

It's my privilege to be invited here at the highly prestigious LSE. Many thanks to all of you for giving me the opportunity to talk about the most challenging issues which are determining our current political and economic situation and our prospect in Central East Europe and particularly in Hungary.

I would not like to make a political speech, but much more to give you a brief overview of my understanding and my analysis on where we are in our region. But because I am a politician, neither me, nor you must be satisfied with just an assessment. Therefore, I also would like to share with you my program of changing Hungary.

Let us start with a short quotation from Ralf Dahrendorf: "the issue in most countries remains the same: how to provide a sustainable basis for economic growth in the harsh climate of the global marketplace while at the same time maintaining solidarity and a sense of fairness throughout society. Whoever governs must try to square this circle."

Squaring the circle is impossible, at least in terms of mathematics. However, in terms of politics and societal life we not only can but we also have to do it. And we have some evidence that it is possible if we remind ourselves of the example of countries like Denmark, Finland and in many aspects Great Britain. If we look at these success stories, we find that high economic and social performance is based on the

wide social acceptance that the market and social approaches, the individual and public responsibilities, national pride and the open society are not conflicting but complementary. In case of the most successful countries the horizon of social thinking and practice has changed from short term challenges to long term adaptation; from direct state protection to preparing the people for obtaining a competitive social attitude, culture and knowledge; and from short term growth to sustainable growth with high environmental consciousness.

If we would like to describe these national success stories, we generally use the following terms and expressions:

Consciousness, long term vision, trust and cooperation, partnership, investment, openness, private initiatives, responsibility. These qualities are the features of mature, democratic, self-confident societies.

Where are we with these features? Not ignoring the very important differences between the countries of our region like Poland, the Czech Republic, Slovakia and Hungary, we may see one very similar characteristic in the history of these countries. This is the lack of a long democratic tradition, national sovereignty and uninterrupted social progress. In our region there is even a country the state independence of which is not more than fifteen years old. Some other countries are very proud of their centuries or thousand years old history, but these countries lost their independence and were ruled by

foreign powers, and used to be parts of foreign empires for centuries. Until the very deep political and economic transformation in the late eighties and early nineties, which is called the “change of regimes”, the peoples of these countries did not consider their respective states to be their own. Hurting and breaching the rules was seen as a patriotic act, the most important personal obligation was to survive and not to plan for long term future. If you are subordinated, if you do not have rights, your responsibilities are also limited. These nations’ history is characterized by failed revolutions and top-down reforms. Never in our history, except for the last seventeen years, have we experienced the feeling that the state is ours.

But the situation has changed, we got back our countries. It’s hard to understand that the rule of the democratic state is our rule. Keeping this rule is in our interest. We are not alone but we are creating a democratic community in which rights and responsibilities go hand in hand. Understanding and accepting the democratic duties and responsibilities, the consequences of independence and democratic, social and political life, the terms and conditions of the social market economy – this is the most challenging task of these new democracies. We have changed our constitutions, and we have built up new democratic institutions in a couple of years. We have transformed our state-owned, state-planned economy into a market economy in just five to ten years.

But changing the mindset, the attitude of the people requires much longer time than we had ever expected. Let me share some evidence with you based on scientific research: The American Economic Review recently published a relevant study about the differences between the two halves of Germany. Their results are devastating. Having lived under communism makes people favor state redistribution to a significantly higher extent than their West German peers. This effect gradually fades away – the change is already measurable – but it's a very-very slow process. The authors extrapolate that it should take another 20 to 40 years for the average attitudes of East and West Germans to converge. We do not have any cause to question that this phenomenon is not unique to Germany.

Let me quote Sir Karl Popper here: "Institutions alone are never sufficient if not tempered by traditions". What is the message of Popper? I think that the modernization must not lean on institutional transformation only, but simultaneously on supportive social attitudes and tradition. In our case, as I introduced and described above, we are missing the co-existence of supportive tradition and modern, democratic institutions and rules. This is the main conflict in our societies. Democratizing without democratic tradition, having an open society and economy without relevant organic traditions, making the people accept the obligation of cooperation and competition at the same time while not having any similar imprinting in their social genes.

Let me sum up bluntly. We have democratic institutions in place, but traditions and attitudes are not matching them.

In the last couple of years the countries of our region became aloud with unprecedented political and social conflicts, street demonstrations and fights, various signs of political and social uncertainty. What happened to those countries that were welcomed very warmly and were seen with great interest by our West-European counterparts after the fall of the Berlin Wall? Is it a coincidence that we can see a very similar turbulence in all countries regardless of the color of their governments, the structure of the government coalitions, or measurable results of their economic performance?

I do not want to underestimate the impact of different national measures, policies and decisions, but I tend to believe that these political, social uncertainties and turbulences are rooted in lost illusions we used to share widely before. We celebrated the change of regimes as a victory of democracy and freedom. But we failed to understand that ordinary people had had more simplified, tangible desires. "Freedom is important, democracy is fine, but we were looking for a radical increase in our standard of living from these changes on short term" – this was the general hidden expectation towards the changes.

These seventeen years could prove that freedom and democracy in them do not automatically bring higher salaries,

larger consumption, and better quality of public services. It is difficult to accept that while social differences are growing, traditional personal capacities like vocations devalue, and the perceived social security has been replaced by a permanent pressure to adapt. These kinds of widely experienced disappointments are the main source of the currently seen disturbances.

What can be the response to these challenges? There are two basic or typical approaches:

The first one is the reformist, modernizer approach. The main target of the supporters and followers of this approach is to shorten the period of macro-adaptation and to accommodate the changes in human attitude by initiating deep structural reforms in public services, state administration, market regulation and so on. 'Quicker is better' – might be the slogan of this approach which reflects the existing and deeply rooted public sentiment called the 'catching-up effect'. This modernizer approach is not able to separate itself from the inherited reform tradition which we called earlier the top-down reform. This means that in most cases these structural reforms – at least in the beginning, in their first phase – don't lean on wide social, political consensus and support, but are based on concentrated government initiatives.

The greatest dilemma is how you can enlarge and widen the social support of the reform programs without paying the price of diluting and softening up the original intention. It's obvious that – although you may have the power and influence to make the necessary decisions – implementing them, making them work requires the cooperation of many. The opponents of this approach accuse this line of reform dictatorship, and in most cases of betraying the national interest by accepting the nature and rules of globalization, and also of giving up the idea of social justice, equality, solidarity – i.e. the values of the political left.

I call the second approach the traditionalist, anti-reform approach. This approach is very skeptical about private ownership and market mechanisms, harboring some animosity towards globalization, especially multinational businesses. It represents a defensive and not pro-active attitude, they rely on the state to fulfill their policies much more than to give more space for the private sector. In their vocabulary the representation of the national interest is conflicting with social and economic openness, and national pride comes together with the sense of national offence and/or national supremacy.

The representatives of the anti-modernizer, traditionalist approach promise defense against changes to individuals and families, and avoidability of structural reforms in education, healthcare and the pension system. This approach can be very

popular, widely supported on the given historically determined social background, and it's able to capture the people's minds sending them the message that they do not have to do anything for themselves, but the state can provide security and welfare as a Christmas gift. This approach is not only weakening the democratic public sentiment, but rather it directly devastates that, while it is already vulnerable.

This dichotomy of modernist and anti-modernist, reformist and traditionalist approaches determines the political and social life in this region. This kind of description provides more unequivocal explanatory power for understanding what is going on than just using the typical instrument of differentiating political wings and players as right, left, conservative, liberal or social democrat. You can find modernizers and also traditionalists on both sides. We can even find a left-wing party in our region saying that reforms serve only the interest of the high society; and there are others who are the frontrunners of the reform agenda.

There is a very similar situation on the right side: there are parties which represent brave structural reforms; and some others which oppose even just touching the inherited and currently working structures.

Let us turn our attention towards Hungary.



Hungary is very proud of its more than one thousand and one hundred year-long history. However, while the 16<sup>th</sup> century brought about a new era of modernization for West-European countries, which was signaled by the discovery of America, at the same time we Hungarians lost our independence as the Hungarian army was defeated by the Ottoman Turks. Hungary was ruled by foreign empires in the next 400 years until the end of the First World War. Lost independence together with the reluctance of the national elite to open the road to modernization gradually and permanently increased the distance between Hungary and for example Great Britain and France in terms of the development of social and economic life.

Although we regained our independence in 1918, and for a few historical moments we had the chance to catch up with the West, the Second World War ended this process, also not independently of some very painful inner reasons. After a three year-long democratic dream and battles, Hungary became a part of the Soviet communist territory of influence seemingly preserving its constitutional independence, but in reality it was less than half independent. 1956 demonstrated how narrow can be the scope of movement for representing the national interest.

1989 found Hungary in a situation in which we were considered to be the 'happiest barrack' enjoying relatively wide freedom in comparison to the region, possessing a considerable business

culture and attitude due to the market oriented reforms in 1968. But in parallel we also inherited one of the highest levels of public debt, and companies which were unable to compete on the open market after the fall of the Berlin Wall.

During the period of changing regimes we did our obligatory homework. We adopted a democratic constitution, we gave back the right to people to live in freedom. We set up independent institutions as a network of guarantees to supervise and to limit the influence of the state over the people's rights; we started to pull down state ownership and privatized our economy. We applied a market oriented privatization method that attracted foreign capital and investors, while at the same time offering some financial incentives to Hungarian small and medium sized companies and entrepreneurs to be involved in privatization. We have also privatized to a very large extent the sectors which play a key role in the economy, therefore they are called strategic sectors, like insurance, banking, energy and in some counties and towns also some public utilities like water supply.

By the mid-nineties we faced a very serious public finance crisis, which was responded to by implementing a very tough austerity package of that-time Socialist finance minister Mr. Bokros. The finally very successful program in terms of macroeconomic equilibrium was also very painful socially, but – which is the most important point for our current subject – it

was not able to even touch the social culture, attitude and structure of the public sectors regardless of its original intentions. Bokros was a brave reformist modernizer, but after a while he lost his political backing not just in the eyes of the public but also in the government, which made it impossible for him to continue.

His successor, Mr. Medgyessy, who finally became prime minister in 2002, introduced the pension reform in 1997, which was the first successful attempt to change the structure of responsibilities thus motivating the people to accept the idea of taking care of themselves. This pension reform was a singular and unique example of undertaking a reform program without a direct and unavoidable pressure while it could touch the people's everyday lives by 2006.

In 1998, the Socialists and the Hungarian Liberals lost the election, and in the next eight years the fight for power on both sides made the parties too timid to face increasing structural challenges, and they wanted to benefit the people in a very traditional, let's say, social democratic way to an ever greater extent. People loved the newly implemented housing policy that offered a heavily state subsidized mortgage, the public cost of which exceeds 1% of the GDP by now. Civil servants admired their salary increases by 50-70%, there was not a single family who would have refused the one-month extra family allowance,

or a pensioner who would have rejected another month of extra payment. Good news with bad consequences.

The parties in government and in opposition tried to outbid each other, everybody wanted to give more and more to the people. Although there were many signs of the non-sustainability of the budgetary process, none of us was brave enough to draw the final conclusion. We wanted to believe that we could avoid facing the challenges. By the summer of 2006 we had to realize that without a sharp and deep intervention into public finances the budget deficit could reach 11% by the end of the year. It was a sobering recognition. If you have to handle this huge deficit, it is not enough to scratch the surface only. If you have to cut back the budget by a half percentage point of the GDP, you might have a chance to spread the impact evenly. But in our case this remedy could not be applied. It was time to raise the most important question: Can we make Hungary stronger in terms of its economy and society without reforming the public services like education, healthcare, state administration by reallocating the responsibilities between the people and the state?

Whether we are brave enough to tell the people that everything we get comes at a price, the belief that this price is paid by the state – it is an illusion! It is paid by the taxpayers, the people themselves. How can we make the people understand that their simultaneous intention and expectation to get more but pay

less is impossible? For you to understand the public environment I can tell you that one of the parties promised to the people two things in parallel: Decreasing the social security contribution by 1/3 and at the same time increasing the amount of social benefits by another extra month.

So we decided that we should give up the devastating social and political compromise that had characterized our lives in the last years. Namely, we politicians told the people what they wanted to hear, and the people pretended that they believed but never really held us accountable. Being critical with ourselves, I have to admit to you that we were braver to act than to talk about what we did and what we wanted to do.

In this situation we applied a twin track method. On the one hand we introduced a very tough austerity measure program on the budget that mainly focused on decreasing public expenditures complemented by some measures which increased our revenues. The result is very promising. In comparison to the previously mentioned 11% of deficit, we expect a deficit of 6.4% by the end of this year, and there is no doubt that we can go down to 4.1% within one year, while in 2009 we shall achieve the 3.2% target. At the same time we have been able to reduce significantly the current account deficit. I know that having a track record like ours, observers and analysts ask us what are the guarantees that will not allow the budget to soften up as we approach the election year. Our

determination and commitment is very important, but we would like to build on more than that. Therefore we are establishing new rules and new institutions for creating very effective obstacles to overspending.

We were aware of the fact that if we didn't touch the structural, institutional and regulatory framework, our success would be temporary only. Without structural reforms the desired budget equilibrium would be lost again.

At this point I should give you a list of the various reforms we have implemented. Before I go into details I want to tell you that, by my view, we just have one real reform program. It is reforming how we see ourselves as sovereign but responsible individuals, and how we see our nation. In the focus of my reform agenda there is one paramount issue: to wake up my fellow countrymen, make them accept that we make up the country. Hungary cannot be strong and competitive unless we the citizens of Hungary are strong and competitive. Hungary derives from us and not the other way around. The country is not a table that everybody can approach and take everything that he or she needs. I know that it sounds very simple, but listening to the voice of the public it seems more difficult that we would like to admit.

Let's take a step forward and see the concrete reform steps.

We started on ourselves. We cut back the volume of state administration by decreasing the number of civil servants in the ministries by 20%. To achieve this goal we have restructured the institutional framework, the leadership structure of the ministries, and also increased the responsibility of government members. We have made very rigid labor regulations much more flexible within state administration, we have implemented a performance measurement and assessment program, and we have made the salaries dependent on performance. The next step is to gradually widen the circle of institutions involved in this program.

The biggest challenge is the healthcare reform. The Hungarian healthcare system preserved its most important characteristics in the last two decades, and it very much resembles the structure and way how it worked in the communist era. Although we said that our system was based on insurance, hundreds of thousands of people who had an income did not pay a single penny of contribution and still received services without any limitation or consequences. There was no interest in paying and being honest and fair. The accessibility of services is not fairly regulated. Although we have been speaking about equality, it is a widely known phenomenon that any member of the high society would get much better service than average people or a member of the underclass. Doctors and nurses are underpaid, however, everybody accepts that many of them provide private or semi-private services on state-

owned infrastructure, and they don't share and don't pay any tax on their revenue that sometimes exceeds their official salary by two to twenty times. There is a strong interest to maintain the huge capacity of hospitals because it provides the source of this private income.

The result of this situation was that we had almost 50% more active hospital capacity than Germany, and the health budget was overrun dramatically year after year. We had a lot to do. We cut back the capacities, closed down some hospitals. We introduced an 80 pence direct co-payment for each visit to the doctor and each day in hospital, capped at 17 pounds per year, except for the poor and for certain services, especially prevention. These are not huge figures, even for a country where the average gross monthly salary is around 500 pounds. It ceased the illusion that the service is free of charge, and has lead to a more conscious attitude.

We have strengthened the link between paying one's social security contribution and actual entitlements in order to make the hundreds of thousands of free-riders change their behavior.

Right now we are in the middle of perhaps the most far-reaching decision that restructures the insurance side of the healthcare system. We preserve the unified social insurance system, but in parallel we open the door to private players to



create an effective link between the insurer, the insured and the service providers.

In the field of higher education, we introduced a tuition fee for state-financed students as well. It amounts to 290 pounds for an academic year for an undergraduate. We also made institutions compete for the best students, and we obliged the universities to use the funds from the tuition fees for increasing scholarship amounts and modernizing and developing the universities. The main target is increased competition, more responsibility and improved achievements on the sides of both the students and the universities.

In the field of public education, a demographic slump has not been matched by a reduction in resources. While the number of pupils has decreased by one third, the number of schools and teachers has remained unchanged. First of all it is not a question of money. It is a matter of quality. You cannot provide best quality in schools where there are five to eight pupils in a class. Therefore we have urged and financially support municipalities to cooperate with each other in the maintenance of joint schools, merging their capacities, and additionally we offer a school bus service to pupils.

We used to have an automatic gas price-subsidy system that misled households concerning the costs of energy. This was a good example of the state socialist mindset living on. Everyone

considered it their birthright to get gas and electricity at low and fixed prices. As gas and petrol prices have increased in world markets, the low domestic prices cost the treasury ever more money, and made people themselves make wasteful decisions. The worse consequence of the price subsidy system beyond the impact on the budget is that it gives more to those who consume more, which is consequently the wealthier people. We changed this system not to subsidize the price anymore, but to subsidize the families who are in need in a targeted income-dependent way. This is a justifiable and fair change.

We launched a complex assault on the grey economy, making sure people pay their dues and companies theirs. We do not think that this is a one-time exercise, and we are in constant dialogue with Hungarian and international experts to find the best ways to “whiten” the economy without hurting and insulting the poorest. The higher fines are accompanied by a public awareness campaign under the heading “fair play”.

Let me not continue with the details.

I can hear your question: Is this reform program popular? No, it is not yet. Is it necessary? I am convinced it is.

Changing the social attitude contains two phases. In the first phase we are pulling down the old culture, the old mindset; this causes uncertainty in everyday practice. In the second phase

we start building up new habits and thinking. It requires a long time for the new rules to become commonly shared and accepted. Now we can see the light at the end of the tunnel. We are close to the end of the most painful part of this transformation: The adjustment period involves less and less austerity and more and more progress and development. We are facing a new era of development and investment. Investing into education, culture, research, healthcare – in one expression: investing into the people. Using a previous term we are not simply defending the people but investing in them. Dynamism without jeopardizing the equilibrium, and permanent adaptation – this is our duty and fate.

At long last, I have arrived at the last part of my remarks, the future. Let us not try to look too far ahead into the future, and let us pick the date of 2020.

Hungary will not be a country that competes with the third world and some Eastern European countries by low taxes, limited social services and cheap labor. On the contrary, it will be one that offers a well-trained, creative workforce and state services that are worth every penny they cost the taxpayers. What we offer will be our hospitality, our culture, our knowledge, know-how, high tech and high value added services.

Another potential we can and we will build on is our location. We are in the centre of Europe. Goods will move across Hungary and people will come to meet there.

Let me give you a more pedestrian version of my vision, too. When you drive east from Vienna or Graz in 2020, presumably to do business in a Hungarian logistical center that is the hub of European land transport, to give a lecture at one of our academic centers of excellence, or just for a visit at a spa, you will have a hard time to tell whether you are still in Austria or in Hungary.

The border guards will have been gone a long time (we will join the Schengen area within weeks), and a road-sign is easy to miss. The currency will have been the same for more than six years. Thanks to a modernized school system, the people you meet will speak just as good English as the Austrians. The way to make sure you are in Hungary will be the better wine and the spicier food you will be served once you make a break.

At the end of my talk, let me show you something.

This, ladies and gentlemen, is the gömböc. The impossible-to-translate Hungarian name of this mathematical object, officially called the self-righting object in English, refers to the solution to a problem posed by a famous Russian mathematician. V.I. Arnold. It is, to be precise, a convex three-dimensional

homogeneous body with just one stable and one unstable point of equilibrium. It is a homogenous mathematical “comeback kid”.

I show you this stunning turtle-back object, invented in 2006 by two young Hungarians, Gábor Domokos and Péter Várkonyi, because it is a tangible example of the creativity and innovativeness we want to build our future on. But also because it gives me hope. Trying to find the right third way for Hungary, leading to modernity and prosperity without giving up our core values of fairness and solidarity does not always come easy. At times it looks almost impossible. That is why the gömböc always cheers me up: according to the editor-in-chief of the journal *The Mathematical Intelligencer*, “it is a shape whose impossibility might have been an elegant theorem, but whose existence may be much more elegant”. My aim is that, in 2020, we be able to say the same about prosperity and equality in Hungary, Central Europe, and Europe as well.

Ladies and gentlemen, thank you for your attention.