels of consciousness has its own typical emotional and cognitive characteristics, which in turn lead to specific behavior patterns. The relationships and interactions with nature and community are significantly different at each level, and involve changes in Praxis leading to substantial differences in economic behavior as well. These changes in Praxis reveal the turning point at which the inner reality and the outer one have become coherent at the next level of consciousness.

To understand the issues that contemporary economic theory is dealing with, the transition from a conventional world to a post-conventional one is the most important. Practically everything we know about economic theory has evolved under the conventional modes of thinking. And the challenge is to discover which way this theoretical construct is likely to evolve as the shifts towards post-conventional economic behaviors become more prevalent or significant.

3.3.3. Evolutionary Economic Systems

The psychological development framework just presented above is based on a strong theoretical framework that has evolved over the past century of psychological research. More importantly, a huge volume of clinical and field experience empirically supports it. Therefore, until someone proposes a better one, it should also be a valid psychological framework for economics.

Unfortunately, the psychological hypothesis implied in economic theory has remained frozen for several centuries on an assumption of human behavior synthesized as "Homo Economicus". One typical definition describes him as: "A hypothetical man supposed to be free from altruistic sentiments and motives interfering with a purely selfish pursuit of wealth and its enjoyment."[10] This concept, initially introduced by Adam Smith, actually pre-dates the discovery of the unconscious by Freud by over a century.

In all fairness, at least since Wesley Clair Mitchell, economists are aware of the oversimplifications built into "Economic Man". This same economist also pointed out that "Economics without input from psychology is similar to doing mechanics while ignoring the laws of physics"[11]. But in practice, precious little has become available so far to try to replace this mythical man with another model closer to real human behavior. This is what will be attempted in this section of this paper.

The key question becomes: what are the implications for economic behavior of the psychological development process described earlier?
What will be shown is that economic activities and their institutional framework exhibit themselves an evolutionary pattern, directly related to the level of consciousness of the people involved. This shouldn't come as a surprise, because the value system corresponding to a specific psychological development level affects the nature of all interactions, including therefore economic exchanges. For that reason, if the psychological reference shifts, we should expect both individual and collective changes in economic activity and institutions as well.

We will see that the classical hypothesis of "Economic Man" is not an invalid model, but that it corresponds only to a particular phase in the development of consciousness – the conventional one - and is therefore an appropriate model of economic behavior only for that

[10] Webster New International Dictionary of the English Language.

particular development stage. As humanity evolves psychologically, it would be interesting to try to foresee what this would mean for the evolution of economic behavior and therefore for economic theory itself.

One of the more revelatory signs of different levels of psychological operation of an economy turns out to be changes in its money system. Every society, including our own, invariably considers its own currency system as self-evident. This is remarkable, given the extraordinary variety of things that have been used as currency in different societies.[12] As psychologists would point out, such "obviousness" is invariably a sign of something that hasn't yet been brought up to conscious awareness. Money systems are therefore an ideal area to observe in an unadulterated way the average level of consciousness of a society. We should expect it to be a somewhat lagging variable: individual psychological changes can and do happen one person at the time, but for something to become credible money it needs to be acceptable for a non-negligible part of "ordinary" people in a society. So one needs to have accumulated over time a critical mass of individual consciousness transformations before an institution like money can change. Notice that we do not necessitate a linear mechanical cause and effect relationship between consciousness levels and money systems. What we are dealing with instead is a correlation, a coherence between personal values and perceptions and the values built into the money system.

Money Evolution

Economic textbooks tend to define money in terms of what it does: i.e. its functions as standard of value, medium of exchange, and store of value. Here we are more interested in what money is. For our purposes we can define money as an agreement within a community to use something as a means of payment.(Lietaer, 2001)
So what is the evolutionary pattern of our collective agreements (typically unconscious ones) over money systems over time?

In his massive study entitled "The History of Money from Ancient Times to the Present Day", Glyn Davies remarks that over the past five thousand years there have only been two fundamental innovations in the technology of money. The first was paper money, invented in

[11] Mitchell, Wesley Clair (1925)
[12] Without even mentioning the most recently prevailing forms of money, such as paper, gold, silver or bronze, one can create a full money alphabet with a small selection of objects that served as symbolic of value: amber, beads, cowries, drums, eggs, feathers, gongs, hoes, ivory, jade, kettles, leather, mats, nails, oxen, pigs, quartz, rice, salt, thimbles, umiaks, wampums, yarns and zappozats, which are decorated axes See Glyn, Davies (1994) pg. 27

China during the 9th century and spreading to Western Europe during the early Industrial Revolution. Notice that this technological change had one key institutional consequence: the transfer of the power of creation of money from sovereigns like kings and emperors to the banking system.

We are now in the middle of the second fundamental innovation: electronic money. Already today, over 95% of the money existing in the world resides in the form of bits and bytes in computers at banks and brokers. And interestingly - although rarely noticed - this technological change again seems to be accompanied by a shift of the power of creation of money, this time from the banking system to new actors in the community. As Konrad Alt, from the US Treasury Department, stated: “We are witnessing nothing less than the birth of a new industry –the development, issuance and management of private currencies”. Evidence about these private currencies will be provided later.

But what is most interesting to observe here are that the shifts from the pre-conventional to the conventional, and then to the post-conventional levels of monetary evolution, happen to be articulated around these two key technological money changes. Because in psychological development, historically not all people switch levels at the same time, we should also find transition monetary models that actually partially belong to different levels. The money changes that historically accompanied the three levels of consciousness will be described next.

Pre-conventional: Commodity-based Money Systems

The history of pre-conventional money is a very long one, spanning many Millennia. The one common characteristic among all pre-conventional currency systems is that some valuable material object is being used as means of payment.

The oldest technique for exchanges is **Barter**, the exchange of goods or services without any form of currency. Barter requires as a prerequisite that the parties have “matching needs and resources”. This is a strong constraint to the fluidity of exchanges, and according to Aristotle (384-322 BC) the reason money was invented in the first place.

The second typical step were **Commodity Currencies**, the use as means of payment and/or as standard of value of a product or commodity that has also a well-established utilitarian value. Many so-called “primitive” currencies are of that type, including cattle, rice, eggs, or salt (Einzig, 1948).

The next step is the establishment of an authority in the system - typically the sovereign of the area involved - that standardizes and guarantees the purity, weight and other qualities of the particular commodity used as currency. Coinage followed fairly quickly when that stage was reached. Herodotus credits the Lydians with this particular invention in the 7th century BC, and from then on it has spread like wildfire all over the Ancient World. Precious metal coinage remained the main form of currency used for between one and two thousand years depending on the area, until our first key technological revolution: paper money.

Conventional: Paper-based Money Systems

The first paper currency was issued in China during the reign of Hien Tsung (806-821 AD) as a temporary substitute for the traditional bronze coins.[13] The first time the West heard about paper currency - with total disbelief - was through Marco Polo who was in China from 1275 to 1292. But we have to wait until the beginning of the Industrial Revolution for paper currency to be used among ordinary people in the Western world.[14]

The Gold Standard was the transition mechanism between the commodity-based currencies and the paper currencies. As Nobel laureate Robert Mundell most succinctly described this money system: “Currencies were just names for particular weights of gold.”[15] During that time, the paper money issued was supposed to be 100% backed by gold coinage or bullion. In fact, this wasn’t true most of the time, but the idea of a gold backing was still deemed an important fig leaf.[16] This fig leaf was officially dropped only in 1972, when President Nixon unilaterally eliminated convertibility of the dollar into gold even for Central Banks, putting thereby an end to the Bretton Woods Agreement of 1945.

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[13] Davies, Glyn (1994) pg 180

[14] Merchants in Italy invented private paper receipts for specific quantities of metallic coins called “bills of exchange” during the 13th century, and their use among professionals spread to the rest of Europe particularly through the Hanseatic League during the 15th-16th century. There was even a trade fair in Medina del Campo in Spain where trading of bills of exchange was the only activity. See Bouyer-Xambeu, Marie Therese; et al. (1984). Paper currency to be used among ordinary people was first attempted (and failed) in Sweden only in the 17th century. Two generations later, the notes of the Bank of England became the first , successful paper currency widely used by common citizens in Europe. See Kindleberger, Charles A (1993).

[15] Wall Street Journal Op-Ed page, December 10, 1999

[16] For example, the Bank of England ratio of gold reserves to note issuance ranged from 70% in 1794, to less than 50% in the early 19th century, to less than 10% by 1913. See Cannan, Edwin (1969) pg. xliv; and Gallarotti Giullio (1995) pg 167.

In reality, paper money was almost always what is technically called a "fiat" currency,[17] i.e. a currency created out of nothing, for which an authority simply declares that something that intrinsically has no value (i.e. a small piece of paper) has a particular value.
This "technological" shift, as noted already, also facilitated a gradual shift of the power of creating money from the sovereigns of the pre-conventional era to the banking system of the conventional era.
A legally enforced monopoly of this kind of money as "Legal Tender" further strengthened this banking privilege. Legal tender means that if someone owes a debt and offers to pay with this currency; if the currency is refused the debt can be legally declared void. One important debt covered in this respect is tax payments.
And as far as conventional economic theory goes, the implicit hypothesis remains that those "national" currencies are the only currencies in existence.

However, as Richard Timberlane put it: "Money to be money […] does not have to be legal tender. It can be what one might call 'common tender', i.e. commonly accepted in payment of debt without coercion through legal means." [18]
We will see next that in reality this is now happening in an increasing way.

Post-conventional: Electronic Money Systems

As we are starting to see the beginning of an evolutionary pattern towards post-conventional psychology, can we also detect some of the early signs of a post-conventional monetary system? As this is about the future, this exploration has to remain tentative and will undoubtedly be more controversial than what has been said about a well-known past.

There is no debate that the bulk of our money today is electronic. Only an estimated 5% of all money in circulation is still in paper form. There is even a country that has officially declared that all its money will soon be exclusively in electronic form: the Singapore government intends to go 100% electronic by 2008.

[17] *"Fiat Lux"* were the first Words that God pronounced, according to Genesis: " Let light be." The next sentence is, "And light was, and He saw it was good." We are dealing with the truly Godlike function of creating something out of nothing *("ex nihilo")* by the power of the Word.
[18] Timberlake, Richard H. 1987 pg 437-447.

What is less widely perceived is that – just like was the case when paper money was introduced – the power of money creation is again shifting. In reality, the monopoly of bank money has already died without much fanfare over the past couple of decades.

Given that those new types of currencies are less familiar, a few specific examples will need to be provided next.

We will address three topics in this section:

- The emergence of private commercial currencies;
- Of social purpose currencies;
- And the motivations behind the appearance of these non-conventional currencies.

Private Commercial Currencies

There are two major types of private commercial currencies in operation today: loyalty currencies (the best known of which are airline miles), and the so-called "barter currencies".

The Emergence of post-conventional Currencies

Twenty years ago, airline loyalty currencies were only a marketing gimmick issued by each airline individually. But today, there are 5 major alliances issuing annually over 1.5 Trillion passenger miles, a multiple of all conventional national currencies issued per year. More significant: 2/3 of all British Airline Miles, for example, are now cashed in for something else than purchasing air travel. The first non-airline uses included paying for rental cars, hotels, and telephone services. But now even Sainsbury, the largest supermarket chain in the UK, is accepting British Airways Miles as payment in their shops.

Phone companies, book-chains, supermarkets have similarly started issuing their own loyalty currencies. Just like what happened in airline companies, initially each of those currencies has only a narrow use, but alliances among different issuers gradually broaden the acceptability of such currencies.

The second type of commercial currency is barter credits. Barter - the exchange of goods or services without the use of any currency - has been around since the dawn of mankind. Until the 1980s, barter used to be considered a shady business mostly associated with tax evasion and illegality. International barter, "countertrade" in technical parlance, was used as a last

resource with countries without convertible currencies, such as the old Comecon or some Less Developed Countries.
All this started to change when in 1982 the US Congress formally legalized barter and introduced specific IRS tax-reporting requirements. The barter industry has now over 600 professional barter companies, regrouped in two official trade organizations (the International Reciprocal Trade Association (IRTA, website www.irta.com) and the National Association of Trade Exchanges (NATE; www.nate.org.) BarterNews, the leading industry publication (with a circulation of 30,000; see www.barternews), estimates that broker-facilitated barter deals in North America now amount to approximately US$ 10 Billion per year, and are growing at 15% per year, three times faster than normal currency facilitated transactions.

Far from being a "primitive" form of pre-money trade - as Aristotle was the first to label it – part of their growth today may be a sign of maturing of an information society. Corporations in major industries such as media, travel and hotels are now handling up to half of their transactions without exchanging conventional national currency. Notice, however, that in many of those deals, the word "barter" is in fact a misnomer, as these systems use in fact a "barter currency" useable among the members of each barter group. There are also now attempts at improving liquidity by creating a "universal currency" and facilitating some clearing among different groups.
More noteworthy still is countertrade, or international corporate barter. Fortune reports that two out of three of the major global corporations perform now such transactions routinely, and have specialized departments focusing on such deals. The US Department of Commerce, the World Trade Organization (WTO), and The Economist (UK), all estimate countertrade to be common among 200 countries around the world, with a staggering volume now ranging between $800 Billion and $1.2 Trillion per year. This represents between 10 and 15% of all international trade!

The driving forces behind this unexpected phenomenon of a barter resurgence vary widely. Some barter deals still are being done simply because the countries involved don't have access to hard currency financing: a typical example is the PepsiCola deal in Russia with payments in Stolichnaya vodka. But this argument cannot explain why there is such a growth of barter even within the same country: for instance, why United Airlines would barter airline seats for TV advertising spots with CNN in Atlanta.…

In fact, shocking as it may be to some people, it turns out to be more cost effective to use one's own inventories as working capital instead of having to borrow dollars with interest to perform such exchanges. Furthermore, the old argument that multilateral barter is too complex to arrange so that each party ends up having exactly what is wanted – another line of reasoning dating back to Aristotle - is now also being turned on its head. Cheap computing and sophisticated relational databases now enable such matches to be made automatically, at a very low cost.[19]

In any case, as was noted by Konrad Alt at the US Treasury quoted earlier, the time may have come to acknowledge that something different and non-negligible has started happening in the monetary domain. These non-conventional currencies are obviously facilitating transactions that otherwise might not happen, and they have grown to the point where they can't be dismissed as insignificant.
For instance, one could acknowledge their existence by updating our definitions of quantities of money.[20]

One should notice that none of these new commercial private currencies, whether loyalty or barter currencies would have appeared had it not been for universally available and cheap information technologies. They are therefore part of the shift of the power of creating money relating to the appearance of electronic money; similar to what happened with the shift from sovereigns to the banking system when paper money became important.
The same applies for the social purpose complementary currencies that will be described next.

[19] See also literature describing the role of barter in modern economies, such as: Amann, Erwin & Marin, Dalia "Risk-sharing in international trade: an analysis of countertrade" The Journal of Industrial Economics Volume XLII (March 1994) pg. 63-77; Williamson, Stev & Wright, Randall "Barter and Monetary Exchange under Private Information" The American Economic Review March 1994 pgs 104-123; Taurand, Francis "Le troc en Economie Monetaire" L'Actualite Economique, Revue d'analyse economique Vol 52 numero 2, Juin 1986.

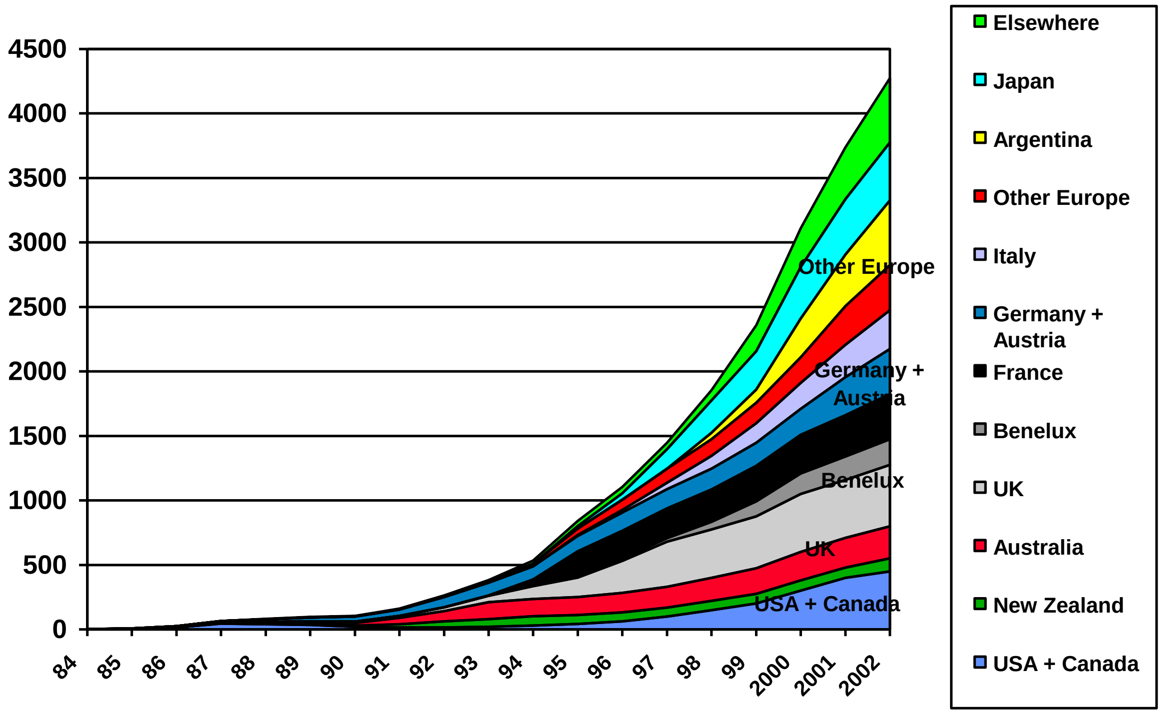
[20] Neo-classical economics usually defines three different types of quantities of money:
M1 = Money issued by Central Banks, also called "High Powered Money"
M2 = M1 + checking accounts and short-term deposits (up to 1 year)
M3 = M2 + savings accounts and longer-term deposits.
We could define M4 = M3 + complementary currencies as defined in this text.

Social Purpose Complementary Currencies

Social Purpose Complementary Currencies are those aiming at resolving a variety of social problems, such as elderly care currencies, unemployment currencies or environmental currencies. Currencies are called complementary when they do not aim at replacing conventional national currency, but are designed to function in parallel with – or as complement to - conventional currencies.

The following graph (Figure 3) shows the evolution of the number of social purpose complementary currency systems operational in a dozen different countries. In 1984, there was only one such system. By 1990, one could find about one hundred around the world. Today, there are over 4000!

Figure 3: Number of Social Purpose Complementary Currency Systems Operational in a dozen countries (1984-2001) (Source: The Future of Money).



Notice that this is not the first time in history that such "local" currencies have appeared.[21] The last time was in the 1930's as "emergency currencies" in the middle of the Depression. What is different about such local currencies today is that they have appeared without being triggered by a major economic collapse, a war or a civil war. Another key difference: the current systems are designed not as short-term emergency measures, but as systematic tools to solve some specific social problems. Finally, the vast majority of them today are electronic currency innovations. Just like the commercial loyalty currencies, they wouldn't be thinkable without low cost computing being available to everybody.

There are a wide variety of social purposes pursued by various local complementary currency systems. They vary from elderly care to local unemployment; from the restoration of community in well-off neighborhoods near Washington DC to getting kids off drugs and crime in ghettos in Chicago; they operate in a megapolis like Mexico City and in fishing villages in Canada; they use low-tech paper based systems in Berkeley, CA, to high tech smart card applications in Asia; they were designed for small groups of 50 people in Australia, a city of 2.3 million people in Brazil or prefectures of 10 Million in Japan.

While local activists on a shoestring budget have started most of these systems, governments actively support others:

- The city planning office of Curitiba, the capital city of Paraná in Southern Brazil, has launched and managed for over 25 years a community currency that is providing now up to one third of all income of its citizens, and has been a key for its remarkable development as the "most ecological city in the world" by UN standards;
- In Australia and New Zealand local authorities are funding local currency start ups;
- In the US, the IRS has declared one such system (Time Dollars) officially tax-free; and 31 States now pay State employees to start up Time Dollar systems;
- In Japan, the Head of the Services Department of the Ministry of International Trade and Industry (MITI) has started 40 different experimental "eco-money projects", in order to choose the models that would be most appropriate for general application in the country;

[21] For instance, in the US there have been a number of historical periods where local currencies sprung up. They became popular during the Panic of 1837, the Civil War years, and the Panics of 1873, 1893 and particularly of 1907 and the Great Depression of the 1930s. During the Depression, more than 5000 local currency systems operated in the US. For a detailed catalog of this last period, see Mitchell, Ralph A. And Shafer, Neil (1984)

- During the Summer of 2001 in the UK, the Blair government financed a 500,000 Pound start up for a Time Bank in London.

Detailed descriptions of those various systems, their specific uses, and their respective qualities and problems are available elsewhere.[22] What matters here is what they have in common:

- 95% of these systems are computer driven;
- They have already proven that they can solve real-life social problems without burdening taxpayers or governmental budgets;
- The vast majority are small-scale affairs that are purposely kept on a local scale. But the only mature system today (the WIR in Switzerland) has now 80,000 members including one quarter of all small and medium size businesses in the country, and enjoys an annual turnover equivalent to US$2 Billion.

There is one generic question that should be addressed if one is to fully understand the societal implications of this phenomenon. Why would people bother with creating and using a currency other than the familiar national money?

According to one implicit economic assumption dating back to Adam Smith, money is supposed to be value neutral. It is indeed seen as a passive instrument that doesn't affect the nature of the exchanges or the relationships between its users. This is why the predictable reaction to the above phenomenon by someone trained in economics is to dismiss it as a tax-dodging scheme.

However, in this case, this explanation clearly doesn't hold. As any drug dealer or tax evader can explain: "the best way to avoid taxes is to get paid in cash, and specifically in national currency bills. The most ineffective way would be to be part of a system where every transaction is recorded on some computer somewhere…"

Is Money Value Natural? As more than 95% of the 4000 systems currently operational in the world are computerized systems, there has to be another reason that explains this strange phenomenon. What could that be?

In fact, what both empirical fieldwork and theoretical research have proven is that Adam Smith's assumption that money is value neutral simply isn't valid. Instead, what has shown up again and again is that the use of different kinds of currency does significantly affect both the

[22] See Lietaer, Bernard (2001) Part Two

behavior and relationships of the people using it. And the users of complementary currencies actually state that this is indeed one of the main reasons why they are bothering with the use of different currencies in the first place.[23]

Rather than argue from theory[24], two concrete examples will show that the use of different money types can encourage different behavior patterns. Among the many possible choices, the Japanese Hureai Kippu currency, an elderly care system of which more than 300 examples are currently operational in Japan will be used as illustration of how a currency isn't "socially neutral". A second example demonstrates the non-neutrality of money systems in the choice of time horizons for investments.

One Illustration: Japanese Hureai Kippu

The Japanese population is the second fastest aging one of the entire world. There are already 800,000 retired people needing daily help and another 1 million handicapped people, and the Japanese Ministry of Health forecasts a vast increase in these numbers over the foreseeable future. In order to face this rapidly rising problem, Tsutomo Hotta, a highly-respected retired Supreme Court Judge, started in 1995 a new type of health-care currency, that he called Hureai Kippu (literally "caring relationship ticket"). [25] It is designed to complement the normal national health care plan: any help not covered by health insurance can be obtained through this means. Each contributing volunteer has a Time Account, managed exactly as a savings account, except that the unit of account is hours of service instead of Yen. Different values apply to different kinds of tasks. For instance, a meal served between 9 a.m. and 5 p.m. has a lower credit value than those served outside that time slot; household chores and shopping have a lower credit value than personal body care. These Hureai Kippu Credits are guaranteed to be available to the volunteers themselves, or to someone else of their choice, within or outside of the family, whenever they may need similar help. Two national electronic clearing houses have sprung to enable people to send their credits, for example to their parents, even when they live in other parts of the country.

Most significantly for our purpose, a survey among the elderly themselves reveals that they prefer the services provided by people paid in Hureai Kippu over those paid in Yen, because the relationships turn out to be of a different quality than those established with Yen-paid

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[23] In a German survey of all members of six different Local Exchange Trading Systems (LETS), a majority (57.3%) state a different social contact as their main reason to participate in this exchange system. See Meier, Daniela (2000) pg 6.

[24] For theoretical considerations, see Ibid. chapter 6 and 9.

25 Information collected by personal interviews with Hotta-san in Tokyo. See also: A l'ecoute du Japon (Brussels: Information bulletin of the Japanese Mission to the European Union) July 3, 1995 pg. 7-8.

social service workers. In addition, it enables them to stay in their own familiar homes even when they can't take care of themselves anymore, rather than being sent to seniority retirement places, where the costs to the taxpayer skyrockets as well. So it is a win/win all around: for the quality of life of the elderly, for inter-generational relations, and even for the taxpayer. Started in 1995 with a few local systems, this approach has grown to over 300 time credit systems by 1998.

Interestingly, as of mid 2001 the Chinese government has started implementing a similar system in China, because they also try to reduce the number of people needing to be moved into seniority homes as their own populations now starts aging rapidly.

Just to prove that this difference in relationships when two different types of currencies are used isn't a peculiar "oriental" phenomenon, one could mention a completely independent experiment known as Elderplan, also on-going since 1995, but in Brooklyn, NY. Here the unit of account is called Time Dollars, the brainchild of Edgar Cahn, a well-known lawyer and professor in Washington DC. Here again, the users report that they enjoy the better **quality in human relations made possible by this approach. Since the year 2000, the Elderplan system has started spreading beyond Brooklyn to Queens, Staten Island and Manhattan.**

Finally, statistical data is becoming available about the social non-neutrality of different money systems. For example, using legal tender for services rendered among friends and neighbors tends to be taboo, taboos that don't apply to the use of other types of currency.[26] Similarly, a survey performed among members of six Local Exchange Trading Systems (LETS) in Germany, found strong statistical support for the hypothesis that the use of local money significantly differs from that of legal tender.[27]

Interest and Time Perception

It is generally assumed that there is no relationship between the short-term thinking typical of our civilization and the kind of money we are using. This section will show why this isn't the case. Specifically, the point is that whether one uses an interest bearing currency or not, dramatically affects the kind of investments that will be made in a society.

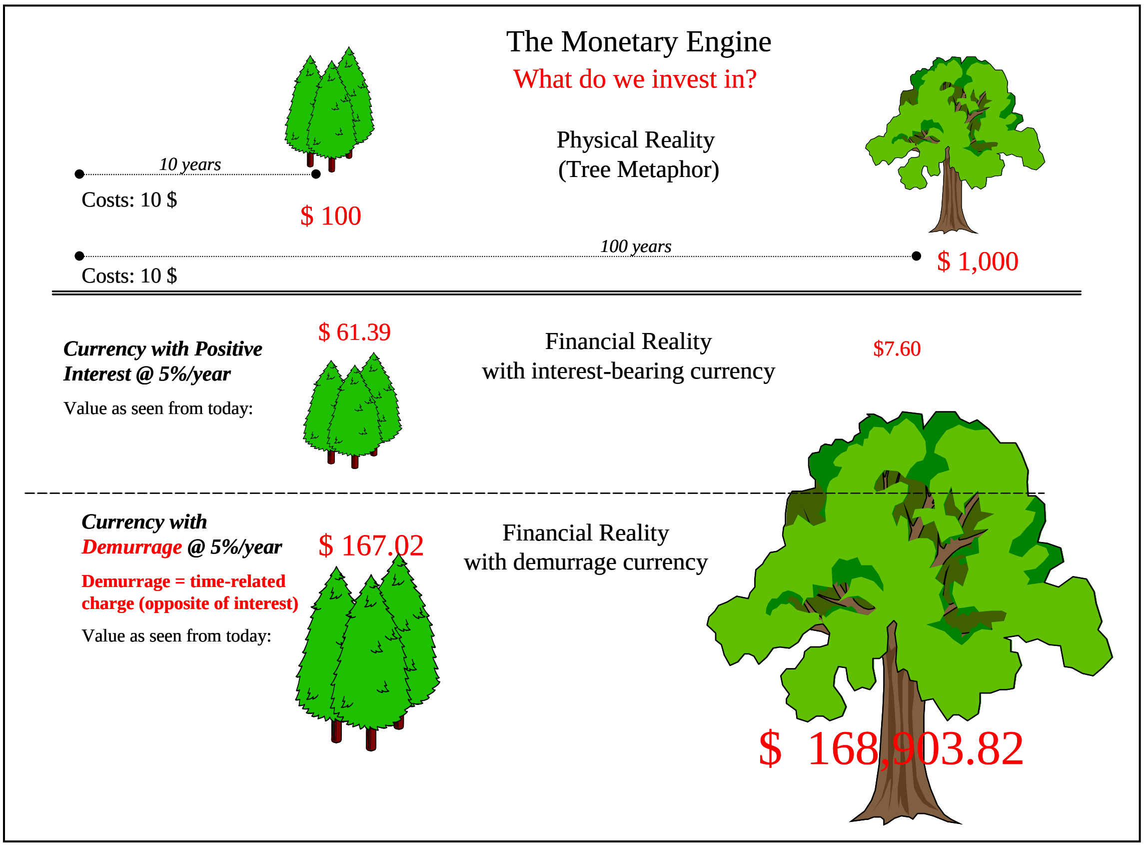
[26] Belk.& Wallendorf. (1990) Furham & Argyle (1998); Lea et al (1987). Webley et al. (1983); Luo (1999).

[27] It is interesting that this 1998 survey covered both East and West German LETS systems, with the same results. More than 50% of the respondents state that they appreciate the opportunity offered by the local currency to get help from friends without having to ask for a favor. Furthermore, nearly two-thirds of the respondents stated that they use the local currency for buying goods or services for which they wouldn't have paid legal tender. This proves that complementary currencies also facilitate transactions that –without it – simply wouldn't occur. See Meier, Daniela (2000).

To illustrate this point, we will use a simple metaphor. Let us suppose that we have to choose between 2 simple investments: planting a pine tree or an oak tree. The costs of planting either one are assumed the same at US$10 per tree.

The top part of the graph (Figure 6) shows that after growing 10 years the pine ready for harvesting is worth US$100; while the oak takes 100 years and is then worth US$1,000

Figure 6 : Tree investment metaphor in physical reality, and in two different monetary systems



Let us further assume that all the numbers used in these examples are in constant dollars.

The middle part of the Figure illustrates the situation when we live in a world with a positive interest rate currency.[28] If one looks at the financial world through a positive interest rate

[28]This metaphor has been somewhat simplified for didactic purposes. The applicable discount rate is not only interest but the "cost of capital of the project" which includes three components:

- the interest rate of the currency involved;
- the cost of the equity financing of the project;
- and an adjustment reflecting the uncertainty about the cash flow of the project itself.

currency (in our example, at the rate of 5%/year), one sees why one will always invest in pines and not oaks. The pine value discounted to today is valued at $61.71, but the oak's value seen from today melts down to an insignificant $7.60. It makes therefore a lot of financial sense to cut down oaks and plant pines, something we are doing metaphorically (and sometimes literally) on a worldwide scale today.

Finally, the bottom part illustrates what happens when a currency with demurrage is in operation. Demurrage is a time-related charge on hoarding money i.e. the reverse of interest. This may sound like a very strange idea to us today, but entire civilizations used to consider it quite normal for many centuries (including the Egyptians for a couple of thousand years; and the Western Europeans for three hundred years, during the "Age of Cathedrals" from the 10th to the 13th century.)[29] Just to put to rest an immediate objection in the minds of today's readers: people would still save and invest in those societies, but they wouldn't save in the form of this kind of money, but rather in the form of productive assets. Such currencies were used exclusively as a medium of exchange, and not as a store of value…

Now what happens to our little tree metaphor in those societies?

With a demurrage-charged currency (also @ 5%/year), oaks become the obvious winners as an oak tree as seen from today would be worth a whopping US$ 168,903 !

That this is not just theory is demonstrated by the fact that societies using such currencies would invest with time horizons that look outlandish to us today. For example, their buildings were designed to last forever: we can still visit their temples and cathedrals today…In contrast, how many of our own creations will be standing in 800 years?[30]

The purpose of this metaphor was to show that, contrary to the generally prevailing hypothesis, the type of money system operational in a society can significantly affect investment patterns and priorities in time perceptions.

It is also interesting that none of the 4000 social purpose complementary currency systems that have spontaneously manifested over the past 15 years have interest built in, while all our conventional national currencies invariably do.

The third component is completely project-related and therefore unaffected by the currency used. It would remain identical whatever the monetary system. For relatively safe investments like trees, this project risk is also very low. The first two, in contrast, are directly affected by the monetary system of the currency involved. And interest has typically the larger influence of these two, which is the reason we focus on it here.

[29] See detailed case studies in Lietaer, Bernard: (2000)

[30] We do not claim that *all* things should be built to last forever: Schumpeter has convincingly described the advantages of "creative destructive" processes. But we do claim that not all things should be done for short-term benefit either.

The relevance of both examples above – the Japanese Hureai Kippu system and the tree investment metaphor - is that monetary experiments may have a deeper

Pre-conventional, Conventional and Post-conventional Economic Systems

relevance for our societies than is sometimes perceived. If it is true that money is not value neutral, that different behavior patterns can be generated - spontaneously, without regulation or coercion, when different types of money system are made available - then monetary experimentation may become a key social engineering or evolution-promoting tool in a post-conventional world.

For example, complementary money systems have been started in over a dozen different countries that aim at promoting objectives such as long-term sustainability in social, political and ecological terms.[31] Humanity faces today a series of challenges the likes of which we haven't seen in historical times. Should we continue to assume that a Knowledge society will not be able or willing to use the remarkable motivation power of money to try to solve some of them?

Now that we have identified the characteristics of the key money variable at the three development levels discussed previously – in pre-conventional, conventional, and post conventional realities – we can build on it to identify the evolution of the corresponding economic systems themselves.

Table 3 presents a synthetic overview of what the three levels discussed previously would mean for the economic framework of society.

[31] See Lietaer, Bernard (2002).

Table 3: Some Characteristics of Pre- conventional, conventional and post-conventional Economic Systems

Evolutionary Stage	Economic System	Currency System	Organizing Framework	Time Perception	Human type
Pre-conventional	Primitive barter, Agrarian societies	Commodity-based No currency Commodity Currencies	Religions – Mythologies Local/Regional traditions	Cyclical Here/Now priorities	Homo Ritualis
Conventional	Industrial Age Competitive Markets	Paper-based "Gold Standard" Bretton-Woods Treaty	National: Legal systems International: Treaty systems	Linear Short-term priorities	Homo Economicus
Post-conventional	Post-industrial, Knowledge society.	Electronic Complementary Currency Systems	Global/Local Complementary Systems Multiple organizing frameworks Conscious choice in transactional effects	Simultaneous Multiple Time perceptions Conscious choice in time priorities	Homo Universalis

First of all, we should realize that all three levels of economic systems are being practiced now simultaneously, somewhere in the world.

For example, anthropologists and ethnologists describe many agricultural and some hunter-gatherer cultures that operate still today at the pre-conventional stage, and are exchanging as "primitive barter", without any currency as a medium of exchange. By now, many of these "primitive" societies have evolved to using various types of commodity currencies as well (e.g. salt, cattle). Religious and mythological references justify the local and regional traditions that govern such exchanges. In those societies cyclical time perception is dominant, marked by seasonal events and periodic festivals around which markets are organized. Economic exchanges are a subpart of ritual processes, and have evolved over time to ensure that they also provide the key necessities that makes sense for each party's survival and well being. We will label as homo ritualis the human that is operating completely at this level of reality.

Because we have the majority of humanity today operating at the conventional level of psychological development, we should also expect that the majority of the economic exchanges operate at that level. This is the world of the Industrial Age where competitive markets operate in which monopolies of national currencies were created by law or by international treaty. The predominant time perception is Aristotelian: linear, granular time going from an infinite past towards an infinite future, with in economic terms a particular emphasis on the short-term. All the characteristics of the conventional value system and psychological framework apply to homo economicus. He fits perfectly the conventional consciousness descriptions of Table 2: a totally rational, competitive, individualistic being, "unencumbered" by any post-conventional concerns like altruism, solidarity, or sustainability. It is also the level on which conventional economic theory has been built.

Finally, there are some early signs of a post-conventional reality taking shape. It should be emphasized that these new processes are still embryonic at this point. It is now widely acknowledged that "advanced economies" are being transformed into post-conventional, Knowledge-based economies. But, the monetary system, being a lagging variable, is still almost exclusively conventional. Observing from the conventional level the budding signs of the new post-conventional monetary changes, one may be tempted to dismiss them as below contempt. We could describe the whole field of complementary currencies today roughly at

the stage where aeronautics was when the Wright brothers took off with their first plane. The miracle is that their contraption flew at all. But their real achievement was that they did prove that flying was possible.
When an innovation of this type appears, it is most likely to be muddled, incomplete, confusing and insignificant in scale. After all, during the transition from the pre-conventional level to the conventional one, many people didn't consider the first paper currencies in Europe very convincing or significant either…[32]

To return to the post-conventional psychological characteristics described in Table 2, we find as dominant emotions reciprocal tolerance and recognition, solidarity and long-term sustainability. Values such as universality while respecting cultural diversity, the capacity to empathize with others, and universal fairness are becoming relevant on the agenda. This is a world where the old polarities between the individual and the collective, and today's hot debate between the local and the global, have been integrated and transcended.
As shown in Table 3, complementary currencies would support such a value system, and would help in creating an economic balance between the local and global priorities. People in such a society would have become aware of the non-neutrality of money choices, and the corresponding Praxis is to choose as currency for their transactions the ones that support the objectives or the type of relationships that they want to promote in that particular transaction. For instance, when dealing with long-distance or commercial relationships, they would continue to use the conventional currencies of today. But when exchanges involve their neighbors, or have as purpose to promote better care for the elderly or a wider variety of life experiences for their children, it would make sense to use complementary currencies of another type than the scarce national currencies.

Pre- and post-conventional Fallacy in Evolutionary Economics

Just as is the case in psychology, there is a risk in confusing characteristics of post-conventional economic levels with some aspects of the pre-conventional. And just as in psychology, one needs to look beyond the superficial similarities before one can decide in each case with what one is dealing.
For example, conventional economists may dismiss today's barter currencies as a regression into "primitive pre-money exchanges". And yes, there are cases of barter that are pre-

[32] The Swedish inventor of bank-issued paper money in Europe ended up condemned to death, and saved his life only through the intervention of the king's mercy.

conventional economic regressions: barter appears spontaneously when a national currency collapses, as was the case in the late 1990s with the Russian Rubble or at least in part in Argentina in the first years of the 21st century. But there are also sophisticated information-age corporate barter exchanges that are genuinely post-conventional. They are performed because they are actually more cost-effective than normal dollar denominated transactions.

In short, exactly as in the case of psychological developments, regressions towards a pre-conventional level and advances towards post-conventional level can both be observed in the field. And one needs to analyze case by case beyond superficial similarities to find out what is really happening.

Evolutionary Economics as a Development Process

How well does the evolution in money and economic systems map the psychological development process of the previous chapter?

At the pre-conventional level, when the capacity to distinguish between idea and object isn't universally developed (see Table 2), it makes sense that only physical, valuable objects would be used as medium of exchange. Once the abilities for abstraction are fully developed, it becomes possible to gradually substitute a scarce commodity first with a paper receipt supposedly pointing to where the metal is kept (i.e. the "gold standard"), and finally with a pure fiat currency without any material backing.

In the post-conventional worldview, the concept of complementarity is part of the core consciousness, and therefore complementary currencies are a natural fit. In this context, the conventional national currencies just become one of the available options for settling payments. As the awareness that money isn't value neutral spreads, the Praxis to choose a currency most appropriate to the purposes of the exchange should also follow.

At the start of this article, four criteria were identified as necessary conditions for a genuine development process to happen: differentiation, integration and transcendence, hierarchical development, and overcoming survival challenges. These four principles are respected in both:

- the evolutionary money sequence,

- and in the development from Homo Ritualis to Homo Economicus to Homo Universalis.

3.3.4. Implications for the Future of Society and Economical Theory

If this evolutionary schema continues to prove itself valid, it could mean a positive, optimistic future for both human society and for economic theory.

Humanity is a young species, and it is actually not the first time that it undergoes a major consciousness mutation. The shift from the pre-conventional to the conventional consciousness level facilitated the transition from an Agrarian to an Industrial Age. Although such a transition was obviously not painless – just think of the fate of the small farmers or the loss of power of the landed aristocracy – it did lead to a richer, more complex, more interesting world. We are struggling now with the cumulative negative consequences and the limitations of that Industrial Age, but this shouldn't blind us to the fact that an improvement in living standards and of life expectancies did occur for the so-called "developed" countries. On the basis of this precedent, we can expect that a post-conventional worldview will continue to evolve and grow in acceptance until it ends up becoming a new common-sense. In light of such an evolution, we can perhaps hope that the vaunted Knowledge Society of the future may disprove some of the apocalyptic views of today's ecological and social literature.

Similarly, the reputation of economics as "the dismal science" may also be a temporary phenomenon. This name may become inappropriate if economic theory moves from the conventional world of homo economicus to a broader post-conventional worldview. But this may take some time. It took almost a century to progress from the economic theories based on agrarian metaphors of the French Physiocrats to Adam Smith's industrial age economics. Things move faster now, but we are still waiting for an Adam Smith for the Knowledge Age…It can be anticipated, however, that one of the ingredients in that post-conventional economic theory will be a psychological model that takes account of the characteristics of the post-conventional human.

The signs of tensions between conventional and post-conventional economic thinking manifest today as an ideological battle that lines up on the one side proponents of neo-classical, abstract mathematical modeling of economic reality; and on the other economic "young Turks" who are attacking this approach. The critiques leveled by each group against the other are revelatory of the underlying issues at hand. Conventional economists criticize the new group as lacking "scientific rigor" and not understanding "the specificities of the field of economics"; while the latter condemns the former as teaching an "autistic dogma", locked into "circular logic" arguments, and lacking "social relevance". Just return to the value systems mapped in Table 2, and the arguments on both sides become quite predictable.

If this debate is part of a development process in economic theory, then we can forecast that the ultimate outcome will be an integration and transcendence of these two positions. This may be the one of the most interesting challenges that economists and economic theory will have to deal with in the foreseeable future.

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