

## CHANGE IN LINEAR DIMENSIONS OF WEFT-KNITTINGS WITH BAMBOO THREADS CONTENT AFTER WET TREATMENTS

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**Objective.** study the nature of change of weft knitting fabrics containing bamboo yarn in linear dimensions after wet treatments. Testing hypotheses about the possibility of reducing the change in the linear dimensions of bamboo knitted materials by adding cotton yarn into their structure.

**Methodology.** the methodology regulated by the standard of DSTU ISO 5077 - 2001 "textile materials. The method of the linear dimensions changes evaluation after washing and drying."

**Results.** the use of combined weft knitting structure, which allows to preserve the benefits of bamboo yarn knitwear, and eliminate some of its shortcomings is suggested. Knitwear proposed weave, made only from bamboo yarn substantially deform after washing. There was a significant increase in the linear dimensions along the rows of looped and looped reduction along columns. Introduction to the structure of jersey cotton yarn can reduce the change of linear dimensions after washing.

**Scientific novelty.** the character of changes in linear dimensions after wet treatments knitwear containing bamboo yarn is studied. The structure of knitted fabric that present a knitted product in which bamboo yarn comes to the human body and provides natural anti-allergy effect and the antibacterial properties of bamboo and cotton yarn can improve the shape stability and reduce the change of linear dimensions of the jersey after washing.

**Practical significance.** a structure is worked out and raw materials set for knitted garments containing bamboo materials, thus reducing the linear dimensions change after wet treatments is recommended.

**Keywords:** *jersey, bamboo, weft-knitting, ecological raw materials, changes in linear dimensions after washing.*

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## UNORTHODOX HUNGARIAN PUBLIC FINANCES IN ACADEMIC BACKGROUND AND INTERNATIONAL COMPARISON

### **Abstract**

*The paper introduces into the reshaped Hungarian public finance system and provides historical background and international context of the recent policy changes. Besides, the study describes some deficiencies of neoliberal financial system that manifested inter alia in collapse of US mortgage market. Until 2010, Hungary was a 'front-runner' in implementing neoliberal disciplines. Afterwards, experiencing many disadvantages of the neoliberal economic system both in micro and macroeconomic level, Hungary started to balance all the negative effects caused. This, however, goes together with the critics of neoliberal disciplines and emphasizes the necessity of changes that is usually described as unorthodox. According to the viewpoint of the author, the public finance system of a developing Central-European economy should reflect the characteristics of the historical and cultural background of the country including economic issues as well as the time required to adopt new ideas. After the collapse of soviet-type planned economy, Hungary started to implement neoliberal market economy without leaving any time to the Hungarian economy and society to prepare for it. After 20 years of neoliberal market based economy experience, the way of Hungarian transformation is finally proved to be inappropriate - Hungary cannot resist to the 2008 financial crisis and required loans from international organizations to survive. Contrary, the author consider the increasing state influence over the economy (e.g. regulations) as a desirable step, since it suits better to the circumstances of developing countries (not only for Hungary). The increased state influence, however, fits better to the declared objectives of European Union (e.g. it ensures sustainable development course) so the critics about the recent unorthodox measures are not well-established.*

## Methodology

New fiscal and monetary mechanisms had to be introduced after the faltering confidence in neoliberal financial system. The importance of employing these new mechanisms, however, are fundamental for the whole economy and the society. The newly forming unorthodox systems in the world can be considered as an answer for the mistakes of the previous system. In order to provide appropriate answers literature on institutional economics should be analysed first. Besides, the scientific systematization of the current situation is also required. Therefore, the methodology of this scientific research on the unorthodox Hungarian public finance system relies heavily on the analysis of empirical data.

## Dilemmas about the public finance policy choice in Central Europe

Fukuyama, professor of international political economy, argued in his essay *'The End of History and the Last Man'* that after the fall of the communist regimes the development of human history as a struggle between ideologies is largely at an end - the age of liberal democracies will come after the end of the cold war. As a response to Fukuyama's book, Huntington wrote an article titled *'The Clash of Civilizations'* published in *Foreign Affairs Journal* in 1993. Huntington pointed out that after the end of the cold war the primary source of the conflicts will not be political ideologies but cultural differences in which the Western civilisation (liberal democracies) is only one among the others. These theoretical principles become fundamental for countries that were looking for new paths for growth after the four decade long Soviet-type planned economy.

Fukuyama states in his book *'The Imperative of State-building'*<sup>1</sup> that, the dominant aim of recent world politics has been to eliminate the role of the state. This trend can be explained by normative and economic reasons too. The excessive influence of the state has resulted wars and oppression in the twentieth century. Besides, the economic growth and economic efficiency were also hindered by the over helmed state even in the democratic countries. As a result, state downsizing become a general trend while market and society aspects has been over-emphasized and so as under controlled. Parallel to the expansion of global economy as well as the free movement of capital and labour, the autonomy of the sovereign states started to deteriorate.

Despite the fact that the Hungary adopted several market based economy elements - more than any other country in the Eastern Bloc - the Hungarian system of planned economy was facing a crisis by the end of the 1980s. The Hungarian internal economic resources were mostly exhausted, and the international loans that were serving the survive of planned economy turned into an unsustainable level of state debt. The transition from planned economy to market economy was conducted along the disciplines of neoliberal economic policy. Namely, following the Washington Consensus, liberalization and selling out the state owned companies.

After the political and economic transition, Hungary has adopted neoliberal economic policy that was imported from the western countries - the formerly described Fukuyama-Huntington effect<sup>2</sup> can be recognized at Hungarian economic, political and social development as well as at public finances.

In order to join the European Union Hungary had to meet the Copenhagen and Maastricht Criteria which are based on neoliberal principles.

All these what has been said above happened in a too fast way - without any proper preparation. The transition should have consider the historical and social aspects of Hungary<sup>3</sup>.

<sup>1</sup> Fukuyama, 2005 (year of publishing in Hungary)

<sup>2</sup> See the detailed description in: Lentner, 2013 page 44.

<sup>3</sup>It is important to emphasize that the Hungarian tribes arrived to the European Christian world a thousand years after the birth of Christ, where advanced civilisations and state structures were already functioning. After the Conquest of the Carpathian-basin (896), the conversion to the western Christian feudal model and the foundation of the western-type state-administration the Kingdom of Hungary lost its sovereignty in the middle of 16th century. As a result of the Turkish wars, the country was torn into three parts and its economic development was halted for over two centuries due to the defensive war against the Ottoman Empire. After the expulsion of the Osmons, the country became a part of the Habsburg Empire. As a result of fighting on the losing side in the wars of the 20th century, Hungary lost two-thirds of its territory and one-third of its population. Besides, after World War II Soviet Union influenced the development of Hungarian economy and society. As a result of this historical background, the Hungarian political thinking includes traits of (1) the Asian thinking, (2) the European Christianity (social aspects), (3) the despotic and (4) Byzantine thinking of the Turkish Occupation, and (5) the collective thinking of the Soviet era. Essentially, all these historical

From the end of the 1980s, the Hungarian state left its citizens without protection in an economic structure dominated by the international corporations,. The government shifted towards a fiscal policy that did not entirely serve the real needs of the Hungarian-owned enterprises or the real needs of the society. The economic policies were shaped in favour of the international corporations and banks whose contribution to public burden were not in proportion to their means. The imported economic and social model did not meet the needs of the society and the Hungarian corporations. The Hungarian planned economy and later the evolving neoliberal market economy and the society were in trouble. Most of the state owned companies could not operate on a viable level anymore that determined a high level of unemployment. Maastricht criteria became a burden of the state budget that has indirect negative effect on the operation of the Hungarian enterprises while Copenhagen criteria shaped the frames of the society. Although these conditions ensured the functioning of the Hungarian national economy and the existence of the society they did not provide a basis for an independent economic policy and a socio-economic convergence. Furthermore, the regulatory regime employed by the Hungarian governments was unable to handle the market forces that hurt the interests of Hungary. The economy and the society as a whole were still in trouble.<sup>4</sup>

Hungary became a more and more integrated part of the neoliberal financial and social system of Europe and the world. However, the country simultaneously started to fall behind and the financial instability further compromised the chance for a complete convergence. As a result, Hungary could not realize the level of development that was 'envisioned' in 1989 before the transition.

It is important to emphasize that after the collapse of the soviet-type planned economy system, the Fukuyama mentioned neoliberal model seemed to be the only alternative way for Hungary and the other Central European countries on their path to the market economy at the end of the 1980s. However, after twenty years, the countries employing neoliberal economic model were all in a financial crisis.

The western civilisations and their "associated" neoliberal economic policies are in a state of constant system crisis. It is proved again that the entirely autonomous market actors are unable to self-regulation and self-restraint at any stages of the economy (micro - enterprise level; meso - industry level; macro level). Since the elimination of the state control is one of the objectives of liberal market forces, after a while the market drives itself into crises. The market forces in themselves are unable to find the way out of the crises.

According to the current trends, USA remains the leading global economic actor as production and consumption until 2025, but it will lose its first place in the global dynamics. Asia will overtake the European Union in economic terms and Asia role will be significant in the global dynamics. These prospects raise the question whether the post-Soviet countries should maintain the one-sided western orientation in their economic policies (theory, model, practice, orientation), or they should consider diversification and the loosening of the traditional neoliberal principles and relations.

The monopoly of Fukuyama's neoliberal system seems to be over as a consequence of the 2007 started financial crisis. The faltering of the neoliberal economic policies (as economic discipline) may result weakening neoliberal democracies. The question arises, whether the emerging countries – currently following the neoliberal model – should change their economic and social models to a development path that fits their historical legacy and actual capabilities better.

### **Hungarian adjustment until 2010**

The main issue about the Maastricht Criteria is not the requirement of keeping the government budget deficit under 3%. The problem lies in cutting back the government's tax revenues (tariff cutbacks, tax exemptions for international corporations) in order to comply with the neoliberal expectations. At the same

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components are contradictory to the Anglo-Saxon raw neo-liberal system which Hungary forced to implement as an economic and social model over the course of a few decades. Failure was programmed. This was a result and even a textbook-example of the inorganic development path. (This has been the declared opinion of the author for two decades, see Lentner 2010 in Heller Farkas Eszmetörténeti füzetek.)

<sup>4</sup> The countries of the post-Soviet region – and Hungary in particular – adjusted themselves to the neoliberal production mode. Hungary did not protest against this system, and did not collapse under its weight. Although not in the optimal way the national economy still functioned for two decades and in the meantime turned into a market economy. It is still a fact that in 2008 Hungary went bankrupt. Nevertheless a system of democratic institutions and a market economy was established.

time the state transfers for the increasing number of unemployed people was getting higher and higher while the tax revenues of domestic enterprises decreased to a low level. Due to all these factors, the required ratio of government budget deficit can barely be ensured.

Furthermore, government financial policies could hardly protect internal markets and internal enterprises. Cutbacks on protective tariffs, preferential loans and subsidies were required, while the internal markets had to be opened for capitalized firms providing goods and services (with an undoubtedly higher quality) at dumped cheaper prices. The Hungarian production had started to slowly deteriorate. In the short run, the cheaper and higher quality western goods were better than the competing domestic products. However, in the long run this type of economic and financial policy - favouring the import above all - resulted a massive additional government expenditure. The number of available domestic jobs decreased and living standard of the population deteriorated while government expenditure on social services increased. The foreign direct investments modernized the industrial and service sectors, but did not contribute to the public burden or at least not in a proportion of their fiscal means. Because of the freedom of financial and capital transactions international companies were able to 'negotiate' the taxes affecting their operations while domestic industry and agricultural actors were deteriorating. Under these conditions – reduced budget revenues and increased public expenditures – the government budget could not meet the maximized 3% deficit and the Hungary faced further indebtedness. In terms of purchasing power parity the Hungarian GDP per capita was 7.380 USD in 1991, and 21.403 USD in 2011, which is a three-fold increase. The state debt increased from 20 billion USD to 130 billion, which is a six-and-a-half-fold increase, while the property of the state was mostly sold off to foreign investors<sup>5</sup>. Besides, further 40 billion USD private debt also accumulated. However, it have to be mentioned, that state debt started to accumulate from the 1970s and includes loans from both IMF and WorldBank.

The most severe consequences of the applied neoliberal economic policy until 2010 were the indebtedness (see Figure 1) and the population's loss of confidence in the government (see Figure 2). During the "glory days" (2002-2010) of the neoliberal financial policy the Hungarian state debt increased by 31,7 %, while the population's trust in the Hungarian government sunk to the lowest level compared to other OECD countries.



Figure 1: GDP debt ratio of Hungary

Source: Lentner, 2014

<sup>5</sup> It is worth to mention that according to international statistics, during the years of early transitions, as a consequence of neoliberal system, a capital "officially" worth twice the amount of state debt flowed to off-shore companies, because one of the main elements in the economic philosophy of the Washington Consensus was the reduction of state control and state property. See Lentner 2013, Közpénzügyek.

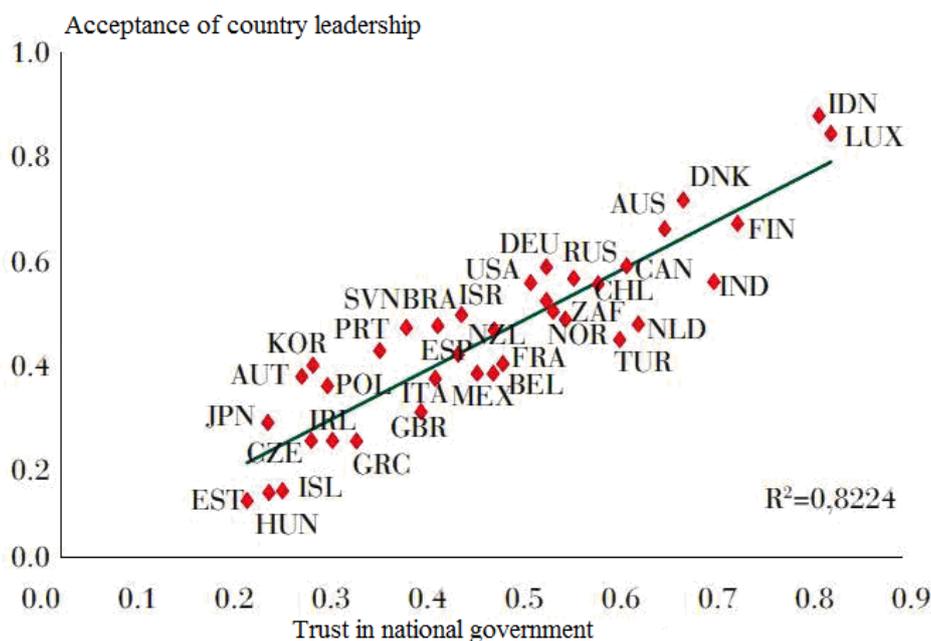


Figure 2: Trust and acceptance of national leadership

Source: OECD, 2010

**Theoretical dilemmas of the changes**

The declining stability of the Hungarian state finances and the decreasing effectiveness of the institutional mechanisms unfolded during the EU integration. It has to be emphasized, that this does not mean that Hungary's EU integration was unnecessary. However, the integration policy and regulating system of the European Union and the Hungarian implementation process are subject to a sharp criticism. From the summer of 2010, to balance the mistakes of previously employed economic and financial policy, new acts was enacted (including budgetary and tax policy) that started to serve national interests. This means that international companies and banks coming from the developed countries of the EU have to contribute to public burden too. This is the most important mean for establishing the stable state budget. The declaration of the right for state intervention arrived more than two decades after the democratic transition.

If 'national' public finance measures or any other policy measures do not comply with the EU rules and regulations, sanctions can be employed by European Union. Sanctions could range from the Excessive Deficit Procedure to withdrawing subsidies. Originally, the founding treaties did not include the possibility of imposing financial sanctions in case a member fails to comply with EU laws. The member states, however, repeatedly ignored the judgements of the Court of Justice of the European Union in the infringement procedures thus the Maastricht Treaty introduced the possibility of imposing financial sanctions. After the Court of Justice of the European Union declared the infringement, the European Commission can initiate the infliction of the sanction in case a member state fails to harmonize its legal system with the regulations of the EU law. In fact, the Court of Justice of the European Union declared – in order to make these sanctions even more deterrent - that simultaneously more penalties can be imposed on a member state. However it is important to emphasize that the evolution of EU law and EU law enforcement is erratic, thus it is very hard to predict the outcome of certain decisions - these decisions have unpredictable government budget expedition consequences too. Therefore, the EU law and the EU law enforcement represent a burden on the national budget too. Consequently the member states only have limited sovereignty regarding their public finances, since a part of them were delegated to the European Union who acts like a federal state in some terms. A harmonic order could still be reached by realizing the interest relations of Europe as a whole, while simultaneously ensuring the actual representation of national interests. However, the neoliberal economy and its 'associated' open society with the functionally weak public administration as well as the European Union are in a state of permanent system crisis.

As a result of the crisis described above, the role of the state is getting stronger again based on different economic disciplines. According to the institutional economic approach, regulations, laws and

informal constraints fundamentally determine the development opportunities of an economy and a society. Regarding the economy, the most important task is to reduce the transaction costs and uncertainty as well as to reduce externalities and information asymmetry. Market failures should be addressed by adequate regulations. Therefore, one of the aims of the economic policy is to establish an adequate institutional matrix<sup>6</sup> that is capable of addressing a given period's issues in the most effective way. A flexible and adaptive regulatory framework should also be established. The sanctions of the EU in the infringement procedure are capable to enforce the Union law against the member states in the long run only. Several years may pass by after initiating the infringement procedure against a national government until a decision is made. In many cases the sanction payment relates another fiscal year. Therefore the Court of Justice of the European Union established the practice of indirect sanctions against the member states. Namely, by the force of the EU law private individuals are entitled to claim compensation from the member states for all the injury that was caused by their infringement of the EU law. Besides the liability above, the non-contractual liability of the EU is also worth mentioning. The non-contractual liability should only be applied in limited cases, since the 'overuse' of this rule could jeopardize the discretionary measures of the EU economic policy. The discretionary measures are essential for the effective economic administration. The solution inevitably lies in a restructured regulatory framework and stronger state control. A good example is the process that started in the United States after 2007 aiming to re-regulation of the institutional system. Maastricht criteria as the regulatory framework of budgets of member states as well as neoliberal economic policy should be revised too. Neither the countries of the Mediterranean region nor the countries of Eastern and Central Europe – namely the recently joined countries - are able to meet the expected budgetary criteria. Even some of the old member states are having a hard time in complying with the expectations. The main reason for their failure is the unreasonable suppression of their national economic policies and the still strongly prevailing neoliberal model.

The change in leading economic basics and theories concerns mainly the state finances and the controlling and regulatory functions of the state - according to my opinion these are integral parts of the science of public administration. The public administration 'in cybernetic sense' does not only regulate but controls. Therefore, the findings of the leadership theory should be also applied.<sup>7</sup> The appreciation of the science of public administration is indisputable.

In times of crisis the state provides stability while in times of prosperity the dynamic creation of values without state controls is preferred. An important question in the theory of public administration is whether the consolidating role of the state in times of crisis also includes the establishment of the rules and institutions of the new order after the consolidation. And what is the role of the state in the new order? Does it get weaker again or does it stabilise on a higher level than before? Obviously, a recession or a crisis is always a correction of a rapid growth. The crisis is a result of overproduction or over-crediting. The 1929-1933 crisis is evidence of the former one while the subprime crisis is evidence of the latter one. In times of prosperity the lack of self-regulation and self-restraint both on production and financial markets is a basic issue. In the neoliberal system there are no constraints, since the controlling and regulating role of the state has already been cut back to a minimum level. The overdriven economy leads to social tensions too. It still remains the responsibility of the state to address the social issues and establishing the balance and rationality in production and crediting as well as in public expenditures. The past centuries proved that it is possible to establish public finance relations that are capable to address prosperity, recession and consolidation. 'Market economy can only exist in market society' stated Károly Polányi<sup>8</sup>. In fact, market economy can only exist in a market society that is interested in and capable of maintaining a market economy.

Economic needs cannot be fulfilled locally, only globally (on system-level) so the extended role of public administration is proved. Consequently, the basic concepts of economics – scarcity and competition - are no longer sufficient for understanding the issues of public administration, or for its scientific foundation. The harmonisation of the rules for fulfilment of the economic needs is necessary in which the public administration performs an organizing role (active economic government). The last 'constraints' of the Glass-Steagal Act were abolished during the presidency of Bill Clinton. One of the main arguments against the

<sup>6</sup>Rodrik's institutional matrices theory (institutions ensuring the protection of property rights, bound to market regulations, supporting stabilisation and legitimating) Rodrik D. 2000, 2003

<sup>7</sup>Bukovics I. 2013

<sup>8</sup>Károly Polányi, 1946

paragraphs of the Dodd-Frank Act entering into force after it was adopted in 2010, that the regulation reduces the efficiency of generating profits. Both cases confirm that when the market actors think that there is prosperity on the market they start to consider the strengthened state regulation and control as an obstacle<sup>9</sup>. It is hard to predict for how long the current 'state regulation friendly' environment will last and what kind of forces with what kind of measures will take actions against it.

### **Local conditions in Central and Eastern Europe**

Market economy can only survive in a society that is interested in maintaining the market economy. This statement applies to the neoliberal market economy currently in ruins, to the new-orthodox market economy currently under renovation, and even to the unorthodox market economy which is the complete opposite of the neoliberal production mode. Thus both national economies and regional world economic centres are organized according to interests including the ways of production too. German authors<sup>10</sup> wrote in 2012 that although nowadays the EU's economic aims are the central topic of discussions, it was essentially founded for political reasons. From the very first moment, the member states were determined to integrate Germany into an international community in order to ensure peace and to prevent the rebirth of a restless power centre in Europe. Furthermore, a single European market has its benefits too: due to the comparative advantages the optimum utilization of benefits arising from different locations is achievable, so is the production in larger (economic) scales for a wider market with reduced transaction costs. The aim of creating a single economic area was already included in the founding treaty of the European Economic Community, providing the free movement of goods, capital, persons and services also known as the four freedoms. As a result of linking the interests is an ongoing 69 year long period of constant peace in Europe. Germany is the economic engine of the European Union. Technological quality standards of production and democratisation of societies in Eastern and Central Europe show significant improvement. However, the transition countries achieves much lower level of development than the countries in the western region of the European Union. Regarding Hungary, 85% of resources for implemented investments came from the European Union. The amount of subsidies received from the EU is several times higher than Hungary's payments to the EU<sup>11</sup>. Even though the rules of the European single market are breached and in times of financial crises protectionism significantly prevails in the member states and 2004 joining member states did not receive any kind of financial help, maintaining the European Union is the interest of Hungary and also the interest of other member states. In spite of all these inconsistencies and controversial solutions, there is no need to be afraid of bankruptcies in case of the recently joined members of the European Union. In fact, their systems are still developing, although the path of this development may not be the most optimal one. It is important, however, for the Central European countries that joined the EU after 2004 – and especially for Hungary – to employ a public finance policy and crisis management which will fit their capabilities.

### **Unorthodox fiscal crisis management**

The formerly employed neo-liberal economic policy was discontinued from 2010. Stopping the growth of public debt and reducing the budget deficit has become the main objectives of the government. Therefore, the national assembly has maximized the desired level of state debt at 50% of GDP in the new Constitution of Hungary<sup>12</sup>. In order to balance the budget the government has implemented several measurements to expand budget revenues – international corporations and banks need to contribute to budget revenues now at a greater level than previously. Parallel to these measurements, the financial governance provided financial ease to SMEs: those firms and enterprises whose net revenue is under 500 million HUF<sup>13</sup> yearly have to pay only 10% corporate tax instead of 19%. The personal income tax burden was also reduced from 36% to 16% thus the financial ease appearing at working population too.

<sup>9</sup> For details see Lentner, 2013. Bankmanagement

<sup>10</sup>Wenzel et al. 2008

<sup>11</sup>Although, in return, Hungary give its entire internal and former external markets for the corporations and banks of the developed member states.

<sup>12</sup> The Constitution of Hungary was announced on 25th April 2011.

<sup>13</sup> 1 USD = 223,7 HUF (average exchange rate of 2013)

The measurements outlined above has resulted a balanced budget on the one hand, and a growth in income of households on the other hand. The income growth of the households has contributed to the increase of the effective demand.

There are some new subsidy schemes included in the fiscal policy, namely, the personal tax benefits of the families with children has extended and public work programs has started in order to reintegrate the unemployed people into the labour market. As a result of the incentives promoting work during the last four years, more than 250 thousand new jobs have created. The statistic shows that working population covers about 4 million of the 10-million-population of Hungary.

One of the main result of the Hungarian fiscal policy is that the averagely 7.2% budget deficit that was characterizing the 2002-2010 period, has reduced below 3% from 2010. This improvement has made it possible that Hungary was dropped out of the Excessive Deficit Procedure of the European Union in the summer of 2013<sup>14</sup>.

In order to increase the income level of the households – as an element of the social support scheme – the official price control mechanism was extended. The fees and charges of utilities and the costs of banking have been reduced significantly.

The course change in fiscal policy have resulted a stable budget deficit level under 3%. This low level of deficit is essential because – considering the classic thesis of finance – the previously increasing level of deficit generated higher level of inflation. Following the thesis, the reduced deficit level resulted lower level inflation in Hungary. Additional effect is that smaller budget deficit contributes to a cheaper state because the need of external (mostly foreign) financial resources has also declined. Since the Central Bank of Hungary has started to reduce the base rate<sup>15</sup> in 2011 (before the 2013 change in monetary policy) the lower level of deficit and also the national debt can be financed in a cheaper way from the market through reduced interest rates on government securities. Besides, the public expenditures of a financially well-organized state are spent more effectively, thus there is no need to borrow additional money (higher proportion of public expenditures are covered by the same amount of state income level). As a result, less public funds are spent on interests of state debt. This way a cheaper state has been created.

The government has paid attention to the fiscal stabilization both of the local governments and of the families. In order to stimulate the economy, the former government applied no restrictions for the foreign currency based loans. However, due to the 2008 financial crisis, the exchange rate of the Hungarian Forint depreciated significantly. Thus both the families and local governments with foreign currency loans become unviable. As for the local governments, the central government assumed a part of their debt. As for the households, the new financial government introduced family saving actions such as fixing exchange rate, providing costless loan pre-payment possibility and establishing of National Asset Management Agency. The reduction of the base rate causes no distortions in the market of government securities and in the level of foreign exchange reserve of the central bank since the demand on Hungarian government securities and foreign currency bonds (major part of the foreign currency reserve) are unbroken.

### **Unorthodox monetary policy**

Another key area of Hungarian public finances, namely the monetary governance, the non-traditional approach could be adopted in March 2013, three years after the fiscal policy shift. The new, non-traditional policy adopted by the National Bank of Hungary is adjusted to global changes (Fed, BoJ, ECB), and the realistic demand present in the national economy. Maintaining its independence, monetary policy subordinated its activity to macro-economic objectives, and undertook a Growth Loan Programme similar to the funding for lending programme carried out by the Bank of England. As traditionally the MNB has macro-economic prudential supervisory power, it merged with the formerly separate Hungarian Financial Supervisory Authority, previously in charge of micro-prudential oversight. The central bank lowered the base rate to approximately one third, and thus the interest burdens on government debt financing have also been moderated.

The National Assembly has adopted a new central bank law<sup>16</sup> in 2013 preserving the guarantees of national bank independence. The former one-sided inflation targeting policy was extended in the new central

<sup>14</sup> Hungary was under excessive deficit procedure from the EU accession in 2004

<sup>15</sup> At the end of 2011 the base rate was 7%. Today (22.07.2014) it is 2,1%.

<sup>16</sup> Act No. CXXXIV of 2013

bank act<sup>17</sup>. Now the monetary policy is based on three pillars. Monetary policy has to contribute to (1) macroeconomic financial stability, (2) governmental economic policy and (3) inflation targeting. The fulfilment of the first two pillars cannot compromising the anti-inflation aim.

To achieve the objectives of the Hungarian central bank – in line with the implemented policy of FED and BoJ – loose monetary conditions are employed. Furthermore, stronger coordination mechanism is in operation between monetary policy and financial regulation.

From 2010 significant tax burden is applied to the commercial banks operating in Hungary because their lending activity – following business interests – was minimized due to the 2008 financial crisis (it is especially true for the foreign commercial banks). The coordinated fiscal and monetary policy in itself cannot cope with the lack of sustain growth: to create jobs and to vitalize the corporate sector loans are required. Therefore, The Central Bank of Hungary has started its economic stimulus program called ‘Growth Loan Program’ in which 2,750 billion HUF was provided to the business sector to apply investments, loans and to replace the high-risk foreign currency based loans. According to the program, the central bank provides the amount of economic stimulus costless to the commercial banks to transmit the money to the businesses applying maximum 2.5% interest rate. The current base rate in Hungary is 2.6%.

The monetary policy measurements outlined above has significant positive effect on both the economy and the society (creating jobs and contributing to economic growth).

As a result of co-ordinated fiscal and monetary governance, GDP is rising quarter after quarter. We have found new allied partners: Russia, the former Soviet member states, the countries of the Arab region and China. In addition to the diversification of our highly unilateral foreign relations, we also endeavour to moderate excessive Western orientation in the market of Hungarian government securities and state investments.

#### **Academic framework of the changes**

The philosophy of the new Hungarian financial governance is based on the pro-active economic influencing, regulating and controlling activity because sustainable fiscal path can be reached only by stable financial system and effective coordination between the fiscal and monetary policy.

The fiscal mechanisms are controlled strongly by the state: to control the public funds the state has built up a three level control system that includes the State Audit Office of Hungary (supreme audit institution), Government Control Office, and internal auditors of the public funded institutions. The aim of this three-level controlling system is to ensure regular and effective public spending.

Jurisprudence and economics, however, are not able to provide scientific taxonomy to the operation of a well-organized and pro-active state in Hungary because on the one hand the excessive descriptive nature of the jurisprudence and on the other hand economic education focusing on business disciplines (profit-making methodologies). Public finance, public accounting and public fund audit are peripheral areas in Hungarian economic education. The Hungarian government has recognized the advantage that can be reached by creating a new university focusing on all areas of public administration, therefore and National University of Public Service was established in 2011. The main subjects are public finances, public administration, public policies, public management policies, state management, human resource management and e-government. Since the need for active management by the state has increased, the importance of public administration also appreciated. Due to the interdisciplinary nature of public administration, it includes policy, economy and law at the same time. The main aim of public administration is not to make profit but to increase the welfare of the society. To increase the welfare, public administration needs experts who can lead the changes in every level of government.

DPM paradigm has shaped in neo-liberal economic system where the economic role of the state was minimized: regulations and controls were hardly applied. This attitude of the businesses has appeared in public administration too and NPM paradigm was developed.

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<sup>17</sup> Before the new 2013 Act on Central Bank, inflation targeting was the only goal (the central bank continuously gave up its role in refinancing the real sector and the government from 1995). It is interesting that finally the strict fiscal policy, the administrative regulation of utility prices and the reduced VAT of basic foods contributed to the low level inflation. Zero percentage inflation was measured in 2014 January by the Central Statistics Office - 40-years ago was the last time that 0% inflation was measured in Hungary.

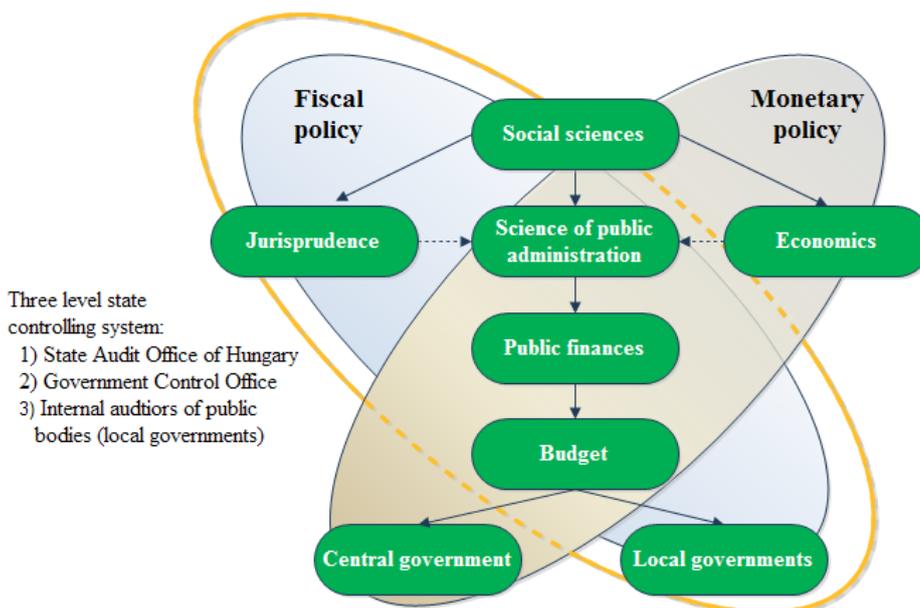


Figure 3: New public finance system of Hungary

Source: Lentner, 2014

However, the crisis of the neo-liberal ideology has increased the importance of public administration. The basis of a strong and pro-active state requires effective and transparent public finances that are based on up-to-date scientific knowledge (academic background). As a consequence of the 2008 financial crisis, bank regulation, bank management and bank supervision has become also a part of the interdisciplinary public administration<sup>18</sup>.

As we can see, the importance of public administration as a science has been increasing. The 2007-2008 financial crisis has shown that it is not appropriate to leave the market on itself and it is particularly relevant today to think of public institutions. It is also clear that economic issues cannot be explained without understanding the direct and indirect consequences of the decisions.

The institutional matrix of Rodrik<sup>19</sup> explains that different institutions can fulfil their task only if all of them are able to make substantive effect on the course at the same time. Protection of ownership, market regulation, economic stabilization and legitimacy are such institutions.

The regulation of financial system is an important field of the institutional approach to public financial system. This area has been significantly reshaped in Hungary because of the 2008 financial crisis. The central bank due to its regulating function has become one of the most important stabilizing factors in the Hungarian economy. According to the classical approach, this stabilization factor concerns only for price stability. However – as it was partly described above – the role of central bank in macroeconomic and social stability also an issue nowadays for the central banks. It also means that the 2008 crisis has ended the consensus about the economic role of monetary policy. For instance, redistributive effect of monetary policy has come into the limelight. In order to model the effects of the central bank decisions it is fundamental to develop a framework for the analysis. This framework should contain both complex economic and social aspects. In Hungary this new framework is under development now.

After the 2<sup>nd</sup> World War, the Soviet plan based economy served as a model for Hungary. Later on, after the transition in 1990, Hungary has chosen another model to follow – it was the neo-liberal market economy model that was in its heyday that time. Finally, from 2010 Hungary started to develop its own economic model using the experiences from the previously applied ones in order to be able to give correct answers for the future economic challenges.

<sup>18</sup>See Lentner, 2013a

<sup>19</sup>Rodrik, D. 2000, 2003

### **Hungarian financial policy changes - international context**

The post second world war economic order is now re-shaping again. During the 1970s the European social market economies<sup>20</sup> were transformed to neo-liberal economies. From the late 1980s, the western European countries were able to successfully plant the neo-liberal doctrines at the post socialist Central and Eastern European (CEE) countries. More than 25 years after the democratic transformation, however, the doctrine became a kind of burden in those countries where the implementation was not properly prepared. As every theory, the neo-liberal doctrines should be revised from time to time and the necessary adjustments have to be made. Today, parallel to the changing world economic map, the nations - including Hungary - are started to re-position themselves on this map.

We have to emphasize, that it does not mean the rejection of whole neo-liberal concept but the disadvantages of the concept have to be managed in order to prevent further welfare losses.

The struggles to obtain economic resources results new methods in the 21st century. The states and governments seek to increase (or maintain) their influence while the chance to realize global governance is reduced. The traditional economic centres (EU, USA) that had significant influence on Central and Eastern European countries previously are losing their positions. The structure of global economic prosperity are now depending on the developing world instead of the developed one<sup>21</sup>. The population distribution shows that USA and Europe together integrates 1 billion people, while Asia alone integrates further 2 billion by 2030. The dynamics of global economy is now determined by the BRICs<sup>22</sup>.

The economic policy of the European Union is less effective than those employed in Asian countries while the financial stability of EU has been decreased recently and its role in world economy is continuously declining. Nevertheless, EU is still serves as a good example in the field of science, culture and innovation. The recent changes of Hungarian public finance system reflects on the one hand the global economic gravity displacements and on the other hand the historical efforts about the 500 year desired independency (including the economic policy). Consequently, compensating the historical deficits (continuously searching for better solutions) and the adjustment to the challenges of global economy are the forces that drives the changes in Hungarian public finance policy.

From the viewpoint of the social and economic values some other statement can be done. The real constitutional state appeared in Central and Eastern Europe - and also in Hungary - 25 years ago. Parliamentary and fundamental (human) rights were new definitions - their content was fulfilled by neo-liberal experts in order to accomplish the European integration and to adjust to globalization. The dominance of "laissez faire" in the fundamental rights definition, however, prevented the adoption of real human rights (e.g. freedom of speech, thought, conscience, assembling), by the Hungarian society<sup>23</sup>. According to the 1989 adopted interpretation of fundamental rights, the freedom of market and entrepreneurship provided unlimited freedom to market participants opposed to other human freedoms. Identifying the freedom of market and entrepreneurship as the most important fundamental freedom is a serious burden for the fulfilment of the other human rights. Besides, misunderstanding of the definition of fundamental rights has led the situation that the human rights were distorted by the market participants.

Beside other policies, the Hungarian public finance policy also has to respond to the mistakes made in the past and provide viable solutions. The changes in public finance policy reflects that the interest of the nation and the society comes first (as in other western European countries). To do this, the state actively influences, controls and regulates the economy. The state provides framework for the economic actors - in this terms the introduced policy changes restricts the excessive freedom of entrepreneurship.

The 2007 financial crisis has empirically proved that the market mechanisms are not able to provide balance at any stages of the economy in the long-term. The market and its participants have misused with the freedom that the formerly neo-liberal approach guaranteed for them (freedom of entrepreneurship, and free movements of goods and capital) and created anarchy. The neo-liberal concept has sank into crisis - if the neo-liberal based economies were unable to avoid the economic and social damages caused by the financial

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<sup>20</sup> Germany, France and North-European models

<sup>21</sup> The situation is the same inside Europe - the growth dynamics of developing Central and Eastern European countries is significantly higher compared to the old member states. (e.g. 2014Q1 growth rate of Hungary is 3,5% while this number is 0,9% for the Euro-zone)

<sup>22</sup> Brazil, Russia, India, China

<sup>23</sup> Deficit in legitimacy - the 4th element of Rodrik model.

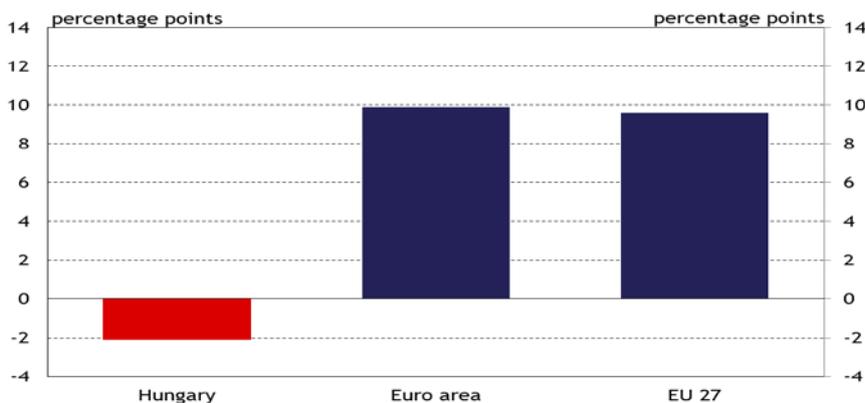
crisis, then how could the same profit oriented model provide the solution? Properly planned state intervention and coordination are required for the consolidation.

As a consequence of the 1989 imported freedom of market and entrepreneurship, Hungary was unable to handle the 2007 crisis and sank in 2008 - only the IMF, WB and ECB loans helped to avoid the state bankruptcy. The collapse of Hungary could be predicted anyway, since the EU integration (started right after the political transition in 1989) created many problems: the Hungarian industry and agriculture has essentially disappeared and the rest is controlled by foreigners while the major proportion of the society is going through pauperization<sup>24</sup>.

The funds from the EU cannot substantially improve the level of economic development of Hungary. The Hungarian GDP per capita in 2004 was 63% of the EU average, while this number was 67% in 2012 - considering the same period, Poland, Romania and Bulgaria showed remarkable dynamic improvement in this index (51% to 67%; 34% to 50% and 35% to 47% respectively). These numbers mean that the convergence in other post-socialist countries are much more better than in Hungary. Undoubtedly, Hungary is eligible to use much more EU funds than the money have to be paid due to the EU membership - these EU funds are the source of the 90% of the Hungarian investments. The nature of these investments, however, are mostly infrastructural.

The EU membership has provided EU funds but in exchange for the membership the protection of domestic markets and support for national companies had to be eliminated that caused serious social problems such as unemployment and fiscal instability.

The aim of the 2010 introduced unorthodox financial policy by the Hungarian government is to support the EU convergence process both in economic and social terms. The decreasing state debt and the increasing level of net financial assets of the households are the first results of the hyperactively implemented unorthodox measures. Figure 4 compares the level of state debt of Hungary to EuroArea and EU 27.



**Figure 4: The dynamic of state debt in Hungary, EuroArea and EU27 (2010-2013)**

Source: own constructed based on Hungarian National Bank data (Lentner, 2014)

The Hungarian economic policy is interested in the mitigation of the Euro area crisis but also interested in the diversification in the field of foreign trade (including non-EU states too). The priorities in economic relation are to enhance internal demand, to maintain fiscal stability and to start economic growth. The positive macroeconomic conditions attract the foreign investments. The 65 year old diplomatic partnership with China that was strengthened 10 years ago resulted that Chinese investors play key role in the development of transport infrastructure. Based on other investment and financing frameworks with Russian<sup>25</sup> and Saudi Arabian investors we can say that *'Hungary is sailing under the EU flag, but the wind blows from the East'*<sup>26</sup>.

<sup>24</sup> Due to the transformation to neo-liberal market economy, between 1989 and 1993, the unemployment raised by 1,5 million. These lost workplaces has never "come back".

<sup>25</sup> Reconstruction of Nuclear Energy basis of Hungary

<sup>26</sup> Saying of the author of this paper

## Results and Conclusions

Since 2010 the Hungarian economy has been governed on the basis of a policy that considers it a function of the state to influence the economy and consciously regulate and control market participants. In order to improve equitable contribution to financing public duties, the fiscal government has included international companies and banks among taxpayers, while the payment obligations of domestic companies and the income tax payable by the population have been cut considerably. Through regulated pricing, the household fees levied by public utility companies have been reduced significantly. As a result of these measures, the state budget deficit fell below 3 percent, the balance of payments became positive, Hungary was released from the European Union's Excessive Deficit Procedure, government debt is on the decrease, GDP is up and employment is increasing. The objective of fiscal government is to increase domestic solvent demand. This is achieved by using the social market economy model of Keynes and Konrad Adenauer.

In another key area of Hungarian public finances, namely monetary governance, the non-traditional approach could be adopted in March 2013, three years after the fiscal policy shift. The new, non-traditional policy adopted by the National Bank of Hungary is adjusted to global changes (Fed, BoJ, ECB), and the realistic demand present in the national economy. Maintaining its independence, monetary policy subordinated its activity to macro-economic objectives, and undertook a Growth Loan Programme similar to the funding for lending programme carried out by the Bank of England. As traditionally the MNB has macro-economic prudential supervisory power, it merged with the formerly separate Hungarian Financial Supervisory Authority, previously in charge of micro-prudential oversight. The central bank lowered the base rate to approximately one third, and thus the interest burdens on government debt financing have also been moderated.

As a result of co-ordinated fiscal and monetary governance, GDP is rising quarter after quarter. We have found new allied partners: Russia, the former Soviet member states, the countries of the Arab region and China. In addition to the diversification of our highly unilateral foreign relations, we also endeavour to moderate excessive Western orientation in the market of Hungarian government securities and state investments.

All these mentioned above do not raise question about the fact that Hungary's main partner is the European Union and it is not going to change.

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