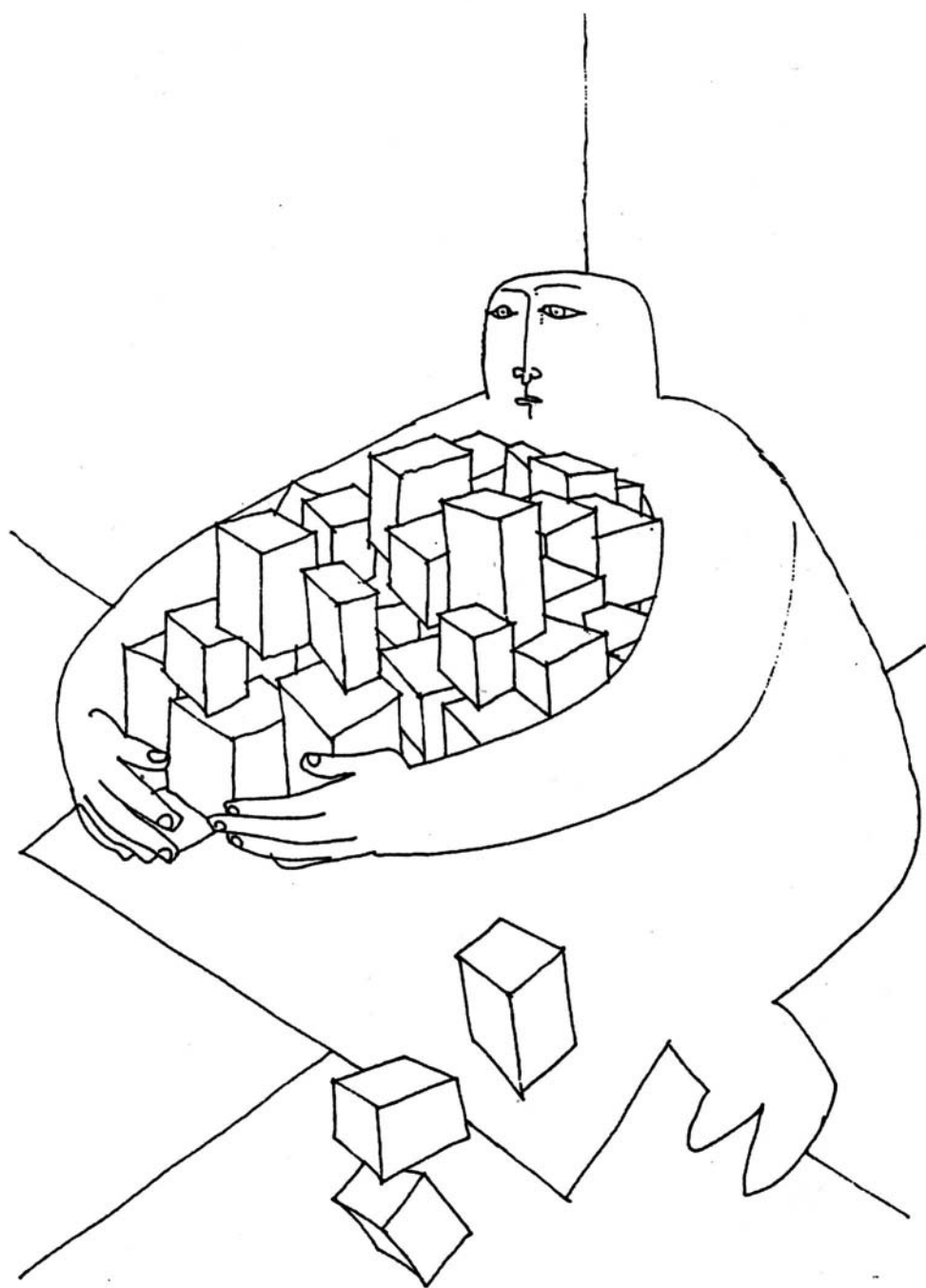


Tsuneo Morita

POLITICAL ECONOMY
AND THE SOCIOLOGY OF SYSTEM
TRANSFORMATION



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Tsuneo Morita

POLITICAL ECONOMY AND
THE SOCIOLOGY OF SYSTEM
TRANSFORMATION

Thirty Years of Social Change in Central Europe



BALASSI KIADÓ · BUDAPEST

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Preface

The collapse of socialist systems and the creation of new socio-economic institutions in Central and Eastern Europe at the end of the twentieth century presented challenges to scholars and researchers not only in the field of economics, but in all the social sciences invested in the study of the collapse and rebirth of major social systems. The relevance on the level of theory and practice of the socialist systems in Central and Eastern Europe is made even more pressing given the fact that, in China, there exists a country which is currently on a path of gradual transition to a highly developed market economy without having undergone any change in its dictatorial political system. Is China's path different from the one followed by the Soviet Union and Central and Eastern European countries, or will it be essentially the same?

The collapse of an old social system does not automatically create a new one. However, Western researchers and advisers belonging to universities and international research institutes proposed a universal "transition strategy" for new economic systems without analyzing actual situations and facts the individual countries undergoing these transformations. They urged the rapid construction of a capitalist economy through the privatization of state owned enterprises without consideration of historical and social conditions. Economists sought propositions which could be universally applied to system transformation (transition) in all the countries involved. But theoretical truths that can be applied to different and differing countries are at times less true in practice. If the approach itself is wrong, the conclusions reached have no validity.

So-called mainstream economists believed that the privatization of state enterprises could lead to a shift from a "planned economy" to a "market economy". Economic advisors at the IMF and the EBRD also believed that the coupon privatization in the Czech Republic would be the best and the most rapid solution to privatization, and they strongly recommended the adoption of coupon (voucher) privatization for almost all the countries in the former Eastern Bloc, with the exception of Hungary. They praised the strategy of the Czech Republic as miracle and a model of radical privatization, and they criticized the Hungarian approach of waiting for investment from outside as overly slow and gradual. However, this coupon strategy did not work if the goal was to create companies which could subsist or thrive in a market economy, because the basic conditions for privatization did not exist.

The countries undergoing this transformation had no capital accumulation and no capital market. There were no enterprises with the adequate technology to compete on the international market, and there were no corporate managers with direct experience of market competition abroad. Workers also had never experienced the strict work ethic of a market economy. In the absence of these preconditions, the privatization

envisioned for these emerging capitalist countries, a privatization which was intended to transform them relatively quickly into advanced capitalist countries, was never realized. These facts clearly show that proposals that ignore socio-economic conditions never bring fruitful results.

The absence of the necessary socio-economic conditions for effective privatization can be dubbed the “Aporia” (unsolvable) of system transformation. How can something be created out of nothing? Most socialist industrial enterprises had no ways to privatize and simply had to face their fate: liquidation and extinction. The coupon privatization of the state companies never went beyond the “Monopoly game” in which companies are traded virtually, where a redistribution of state assets through coupon (voucher) privatization took place. The redistribution of state assets was in fact a type of theft of public assets among those who had insider information concerning assets in the control of the state and communist party, or in other words, young communist leaders, high-ranking government and party bureaucrats, and intelligence agents. Those who succeeded in stealing public assets could become the newly emerging businessmen. The redistribution of the state and party assets was the first process of capital accumulation in the system transformation.

Whether one is speaking of economic or political systems or social ethics and norms, the maturity of a society cannot exceed the level of that society at the given stage of development. In Soviet and Central and Eastern European societies, where political dictatorships had been in place for a long time, even if the communist dictatorships had collapsed, the lowest level of parliamentary politics could not be automatically created. The longer dictatorship had been in power, the less chance of establishing a republic system of politics, because there was no condition for democratic political power to emerge as a substitute for the old system of power and exert influences on people. Therefore, the emergence of a pseudo-dictatorship led by old political forces has been observed in many countries even after the collapse of the communist party.

China merits special consideration in this respect. On one hand, the one-party dictatorship of the Communist Party continues to be unchanged. On the other hand, the economic system is clearly on the road to a type of state capitalist economy. How can we understand the gradual progression of the economic system under an unchanging political system?

A political dictatorship can both hinder and promote the development of market economies. In the Soviet Union and Central and Eastern Europe, the market economy was liquidated with the rise of the communist regimes, but in China, the market economy was never been entirely destroyed. The fact that the buds of the market economy were never completely nipped, in contrast with the Soviet Union and Central and Eastern Europe, is what makes the current market economy in China possible. Only by unleashing the active power of the overwhelming population of the Chinese people can the government save the people from starvation and rebuild the national economy. Chinese political leaders are definitely convinced that they cannot achieve the rebuilding of national economy without developing market economy. This is not an ideological position. It is, rather, a very pragmatic stance on the part of the state leaders. In

the future, the promotion of a market economy in China may pose a contradiction or challenge to the maintenance of the dictatorship of the communist party.

In this manner, the study of the transformation (transition) of socio-economic systems must rest on an overall analysis of a socio-economic change of society. This requires careful analysis of intermittency and continuity through social changes. What has changed and what has remained unchanged since the beginning of the transformation? How different are the system changes between Russia and China? By analyzing the many deadlocks which have emerged during the processes of system transformation, one can perhaps capture the full extent of social change. We should not limit ourselves, in our thinking, to the notion that the privatization of state enterprises creates capitalist enterprises or the disappearance of the communist dictatorship automatically creates a democratic parliament. These assertions are not analyses, they are merely armchair suppositions. Our analysis should be based on studies of facts and realities in the various socio-economic conditions of the societies in each country involved.

I was posted to the Embassy of Japan in Hungary in the summer of 1988 as an economic adviser in the Ministry of Foreign Affairs. Hungarian society began to change in the early 1980s, and the internal conflicts in the communist party (MSZMP: Magyar Szocialista Munkáspárt, Hungarian Socialist Workers' Party) intensified. In the fall of 1988, the Central Committee of the MSZMP was embroiled in open conflict between conservatives and the reformists. This struggle finally led to the dissolution of the party one year later (November 1989).

In 1989, Central and Eastern European societies entered a period of drastic change. In May, tourists from East Germany began staying in various parts of Budapest, and churches were filled with "East German refugees". This was the force that led to the opening of the Austro-Hungarian border in early September, the fall of the Berlin Wall in November, and the execution of the Romanian president Nicolae Ceaușescu in December. Thus, the entire world of Central and Eastern Europe collapsed. I described this historic change in articles published in a Japanese periodical entitled *Economic Review* (*Keizai Hyoron*, July 1989 – March 1990), and these articles were collected and published in an edited form in a book entitled *History of Hungarian Reforms* (*Hangari Kaikakusi* [Tokyo: Nihon Hyoron Publisher, 1990]).

In the summer of 1990, when my appointment as economic adviser ended, I returned to the Hosei University, Tokyo. However, given the historic change that was taking place in Central and Eastern Europe, I could not resist the temptation to continue bearing witness to history in the making, and in the end, I resigned from my position at the university and returned to work as a research fellow at Nomura Research Institute in Budapest, when the Nomura Securities Group had just opened an investment bank in Hungary.

In 1994, I published a book entitled *Economics of System Transformation* (*Taisei Tenkan no Keizaigaku* [Tokyo: Shinseisha Publisher, 1994]) as one volume in the series of the new contemporary library of economics. I was asked to write a book on socialist economies before I left for Hungary in 1988. However, the world changed dramatically, and the title was changed from the original "Political Economy of Socialism" to "Economics of System Transformation". Thus, I fulfilled a promise with a delay of six years.

The economic crisis in Russia in 1998 led to the beginning of a decline in Nomura's business in Central and Eastern Europe. I therefore moved to a Hungarian subsidiary established by the Tateyama Kagaku Group (Toyama Prefecture, Japan) in 2001. The Tateyama Kagaku Group is a group of companies which focuses on manufacturing industries, and I worked in collaboration with the Budapest University of Technology to find the best students and innovations in Hungary. I then became more involved with engineers and physicists than with economists.

I happened to find a biography of Hungarian geniuses that was compiled by Professor György Marx in early 2000. I edited and translated the book into Japanese, and it was published under the title *Legend of the Aliens (Iseijinn Densetsu* [Tokyo: Nihon Hyoron Publisher, 2001]). Professor Marx was an atomic physicist and an internationally known physics pedagogue.

I also met Professor András Szász, who discovered a new method of tumor thermotherapy, and together, he and I published a book entitled *Oncothermia* (oncological hyperthermia) in Japanese (*Onkosamia* [Tokyo: Nippon Hyoron Publisher, 2012]). Although the subject matter does not belong to my field of expertise, my interactions with engineers and physicists expanded my vision and knowledge.

In the 1980s, I introduced Hungarian economist János Kornai's analyses of socialist economies to Japan. In 1983, I invited Kornai to Hosei University to hold lectures and seminars, and I drew on these lectures and seminars and edited and translated three collections of Kornai's analyses: *The Economics of Anti-Equilibrium and Shortage* (Tokyo: Nippon Hyoron Publisher, 1983), *The Political Economy of "Shortage"* (Tokyo: Iwanami Publisher, 1984), and *The Possibility of Economic Reform* (Tokyo: Iwanami Publisher, 1986). The stimulus of Kornai's work was great. However, after the system transformation, I stopped translating Kornai's works, because his analyses of the processes of transformation were not as powerful as his earlier analyses of the socialist regime.

However, when Kornai's autobiography was published in 2005, Kornai asked me about the possibility of a Japanese translation. After giving the book a hasty read, I was convinced that it was an important book on Kornai's life and theoretical work. I worked on the translation for roughly six months, and the book was then published in Japanese as *Kornai Yanos Jiden* (Tokyo: Nihon Hyoron Publisher, 2006). It met with tremendous interest in Japan. The four largest national newspapers and economic magazines printed book reviews, including a long review by Professor Masahiko Aoki of Stanford University in the newspaper *NIKKEI*.

In 2006, I began writing essays in Hungarian on the political and social situation of Hungary, and I also contribute to the periodical *Élet és Irodalom* (ÉS). These essays were collected and published as a book entitled *Változás és örökség* (Change and Legacy) (Budapest: Balassi Kiadó, 2009). My Japanese book *The Political Economy of Post-Socialism (Post Shakaishugi no Seiji-Keizaigaku* [Tokyo: Nihon Hyoronsha, 2010]) is an extended Japanese version of the Hungarian book. A second edition of the Hungarian book was published with additions from the Japanese version. The title remained the same, but a subtitle was added: "A kincstári gazdaság csapdájában" (The Trap of the Treasurized Economy [Budapest: Balassi Kiadó, 2014]).

The present book is a collection of analyses of the system transformation to date and various analyses of the social-economic changes which have taken place over the course of the past thirty years in Central and Eastern Europe. As noted above, my first study of the reforms in Hungary was published in 1990, a theoretical analysis of the transformation was then published in 1994, and a study of two decades of social and economic transformation was published in 2010. Thus, I have decided to contribute to the study of thirty years of system transformation in Central and Eastern Europe as my final work. Although I have cited some passages from my earlier works, the present book was written as a new contribution from the outset. Throughout the book, I have tried to offer concrete and factual analyses without ever relying on the models and analyses of others. My aim is to obtain generalizable propositions through analyses of facts. The significance of my approach is described in detail in Chapter 1.

For many years, economic analysis has been little more than tasteless and abstract model analysis. Rather than offering analyses of the real economy and society, it merely parades clever ideas and armchair models on the world, as if economists could see the world better than anyone from university laboratories and from Washington, New York, or London. This strikes me as the arrogant imperialism of mainstream economists. This type of deductive approach has become very popular in contemporary economics, because many economists do not have access to the actual facts of the socio-economic situations in given countries or regions. They therefore seek general propositions which purports to explain the mechanisms of the world. Economists tend to think that they can understand national economies by making abstract models like in physics. Mathematical economists in particular tend to believe that a mathematical model can further an understanding of the world which will be universal in its relevance and applicability, like the understandings offered by physicists. However, most mathematical models are mere toy models of applied mathematics, not economics. This is the “trap” into which those who study a subject far from the field fall. It is a fatal misunderstanding to think and believe that we can analyze the truth of the economy and society by “inventing models” without studying real economy and society. Many economists do not understand the essential difference between economics (social science) and physics (natural science), and they prefer simply to think that mathematical models will enable us to arrive at a universal understanding of the economic world.

This type of deductive approach is similar to that of a kind of Marxism in the sense that both are based on idealism. Many abstract models are built to explain problems, and articles are full of models invented by researchers, and furthermore the mere introduction of a model becomes an independent article. This is exactly what Prof. Shigeto Tsuru¹ ironically criticized as the pedantic tendency of economics. He thought

¹ Professor Shigeto Tsuru was a classmate with Paul Samuelson and a good friend of Paul Sweezy at Harvard University. He became the first minister of the Planning Agency of the Japanese government immediately after World War II and then served as the president of the Institute for Economic Research at Hitotsubashi University. He was the rector of Hitotsubashi University from 1972 to 1975, when I served as chairman of the community of graduate students at the university.

that economic science (the science of economies) has degenerated into “economics of economics”, i.e., an economics of economic theories and models. In fact, many economists produce articles by introducing models and using established theories, not by analyzing real economies. Has not the analysis of the so-called “economics of transition” fallen into this kind of “pedantic trap”? In order to further an understanding and, hopefully, adoption of a more suitable approach and method of socio-economic analysis, the present book is written maximally based on facts and with the criticism of the “economics of transition” in mind.

The present book consists of the following chapters.

Chapter 1: “Methodology of System Transformation”; Chapter 2: “Social Philosophy of System Transformation”; Chapter 3: “The Economics of System Transformation”; Chapter 4: “The Economics of Post-Socialism”; Chapter 5: “The Sociology of System Transformation”; Chapter 6: “The Politics of System Transformation”; Chapter 7: “Post-Socialism and Populism”; Chapter 8: “Historical Science of System Transformation”; Chapter 9: “General Summary of Twentieth-Century Socialism”.

Chapter 8 offers an understanding of the origins, development and collapse of East European Socialism with a focus on Hungary as a typical example. The culmination of this historical analysis comes with a discussion of the 1956 uprising. By focusing on the incident, I analyze the historical process that led to the uprising and its later consequences. Since the collapse of the socialist system, new documents, testimonies, and records have been released on the 1956 uprising, we can reexamine the historical formation of the so-called Peoples’ Democratic Revolution in Central and Eastern Europe after World War II. Discussions of the Executive Committee of the Soviet Communist Party during the Hungarian uprising have also been made accessible. By using these materials, we can gain new insights into the event. The numerous facts described in Chapter 8 are not yet known widely. Although the task should be left to historians, I venture to undertake it because few researchers have attempted to tackle (or seem likely in the near future to tackle) this task in Japan.

I have been living and working in Hungary for more than thirty years. I also spent twenty-two months in Hungary in 1978–1980. Thus, I have spent more than thirty-three years in Hungary. There is as big a difference in pursuing analytical work on Hungary in Hungary and pursuing analytical work on Hungary in faraway Japan as there is between heaven and earth. I am convinced that, because I took advantage of my geographical location, my analyses and what I have written about my experiences will be a useful contribution to understandings of the system transformation.

In retrospect, I happened to have an opportunity to travel through the Soviet Union and the Eastern European countries in 1968. By chance, I got a student summer job as an English interpreter for a large Japanese delegation to the Soviet Union, Bulgaria, and Romania. At that time, as a university student, I did not have any interest in socialist countries. I knew that there had been an enthusiastic debate on economic reform and the possibility of a revival of capitalism in the Soviet Union, and there was also a political movement in Czechoslovakia. However, on the day when the ship from Nakhodka arrived off the coast of Niigata, the Soviet army invaded Czechoslovakia. I vividly remember listening to the news on the ship radio.

Ten years later, I was given a scholarship by the Hungarian government to study in Budapest, and again, I did not particularly want to be in Hungary. The research and educational environment at the Hosei University, where I had begun to work, was so poor as a result of a violent student movement that I simply wanted to study abroad quietly as soon as possible. One of my teachers, Professor Yoshimasa Kurabayashi² at the Institute for Economic Research at Hitotsubashi University, recommended that I consider studying the national accounting system in Hungary. Professor Kurabayashi wrote some introducing letters to experts at the Central Statistical Office. I was assigned to the Department of National Economic Planning at the Karl Marx University of Economics in Budapest. Which produced specialists in what is known as the “planned economy”. Miklós Németh, who became prime minister during the system transformation, had belonged to this group of specialists. Németh is one year old younger than I am, but he had already moved to the Institute of National Planning Office when I began to study at the department.

In 1988, ten years after this incidental study excursion to Hungary, I was given the opportunity again to be posted to Hungary as an economic adviser to the Embassy of Japan in Budapest. I began to realize that periodical trips to Eastern Europe roughly every ten years were part of my fate. I have done my best to take advantage of the opportunity given to me by fate, and I have contributed to the study of system transformation with insights and analyses which would have been impossible from faraway Japan. This has been my mission as someone who happened to be in Central and Eastern Europe when the socialist system collapsed and the reconstruction of society began.

Finally, I would like to write some words about the cover illustration. It was made by János Kass (1927–2010), a famous Hungarian illustrator and graphic artist. When I visited Kornai’s home in Budapest. I found Kass’s drawings on the wall under the theme of “The Economics of Shortage”. I decided to use these drawings for the Japanese translation of Kornai’s books. Since then, I have also used Kass’s illustrations in my own publications. The present book is the English translation of my Japanese book published in March 2020, and I chose the same drawings for the cover of English publication as Japanese book with the permission of Eszter Kass, who inherited Kass’s bequest.

Last but not least, I would like to express my gratitude to Thomas Cooper, professor of American Literature and Translation Studies at Károli Gáspár University of the Reformed Church in Budapest for his supervising work of the English text. Without his help it would had been quite a difficult task to publish this English version of my Japanese book. I am also thankful to Tateyama R&D Europe Ltd. for its financial support to publish this book.

Budapest, January 2021

Tsuneo Morita

² Professor Kurabayashi is an expert in the field of national accounting in Japan and was appointed to serve as chairman of the UN Statistical Office from 1982 to 1986.

Chapter 1: The Methodology of System Transformation

The Discrepancy between Theory and Reality

An analysis of the social changes of the century – the establishment and collapse of the twentieth-century socialist state and the subsequent construction of a new political and economic system – cannot be contained in a simple economic analysis. It must be a social analysis which also captures the behavior of people living in the midst of political, economic, and social changes, as well as changes in social norms. It cannot merely be an analysis of newly emerging political, economic and social phenomena, but must capture the historical process and logic of the socialist state, from its creation to its collapse.

In turn, how have the social sciences analyzed these historical changes in the thirty years since the beginning of the system transformation? Alongside economics, have history, political science, and sociology not also made the collapse of twentieth-century socialist society and the construction of a new social system an object of analysis? In particular, there were many researchers in Japan who studied socialist countries and socialist societies not only in the field of economics but also in the field of historical science. How did they view the historical changes of the century? If they produced new findings, how are these findings consistent with previous findings, or is such a comparison meaningless? Has each researcher faced the social changes of the twentieth century with intellectual honesty? Even if the social system is reset, it should not simply reset the researcher's thinking. We should not be able to begin analyzing a new regime without a self-reflective examination of whether our previous thinking and analysis were methodologically well founded, consistent, and accurate.

However, to the best of my knowledge, it is difficult to say that researchers at major academic associations of social sciences have reviewed earlier research and conducted comprehensive theoretical analyses and discussions with one another. This is true not only for Japan, where socialist studies were active, but also for the countries involved in the process of systemic change. In the midst of great social change in countries undergoing regime change, scholars have lost the intellectual leeway to draw a new social outlook by reviewing earlier analyses, and many economists have been so busy adapting to the changes and looking for new “sources of income” that they have never become dispassionate social analysts and historians. Only a researcher who is able to maintain a constant distance from the social changes can calmly observe the daily changes in society while reviewing the history of the past.

What about researchers in Japan? Many of them were shocked by the collapse of the socialist system and had no inkling as to how to understand the historical changes which lay behind it. Originally, there were so few researchers in Japan that it can be said that none of them analyzed the reality of socialist society, and there were many

researchers who embarked on the study of socialist societies because they had sympathies with socialist ideology. Moreover, the far-flung socialist states of Europe have been shrouded in a veil for so long that a short period of study abroad did not allow these researchers to gain any deep insights into the realities of life in the socialist societies in Central and Eastern Europe. It is therefore no surprise that the study of socialism in Japan is tightly bound to socialist ideology.

On the other hand, what about researchers who have been skeptical of socialist ideology? This group of researchers has tended to think that the collapse of socialism was inevitable from the outset, and that it is therefore not necessary to analyze the logic of the collapse. But the question of how to analyze and understand the collapse of the socialist state, whether one begins from a position of ideological sympathy or skepticism, is an unavoidable challenge if these societies are the subject of study. But many researchers seem to think they can dispel the past by avoiding these serious intellectual endeavors and aiming to conduct research that is not ideological in nature. This is the researcher's self-defensive reset.

However, there is an inevitability to this reset. This is because the task of exploring the logic of the collapse is not easy, and it prompts intense self-reflection concerning one's own socio-ideological convictions. On the other hand, the countries which underwent system transformation have made progress in building new social systems. Many researchers, trying to keep up with the times, scrambled to find theories and proposals for the new era instead of turning to the "futile" work of reviewing earlier analyses, which, they presumably feared, would take up too much of their time. Again, many Japanese researchers were busy introducing the various models of "system transition" that Western researchers and institutions had come up with. They have come to think of the introduction of the analytical model as if it were a system change analysis. It was the beginning of the "economics of transition economics, i.e., not an economics of the transition economies, but an economics of the transition economic models. However, this type of analysis rarely provides new insights into the realities of a society undergoing regime transformation. The basic approach, which relies on the research and authority of others, is of the same quality as the research produced according to the methodologies pushed by the old regime.

1.1 The Curse of Ideology

A country's economy and society cannot be irrelevant to the state of the world economy or to international politics. The post-World War II world was long dominated by the Cold War struggle for hegemony between the Soviet Union and the United States. The Soviet Communist Party-led socialist ideology thus had a major influence on the analysis of the socialist world led by the Soviet Union. Moreover, there was a definite lack of information about socialist society's continued isolation from the Western world. So there was a long period of time when there was no information to rely on other than the official position of the Soviet Communist Party.

Under these circumstances, many scholars generally ended up debating the rightness or wrongness of official views and orthodox ideologies, and they generally ended

up discussing principles from the perspective of a defense of socialism. This had a huge impact not only on the field of economics, but on history as well. Japanese leftist historians have long held the Soviet Communist Party's view of history, according to which the Soviet-led socialization of Central and Eastern European countries was a "two-stage revolution from people's democratic revolution to socialist revolution". There was a long period of time when both the subject and content of this research were influenced by ideology.

In this respect, Western researchers differ. Western socialist researchers are often exiles, and they have been notable for their willingness to take the real problems of socialist societies seriously and study them. In Western Europe, critical studies of socialism have been carried out by scholars who were either excluded from the real process of socialization promoted in the 1940s and 1950s or were exiled because they could not bear the discomfort. Their experience of the actual process of socialization allowed them to provide much more realistic analyses than the analyses offered by Japanese researchers who relied on ideology.

Nevertheless, it was only after the system change and the release of confidential information that reliable data and sources concerning the socialization process in Central and Eastern Europe became available. At the end of the 1940s, with the start of the Cold War, the communist parties in Central and Eastern Europe, supported by the Communist Party of the Soviet Union, purged one politician after another who opposed the Soviet-led socialization of the country and established a communist dictatorship. The socialization of Central and Eastern European countries, achieved through Soviet military pressure, led to many tragic events, the details of which are still being brought to light and interpreted by researchers in the countries concerned.

The establishment of a power that advocates socialism does not automatically mean the creation of the conditions necessary for the construction of a socialist society. The communist dictatorship justified its usurpation of power with the mantra that dictatorship was only a means to establish a national economic plan, achieve balanced economic growth and build a prosperous society. But the difficulty of realizing these objectives became apparent shortly after the establishment of socialist power.

Even decades after the Russian Revolution, the means of formulating and implementing a national economic plan had not been established, and then World War II broke out. It did not take long for socialist economic planning to degenerate into a war-time rationing system. Even in the socialist countries of Central and Eastern Europe, this immaturity was not overcome, and a de facto wartime rationing system dominated the national economy. The management and revitalization of the national economic activity were entrusted to the political leadership of the Communist Party, and the communist dictatorship was established as the system to control society. To rationalize the communist dictatorship, the fiction that a competent leader could politically lead the national economy dominated the Central and Eastern European world. This led to the stagnation of the national economy and its decoupling from development in the West, and the national economy went through a historic process of self-destruction.

The fiction of political leadership of the national economy by the Communist Party led to the collapse of the socialist economy and, therefore, twentieth-century social-

ist society. Twentieth-century socialism never surpassed wartime socialism, and the stagnation of the national economy created an unbridgeable development gap between the East and the West, and the postwar wartime socialist system was on the road to collapse.

In the midst of the regime change that began in 1989, did Japanese historians revisit the old understanding of the establishment of the socialist state? I have never happened across any indication that any such major discussion or reconsideration took place. In the field of economics, there was a lively debate about changing the name of the Association for Socialist Theoretical Economics, but it cannot be said that there was any rigorous debate concerning how to reinterpret the twentieth-century socialist economy or how to view system change.

It is intellectually negligent for a researcher to neglect the theoretical work of re-examining earlier analyses. It can also be said that the negligence of re-examination shows earlier analyses and research had only limited merits and use.

1.2 The Limitations of the Aprioristic Speculative Model

Ideological dependence is not the only trap that researcher falls into when he or she is geographically distant from the subject of analysis. It is a natural desire for a researcher to want to understand the nature of distant reality, if only for its essence. Many researchers have a desire to build a universal analytical model on the basis of which they can construct understandings of the world. This is a trap for researchers who lack information and data or who work for an international organization or research institute and want to study the world without leaving the confines of a university or laboratory.

Some researchers are not interested in concrete reality from the outset, and their research is focused on and intended to further the construction of speculative abstract models. This type of research is particularly common among mathematical economists who have moved from mathematics to “economics”. Many researchers in the field of neoclassical mathematical economics are under the illusion that the economic world can be understood by mathematical models. This would be something like a scholar in the field of physics using mathematical models to make discoveries. However, the worlds covered by physics and economics are quite different. Ignoring that intrinsic difference, these researchers think that reality can be understood by speculative mathematical models that are not backed up by data or observation. The model constructed by mathematical economists is an applied mathematical model, not an economic and social model that takes reality into consideration. Mathematical economic models that merely mimic physics have their limitations as social models from the outset.

The world covered by physics does not change whether you are in Japan, the United States, Russia, or Central and Eastern Europe. The world covered by the natural sciences can be analyzed no matter where you are, as long as the laboratory is properly equipped. Economic and social analysis, however, does not work that way. It is impossible to use a single simple mathematical model to compare the United States, a multi-ethnic country with a highly developed capitalist economy, with the welfare states of

Europe or with the countries of Central and Eastern Europe, which consist of almost a single ethnic group and are at a low stage of market economy development. Moreover, it is wrong to think that there is a model that can collectively capture all the countries that have made the transition from different social conditions to system change. However, economists and researchers who believe that the world looks better from Washington or London think that they can build a universal model on the basis of which they can arrive at a single valid understanding of system transformation, even without analysis of the real economy and society. This is the arrogance of neoclassical economics.

Originally, in mathematical economics, it does not matter whether a model reflects reality or not. The criterion on which an assessment of the usefulness of a model is defined is that the problem to be solved by the model is clear, the conditions for setting up the model are well defined, and the logic for drawing conclusions from the assumptions is consistent. Realistic reflectivity is not an issue here. Therefore, even if a topic is only an idea or concept, if a mathematical model can be created, this is regarded as a research achievement. If one thinks about setting up a clever problem and one makes no mistakes in the logic from which conclusions are drawn from premises, the model is considered excellent. But that does not deepen our grasp of reality. These methods and models are more a matter of being accepted in the world of academia. The reality-reflectivity of the model is limited by the assumptions on which it is predicated, so the more abstract the assumptions are, the less realistic the implications are. The real problems of economies are never analyzed in such abstract models.

Throughout the 1990s, economists at the IMF and the European Bank for Reconstruction and Development (EBRD) encouraged radical rather than gradual reforms to promote the creation of a market economy in transition, and they recommended policies to privatize state enterprises in one fell swoop, such as the coupon privatization introduced in the Czech Republic. Inspired by these recommendations, economists envisioned an oppositional relationship between radical reform (shock therapy) and gradual reform, and they were ardent in their support for radical reform through shock therapy. From that point of view, the Czech Republic, which pursued large-scale privatization in one fell swoop, was praised, while Hungary, which did not follow this kind of radical policy, was usually criticized.

By the end of the 1990s, however, IMF researchers themselves acknowledged the failure of coupon privatization and suggested that the idea of pitting “radical and gradual reforms” against each other was in itself meaningless. Nevertheless, even after this, a debate continued in the West which discarded the specific issues of privatization and direct investment during the system transition and adhered to an abstract oppositional model which had already lost its practical meaning. This is the same kind of argument that generalizes Kornai’s concept of “soft budget constraints” by the theory of the game, away from its original analytical implications. It is not surprising that the debate concerning “radical and gradual reforms” in the 2000s degenerated into a debate devoid of specifics and unrelated to the pressing issues of the era of system transition. Formal models without concrete content appear to have general applicability, but they are not useful for analyses of real-world events. The contrast between “radical vs. gradual

reforms” can be easily applied to the debate about whether jogging at a pace of nine kilometers per hour is better for your health than walking at a pace of six kilometers per hour. Thus, a general contrast between radicalism and gradualism is a contentless argument that can be applied to all matters.

However, in the case of a “jogging vs. walking” comparison, specific physiological metrics could be specified for the comparison, but there is no general metric that can be used to compare “radical vs. gradual reform”, so the model’s designers can make assumptions in any way they wish. Different assumptions yield different models. This is a kind of “mental gymnastics”, so to speak, and it offers nothing meaningful or applicable when it comes to economic or social analysis. To think that the comparison, which has nothing to do with system transformation, is an important issue related to this transformation it is not only an illusion, but also a pedantic idealism inherent in the world of contemporary economics.

Models and theories that seem to provide a comprehensive view of reality are unquestionably appealing to those who seek to theorize. Indeed, such theories and models can have a certain applicability in our attempts to arrive at understandings of reality. However, theories and models are only useful as tools with which to understand reality if they are supported by an analysis of reality. A model constructed thoughtfully on the desks of universities and laboratories far from the European scene will never have such validity. That is the difference between physics and economics. Most model analyses not based on any analysis of reality are mere symptoms of the pedantic idealism of the researcher and have no actual use in our efforts to offer economic and social analyses of real world. (For more on this discussion, see Chapter 3.4.2 “The Fake Model – The Desk Argument”).

1.3 The Illusion of Metaphor/Analogy

A clever metaphor can give a nudge to social analysis. In a series of socialist economic analyses, János Kornai¹ used a variety of metaphors and analogies to try to characterize the socialist economy of the twentieth century. For example, he referred to the “paternalism between the state and the corporation”, which he used as a metaphor for the typical scene of a socialist economy, the “soft budget constraint”, which captures the easy management attitude of corporations, the “social psychology of shortage”, which produces the reproduction of shortage in a shortage economy, and so on. “Soft budget constraint” is a perfectly fitting phrase to describe the behavioral characteristics of socialist firms. Furthermore, Kornai likened the relationship between the state and corporations in a socialist economy to that of a father-son, and he compared the degree of paternalism by classifying it into five stages and thus offering a novel socioeconomic analysis which differs from conventional socialist economic analysis. In addition, the description of the vicious cycle of consumer behavior in a shortage economy, which creates more shortages, is also a socio-psychological analysis of the shortage economy that goes beyond a simple economic analysis.

¹ For Kornai’s argument, see the literature at the end of the book.

Thus, with his tactful phrasing, Kornai created a stir in the circles of researchers and economists offering conventional socialist analysis. Analogies and metaphors that contrast economic behaviors to behaviors in different fields of analysis can provide surprising and witty promptings which may shatter rigid understandings of economic society. Kornai's analysis are exactly that kind of sociology of political economy. It is no coincidence that in the 1980s, when the embryo of social change was felt in the Soviet Union and the countries of Central and Eastern Europe, Kornai's writings became the bible of reformist intellectuals.² Major social change always requires a palpable ideological conviction that prompts a change in people's thoughts, consciousness or emotions. It is no exaggeration to say that Kornai's socioeconomic analysis was the intellectual backbone that gave rise to the system transformation which began in Central and Eastern Europe in 1989. Non-traditional conceptions and ideas change people's social thinking, which in turn becomes an ideology that leads to significant social change. Kornai's thoughtful analyses provided precisely these kinds of non-traditional conceptions. While it is undeniable that these analogies and metaphors break down old notions and thoughts, the extent to which they actually succeed in providing useful analyses of reality is another matter. In contrast with prevailing practice decades ago, when great scholars used their own methods to construct "grand theories" to understand the entire economy, today we live in an age in which ideas and propositions that offer useful partial understandings of economic phenomena are valued. In particular, it has become necessary to build certain propositions and models with clever ideas in order to build a position in mathematical economics. The various ideas and analogies presented by Kornai in the *Economics of Shortage* are very suitable for building such a model.

For example, the "soft budget constraint" has moved away from its original implications and become a model of game theory as "a problem of inconsistency where promises made at the beginning of the game become unkeepable in the middle of the game". Thus, analogical analysis is often transformed to an economic model. But will this kind of analogy analysis improve our understanding of the real economy? Even if one could generalize the concept of "soft budget constraint" as a "phenomenon that deviates from the rules originally set and fails to maintain consistency" away from Kornai's original implications, that does not mean that one has "analyzed" anything. Such a generalization would be contentless. It would merely appear to be applicable to all events. These kinds of generalizations do not allow us to analyze the specific problems of the real economy. The generalization of analogy is never beyond the realm of analogy. This type of argument is extremely common in individual propositions and partial theories of contemporary economics.

In Kornai's autobiography,³ Rossers's view that "Hungary achieved the hardest budgetary constraint among the regime-transforming countries" because of "the influence of Kornai's economic policy recommendations" is presented. Kornai describes

² Among Soviet and Central and Eastern European intellectuals at the time, the cliché "Have you read Kornai?" became a greeting.

³ János Kornai, *By Force of Thought* (Cambridge, MA: The MIT Press, 2007), 376.

Rossers's statement as satisfying. However, this is a classic case of a misunderstanding of the relationship between economic theory and economic policy. Softening or hardening of budget constraints is only an expression of an economic phenomenon, not an analysis of the essence of the matter. So it does not mean that simply "making soft constraints hard" will solve the real economic problems. The phenomenon of softening would not go away unless we change the economic system that makes budgetary constraints soft to an economic system that makes them hard. It is not something that can be accomplished by simply ordering a company to make its budget constraints hard. Rossers's statement constitutes a view of the relationship between theory and policy that is overly simplistic. Kornai himself does not clearly distinguish between the representation of economic phenomena and the essence (system) that gives rise to these typical phenomena. He does not accept the German philosophical notion of essence, which is invisible to the phenomena, and he eliminates the notion of essence from the beginning. However, the theory is only complete when we analyze the essence of a phenomenon and explain how the phenomenon in question arises from that essence. Physics consists of systems that describe both microscopic and macroscopic physical phenomena, such as quantum mechanics, molecular mechanics, Newtonian mechanics, and cosmic mechanics. The analysis of the hierarchy of matter in nature is nothing more than a way of analyzing the essence from the phenomena and trying to understand the phenomena from the essence. However, in contrast to the analysis of phenomena to essence, it is extremely difficult to integrate the understanding of phenomena from essence. This is because essence alone cannot explain all the phenomena. In a system of physics, there are dynamics that describe fields and states to compensate for the gap. In economic analysis, too, just because you analyze the essence of a phenomenon does not mean that you understand it. This is because even if we have useful clues which can help us arrive at an understanding of a phenomenon, a full understanding of the phenomenon requires an analysis of many ancillary factors.

In any case, it is a leap to think that policy recommendations can be made directly from the representation of a phenomenon without an analysis of its essence. So policy recommendations that remain limited to the expression of phenomena are not effective. Kornai's analysis is limited to an understanding of the chain of phenomena, and it mistakenly assumes that policy recommendations come directly from the representation of phenomena.

The same is true of paternalism: the solution is not for the state to declare that it will stop its "paternalistic attitude" towards corporations, but rather to create an economic system in which corporations can operate autonomously, which is the essence of solving the problem.

Thus, while clever naming and analogies of economic and social phenomena contribute to an understanding of the phenomenon, they are no substitute for the essential elucidation that results in problem solving. In order to solve a problem, we must understand the essence of the phenomenon which has created it. However, it is impossible to get to the heart of the matter if we stay on the dimension of phenomena. An analogy is only an analogy, and a metaphor is nothing more than a metaphor. It is naive to think of metaphors as the "discovery of the century" and to believe that "publicizing

the implications of metaphors will solve the problem”. Analogies and metaphors cannot serve as substitutes for essential analysis, and it would be an elementary error to draw economic policy implications directly from them.

This kind of fallacy is a trap in which most economists fall when they try to understand the economy according to an abstract economic model. The distance between abstract arguments and understanding of reality in economics is too great to be filled. Only by analyzing the essence from the phenomenon and understanding the phenomenon from its essence can we make policy recommendations. Recommendations without this process will have no practical meaning.

1.4 Individual Concept (Concrete) and General Concept (Abstract)

Most researchers have a fixed place of study. They cannot travel to all the transition countries, and even when they can travel directly to the field, what they can learn in the time allotted to them is very limited. Therefore, researchers are forced to use various models and abstract methods to compensate for a lack of empirical knowledge. They therefore attempt to analyze the socio-economy in question with models obtained a priori, but in general without sufficient concrete information. Such an analysis has limitations.

In order to analyze new historical events such as system transformation, it is essential to step into the field to a certain degree and track changes in the situation over a reasonable amount of time. This should lead to the discovery of many phenomena that cannot be elucidated by existing knowledge or existing analytical tools. In such cases, new insights through analysis of specific events will lead to the development of social sciences. However, researchers who do not have a foothold in the field have no choice but to analyze new events based on existing and already generalized findings. Often, the application of such existing knowledge leads only to stale propositions, not to new knowledge. Whether the researcher is aware of it or not, there is a conflict between “concrete analysis of events (individual concrete)” and “reduction of individual events to generalization (general abstract)”.

Valid general propositions and theories for the analysis of reality are obtained on the basis of the analysis of a number of concrete events. Propositions based on the analysis of many concrete events have the validity of a reality analysis. However, many propositions in contemporary economics are based on extremely limited individual events or on a completely speculatively created “reality”. By nature, general propositions and models are poor in terms of content because they truncate many aspects of concrete events. Moreover, speculatively devised propositions and models are contentless from the outset. What would happen if such general propositions were used as a weapon to analyze the phenomenon of countries undergoing system transformation? Can we properly capture the characteristics of systemic change constrained by historical time at the end of the twentieth century? If we apply existing knowledge (propositions) unilaterally, without analyzing historically constrained specific events, the conclusions we obtain will be extremely general and contentless.

For example, the existing knowledge of contemporary economics does not capture the phenomenon of corruption inherent in system transformation. In development economics, however, it is common to view corruption in terms of the concept of “rents” or “rent-seeking”. Therefore, researchers geographically distant from the scene of the transition countries try to use these concepts to describe the phenomenon of corruption in the countries undergoing system transformation. However, the rent concept does not allow us to understand the corruption phenomenon characteristic of regime change.

The prevailing form of corruption inherent in the transition is the looting of state and party assets. Of course, there have been simple acts of theft, but most of the time, the primary form of corruption has been either the cheap sale or the looting of assets through the exploitation of coupon privatization schemes. This type of looting of state and party assets is common to the process of transition in all countries. Where the state apparatus has collapsed, such social action is invariably found, but this is different from the general phenomenon of corruption in an economic society with an established market economy. Moreover, importantly, plundered assets formed the initial accumulation process of capital in the countries undergoing transformation. Unraveling the paradox of this historical dynamic is essential to any analysis of system transition. To apply the concept of corruption on the basis of a contentless rent-seeking approach is to miss the historical nature of the corruption inherent in the system transformation.

As will be discussed in detail in Chapter 3, I see system transformation at the end of the twentieth century as a process of redistribution of state and party assets from an economic perspective. This is precisely the beginning of transformation from the redistribution of existing assets. If we fail to analyze this social dynamic and rely instead on market equilibrium and static rent-seeking concepts, we will fail to offer any accurate or meaningful analysis of the phenomenon of corruption in the societies in question.

Any analysis of new historical events must begin with an analysis of concrete events. Without knowing the field, we should not assume that we can understand the corruption phenomenon of the system transformation on the basis of existing knowledge and propositions made in Washington, London, or a university laboratory. We would arrive at a pedantic enumeration of propositions, at most.

1.5 The Trap of Economics: From Real Economics to Financial Economics

The post-World War II economic world, whether Marxist or non-Marxist economics, socialist or capitalist economies, was exploring the possibility of developing a national economic plan (except in the United States). Reflections on how the collapse of capitalist economies led to world war and the intellectual interest in what could be learned from the planned economy of the Soviet Union determined the direction of the post-war economic world in postwar economic reconstruction. Japan also established the Economic Planning Agency (ECAP), which worked actively to develop national income statistics, create an input-output table originally derived from the Soviet Union’s material balance for goods and services, and construct a macroeconomic model. In

fact, many of the early winners of the Nobel Prize in Economics, established in 1969, were economists who were engaged in research related to this kind of national economic planning.

However, as technological innovations in the advanced capitalist countries brought a new level of sophistication to the market economy, interest in national economic planning gradually waned. In Japan, the Economic Stability Headquarters, which was responsible for postwar economic stabilization policy, was reorganized into the Economic Planning Agency in 1955, and it began to focus on the creation of macro-econometric models. In 2001, the Economic Planning Agency was abolished as an independent agency. It has been succeeded by a number of committees in the Cabinet Office.

In an era of qualitative development of the market economy, state guidance and control will be minimized, the focus on management and control of the national economy will be weakened, and priority will be given to ensuring the freedom of private economic actors. In addition, input-output analysis, which measures the balance of goods and services, may have a certain validity in times of stable industrial structure, but it is not useful in times of structural change. In the era of structural development of the market economy, control-oriented planning is relegated to the background.

The same can be said of the countries that have undergone system transition. In the former socialist countries, including Hungary, national economic planning departments were established at the universities of economics, and economists who graduated from them took jobs in the government's economic planning agency and its affiliated institutes. This government agency, under the direction of the Communist Party, was formulating the government's national economic plan. However, in 1990, shortly after the beginning of the transition, Hungary abolished the National Planning Agency. Its tasks were assumed by the Ministry of Finance, but, importantly, it was not charged with the task of formulating a national economic plan. This is because systemic transformation aimed at the full-fledged introduction of a market economy, and it was predicated above all on ensuring and guaranteeing the independence of private economic agents. In such an era, national economic programs such as the postwar reconstruction plan were regarded as a "hundred harms with no single benefit".

Thus, at the turn of the twentieth and twenty-first centuries, both capitalist and socialist countries abolished organizations such as the Planning Agency, which had been created after World War II. As a result, the weight of the input-output table, which captures the balance between the production and consumption of goods, declined, and researchers' motivation to pursue research itself declined. The main reason for this is that the structure of the market economy had developed in a complex way, making it difficult to analyze the national economy based on real (commodity) economy.

On the other hand, the development of the market economy generated huge amounts of wealth, and the expansion of the financial economy to manage that wealth has brought a variety of economic propositions from financial market analyses. As a result, financial economic analysis has replaced the real economic analysis and has taken the lead in contemporary economics. This shift in the world of economic analysis has changed the very nature of economic theory. Various discoveries and techniques derived from the analysis of financial economy and theories and techniques of finan-

cial market forecasting have become highly valued. Moreover, it has become popular to apply the findings from financial economic analyses to the real economic world.

Since financial economy can be analyzed in the common unit of money, it is much easier to construct a financial model than a real economy model consisting of different industries and commodities. Moreover, financial models can be tested on a daily basis. The result is the illusion that financial economic analysis can replace real economic analysis. With the increasing weight of the financial economy in the national economy, economics has also shifted from real analysis to financial analysis. With that, the character of economic theory gradually began to change.

Thus, in the world of economics, the desire to build grand theories that deal with the national economy as a whole diminished, and techniques and ideas that could explain individual events became more valuable. This has led to the illusion that real economic analysis can be done by applying propositions derived from financial economic analysis. This, too, has further diminished interest in input-output analysis, and financial economic theory and recommendations based on forecasts of financial trends have become the axis of economic policy. Today, when we speak of “markets” we are not referring to the markets of the real world, but to “financial markets”. The term market trends, as it is used on a daily basis, has come to refer to the stock market and the interest rate and currency markets, rather than the real economic trends of individual commodities.

However, no matter how much the weight of financial markets increases, the real economy and the financial economy are two different things. It is an illusion to think that “if you analyze the financial economy, you have analyzed the real economy, too”. This is a major weakness and failing of contemporary economic analysis.

1.6 Fallacy of GDP Supremacy

Since the birth of economics, the search for a metric that captures the real-world development level (scale) of a nation's economy in quantitative terms has continued, and since World War II, the United Nations Statistical Commission has led the development of a quantitative metric of the total national economy. Originally, national income statistics began to be compiled by the United Nations after World War II to calculate the contributions of member states. From there, the United Nations Statistical Commission spearheaded the construction of a system of national accounts to integrate various types of economic statistics, and this standard system came to be established as a system of national economic statistics that should be maintained universally throughout the world. The economic indicator at the core of this system is the concept of gross domestic product (GDP), which is the sum of the value added produced within the territory of national economy.

Today, GDP is commonly used as a quantitative indicator to measure the level of activity in the national economy, and it is an established measure of the substance of the economy. In contrast, the weight of input-output tables, which take longer to construct and are not guaranteed to be accurate, has decreased to an infinitesimal degree. As a

result, the real analysis of the national economy has been reduced to a GDP analysis, and the analysis of the national economic linkages of individual industries has been relegated to the background. The era has born witness to the rise of GDP supremacy. Nowadays, GDP has become synonymous with the real (real) economy, and there is a tacit understanding that we can understand the real economy by analyzing GDP. But can we really think of GDP as synonymous with the real economy, or does GDP analysis mean that we have analyzed the real economy?

GDP is an aggregate concept of value added, which is quantified by giving a “common length (metric)” (value-added norm) to heterogeneous production in order to capture national economic activity consisting of heterogeneous and incomparable forms of commodity production in a unified manner. On the other hand, the method of interpreting national economic activity in terms of value-added norms leads to a failure to understand the complexity of the real economy. This is because the aggregation of national economic activity by value-added aggregation assumes that the differences in the use-value of various industrial activities can be discarded.

Many economists are under the illusion that they can understand the real (real) economy by manipulating the aggregate value-added norm, GDP, but this is only a quantitative understanding of one aspect of the national economy. GDP is an indicator created by economics to quantify the national economy, not to capture the diversity of national economic activities (activities with diverse qualities). The value-added norm (a quantitative measure) and the real economy (the production of goods consisting of countless use-values) are two entirely different things. It is a mistake to think that the national economy can be understood by manipulating the GDP, because GDP is a product of our brains, but the real economy is real.

Similarly, a comparative analysis of the economic development in the transition countries cannot be said to be an analysis of the real economy if it is based solely on the size of the GDP or on changes in GDP. This would be like comparing the shapes of mountains while comparing a long series of peaks in the distance. However, a comparison of mountain forms does not tell us anything about the actual features of the mountain (steepness, flora, habitability, economic viability, etc.). In other words, unless we analyze the qualitative characteristics of each national economy individually, we have not analyzed any of national economies at all. However, many researchers, without questioning the meaning or limitations of the GDP indicator, proceed with the discussion under the illusion that it is an absolute real indicator and do not proceed with any further analysis of the real economy. This does not allow for an accurate analysis of the national economy. We should not be under the illusion that we can understand the current state of the national economies of the transition countries by comparing general economic indicators. There is only so much that can be analyzed without knowing the reality of each national economy. This approach reflects the arrogance of a researcher who does not rigorously inquire into the limits of his/her own analysis. Any serious researcher must have the humility to remain aware of the dangers of not knowing the reality of the system or society he or she seeks to analyze.

1.7 Limits of Phenomenalism

In his magnum opus, *Anti-Equilibrium* (English version published in 1971), János Kornai divided economic theories into two types. One is normative (deductive) theory found in the logical and mathematical sciences. The other is positive (empirical) theory, which is based on experience.

A normative theory is a theory that does not need to be proved by reality. As already mentioned, this is the case with a priori model analysis. In this type of analysis, the legitimacy of the conclusions reached on the basis of the model is required only by the assumptions of the model and the logical mechanisms of the model. If the assumptions on which the model relies are clear and the logic on the basis of which the conclusions are reached working from those assumptions are consistent, then the model is justified. In many cases, this kind of model is, as Kornai argues, a tautological proposition. In my assessment, many economic models in contemporary economics are propositions of this kind, propositions which are valid but which are not based on any examination of reality. This kind of model is often prone to being mere abstraction in the sense that the problem set by the model does not exist in reality. If this happens, it would be fair to say that economics has degenerated into an ideological construct that has not been validated by real-world observation or data.

Empirical theory, in contrast, have realistic reflectivity (verifiability by reality) which affirms or confutes the validity of the theory. The validity of this theory is guaranteed by reality-based testing. Kornai attempted to critique the tautological theory of equilibrium by constructing a theory that describes the disequilibrium of reality.

The grand theory that Kornai aimed at was a system-like theory of Karl Marx's *The Capital*. Following Marx, who began building his grand theory from an analysis of commodities, Kornai identified the concept of "shortage" as a key concept in the grand theory of socialist economy. The *Economics of Shortage* by Kornai is an analysis of why the phenomenon of shortages is not resolved and reproduced, viewing the economic phenomenon that can be universally observed in socialist societies as "(commodity) shortage". Starting with a critique of general equilibrium theory, Kornai believed that a new economic theory could be achieved by constructing a theory of disequilibrium as an alternative to equilibrium theory.

Kornai's "Economics of Shortage" reveals the mechanism by which the phenomenon of shortage is repeatedly reproduced, and it describes how the psychology and behavioral patterns of economic agents in a shortage economy function to reproduce shortages rather than to eliminate them. In this sense, the Economics of Shortage, as I named it, is a "phenomenology of shortages".⁴ The suggestion that the socialist economy normalized shortages and was unable to get out of a state of shortage constituted a strong criticism of the system. Aside from Kornai's intention to construct a disequilibrium theory, the message in the Economics of Shortage moved Russian and Central and Eastern European intellectuals. Kornai provided a real-life example of how

⁴ See my monograph in Hungarian: *Változás és örökség* (Budapest: Balassi Kiadó, 2009).

theories and ideologies provide the spiritual pillars that drive social change. If Marx's theory of Capital was the theoretical backbone of the establishment of the twentieth-century socialist state, Kornai's "economic theory of shortage", modeled on the Marx's theory, was the theoretical backbone of the destruction of the socialist state. This is one of the paradoxes of history.

On the other hand, Kornai's theory did not constitute a theoretical breakthrough, because it only described the phenomenon of shortage reproduction. Too preoccupied with a consistent understanding of the cyclical phenomenon of repeated shortages, the study lacks analysis of the relationship between the phenomenon and the intrinsic factors of the economic system that create the shortage phenomenon. Originally, Kornai rejected the notion of an essence that is not visible from the phenomena. He believed that to build a thorough phenomenological system was to build a grand theory. In this sense, Kornai was a phenomenologist, and the economics of shortage could be called a "phenomenology of shortage".

Science starts from the study of the essential factors and causes of phenomena as well as an interest in the phenomena of events. A multi-layered analysis of the phenomenon and its essence will allow us to understand the phenomenon fully. Lacking such essential analysis, Kornai's "economics of shortage" failed to become the "Theory of Capital" of the twentieth century.

I emphasize this because I have doubts about Kornai's research activities after the system transformation. There are no noteworthy ideas or inspiration insights in Kornai's analysis of the economies in transformation in and after the 1990s or in his comparative analysis of capitalist and socialist economies. On the contrary, Kornai's analyses became little more than simple and superficial comparisons. This is discouraging not only to me, but also to researchers who have studied Kornai economics.

Of course, as a scholar ages, his or her ability to think perhaps declines, so older scholars may not have the same outpouring of novel ideas as they did when they were young. Gradually, our thinking becomes more and more rigid, and our arguments and propositions become increasingly simple. Kornai's willingness to continue writing well past his 90th birthday merits admiration. However, in my assessment, Kornai's phenomenological method of thinking failed to analyze the complexity of the transition economy and society and has reverted to simplistic propositions and axioms.

Kornai emphasized the importance of empirical science based on the observation of reality, and he tried to describe the mechanism by which real economic disequilibria are reproduced. However, his work lacked essential analysis. What was missing was an analysis of the systemic change in the repeating mechanism, an analysis which would have captured the historical dynamics in the creation-establishment-collapse of the mechanism. In order to analyze this, it is necessary to construct a logic for the historical development of the system. This requires going beyond the world of phenomenology.

1.8 Limits of Historicism

Historicism is another way to assert certain propositions on the basis of statements of fact. It is a method of extracting certain propositions about historical development by developing facts based on temporal transitions. It is a social analysis that does not start from speculative propositions but, like phenomenology, starts from an analysis of facts. Phenomenalism analyzes structure, and historicism analyzes the direction of change and development. In this sense, they are opposed to each other as fact-based methods of analysis.

Phenomenal theory is solely concerned with understanding the causal relationship of phenomena. In contrast, historicism is not a simple enumeration of facts, but a method of tracing the passage of facts over time from a certain point of view and drawing certain conclusions from them. Therefore, we can say that the historicist method is an understanding of history that seeks to know the direction of change based on a particular analytical perspective. In other words, it traces a temporal causal relationship backward from existing events.

Thus, if phenomenology is a factual observation in a fixed historical era, then historicism is a factual observation of events of historical time series. If the former is classified as synchronic analysis, the latter is classified as diachronic analysis.

Unless it is a simple enumeration of facts, a certain analytical perspective is essential to the retrospective method. In many social analyses, an analyst's thought (ideology) and social position constitute his or her perspective. For example, the understanding of the postwar socialization of Central and Eastern European countries as a transition "from people's democratic revolution to socialism" is based on a progressivist history and ideology of human society's development towards socialism as a perspective.

The Communist Party of the Soviet Union, the Communist Party sympathetic to the Soviet Union, and many of the intellectuals who espouse communist ideology tended to fall into historicism, and some are still unable to depart from that point of view today. Those who adhere to the progressive view of history base their approaches and, thus, conclusions on the belief that social change and development can only be analyzed by describing history from the progressive view of history. However, the collapse of Central and Eastern European socialism at the end of the twentieth century cannot be explained by a progressive historical perspective. However, up to the present, it does not seem that there has been any effort to analyze seriously the discrepancies between that historical phenomenon and the given intellectual's own understanding of it. This is not social analysis. It is like quibble explaining the phenomenon. Even if this kind of excuse works in politics, it does not work in academia.

Scholars who stand for historicism tend to neglect the structural analysis of society. Neglect of structural analysis leads to simple historicism. Historicism fails to take a structural view of stagnation and collapse and tends to fail to investigate the causes and logic of collapse. Even if a political organization cannot help but try to understand the world through simple historicism based on a certain ideological perspective, if a researcher falls into the same simple historicism as a political organization, if a

researcher relies on the same simplifications as political organizations, then the term itself, “researcher”, loses all serious meaning.

Because of the strong ideological influence of socialist studies in Japan, researchers tended to fall into a simple historicist understanding. As long as we take a simple historicist approach, we cannot analyze the process and structure of the collapse of a historical society and the creation of a new society. It would be intellectual laziness to insist on historicist methods without reflecting on the old methods.

Another pitfall into which historical analysis is prone to fall needs to be pointed out. This is the problem of diachronic analysis. For example, Anne Applebaum’s *Iron Curtain: The Crushing of Eastern Europe 1944-56*, which deals with the process of the formation, development, and collapse of Eastern European socialism, describes the history of the entire Eastern European world. However, the more one tries to encompass the whole, the more one loses all meaningful analysis of the social context of the individual countries and the vividness of the events. This is a typical symptom of a diachronic analysis. The more one tries to paint an overarching history, the more individual circumstances and background are lost. In a way, this is inevitable. For example, the description of the Noel H. Field case (Chapter 12), which was the beginning of the political purges in the Eastern European world, is not only inaccurate, but also contains Applebaum’s prediction. Therefore, the content of the description should not be taken uncritically. This is the reason why I devote a considerable amount of space to the Field case in chapter 8 of this book.

I believe that it is necessary to reconsider the process of the formation of socialism in Central and Eastern Europe. Alongside an analysis of Soviet socialism, I think it is important to analyze the formation, maintenance, and collapse of Central and Eastern European socialism on the basis of historical facts. Acknowledging the limitations and inability of the postwar historical science in Japan, which could not move beyond the propositions of the Soviet Communist Party, we must make efforts to rethink the history of socialism after World War II. I am not a historian, but as a contribution to a rethinking of history, I prepared a chapter on “The Historical Science of the System Transformation” to examine the process of Hungarian socialism in the postwar period, focusing on the Hungarian uprising in 1956. This chapter does not touch on the history of other countries. I believe that this is the issue that should be carefully investigated by experts in each country. I believe that the writing of vivid history, which is not available in overarching historical description, should be done by experts in each country.

1.9 Analysis of Structure and Change

If we want to understand the changes in a historical society, we must analyze both the structures and the changes of the society. Structural analysis without the analytical logic of change or development (collapse) falls into phenomenology, and description of change without structural analysis falls into a mere enumeration of facts (simple historicism). Both of these methods fail to capture the dynamic process of the creation, development, and collapse of historical society. Therefore, an analysis that encompass-

es the logic of structure and the logic of change is essential to an understanding of the historical process of twentieth-century socialism.

Kornai did not accept German philosophical concepts such as the invisible “essence”. However, there are only a limited number of phenomena that can be observed visibly, not only in the analysis of the natural world, but also in an analysis of human society. Every phenomenon has an essential foundation (element) which gives rise to it, and the existence of that essential element is only revealed by analysis. However, if we exclude essential existence because it is invisible to the observer, the analysis faces a major limitation.

Just as the natural world is made up of multi-layered phenomena, human society is also made up of multi-layered structures (various human relationships). Hence, as in the natural sciences, the social sciences also need a multi-layered analysis of the phenomenon. The essence obtained by the analysis of a social phenomenon is itself a phenomenon on the lower levels, and we can extract the essence of the lower levels by further analyzing it. In other words, the essence uncovered by one analysis is itself a phenomenon that has also manifested itself at a lower level, and further analysis of it can capture a deeper essence. Therefore, an analysis that extracts the essence from a phenomenon is not a one-time intellectual activity, but a process of repeated intellectual efforts to capture the essence in a deeper way. By building up such a multi-layered, multi-stage analysis, we can reveal the overall composition and structure.

The essence analyzed and extracted from a phenomenon is at the same time an essential phenomenon, and a new essence is clarified by further analysis of it. In the natural sciences and the social sciences, the progress of science is an iterative process of analyzing the hierarchy of phenomena and essences. An analysis that neglects this intellectual activity cannot go beyond simple observation, which remains a phenomenology or a mere enumeration of facts.

Social relations in human society are one essential relationship obtained by analyzing social phenomena, not a phenomenon that can be captured visibly. We cannot tell what kind of social relationships people have with one another just by looking at them individually. Most social relations are not a phenomenon that can be captured visibly. Whether one accepts and proceeds from Marx’s understanding of society or not, it is clear that human society is made up of multiple layers of social relations, and one individual lives in many complex social relationships. Social science is established in the analysis of these social relations.

For example, Kornai contrasts market relations (horizontal relations) with bureaucratic relations (vertical relations), which is one essential analysis that contrasts essential relations extracted from typical phenomena observed on a daily basis. This is one of the essential understandings that Kornai himself excludes. However, Kornai did not analyze the conclusions further, and he stopped the analysis simply by contrasting the two social relations derived from the primary analysis. Herein lies the limitation of Kornai’s analysis. Though the Kornai theory remains basically phenomenological, in some cases it analyzes the essence from phenomena. However, as in this case, Kornai’s essential analysis ends with a single analysis and never goes to analyze further the essence more deeply. This is the hallmark of Kornai’s phenomenology. In order to analyze

Kornai's analysis in more depth, it is necessary to work on an analysis that extracts the social moments that produce horizontal and vertical relationships. From that analysis, an integrative method of understanding the phenomenon must be taken again.

If we can find the moment of the change in the analysis of the phenomenon-essence and connect this moment with the phenomenon analysis, then we can realize the integration of the logic of structure and change. In the next chapter, I trace the phenomenon-essence relationship back to the "exchange and allocation" relationship and advocate an understanding of the basic state of economic society with this binary opposite. This is a conceptual device which will further a deeper understanding of what Kornai set as market and bureaucratic coordination.

The modern social sciences are moving in the direction of eliminating socio-philosophical considerations as much as possible. An inevitable consequence of this is that much of social science analysis is full of fragmentary model analysis of partial facts. By finding a topic and giving it a logic (theory), a would-be scholar creates a research paper. This leads to a tautological argument which explains only a limited set of facts. It is an easy trap for social science researchers to fall into today. To avoid falling into this trap, it is essential to reflect on one's analytical methods.

It is not possible to analyze the real economy and society according to a tautological model. It is a pitfall for scholars living in a closed world to think that reality can be analyzed or understood on the basis of a simple a priori model. A model of an event relationship that does not exist in reality is a fake model. Fake models are an easy trap for researchers who conduct analytical activities away from reality. Fake models do not contribute to any analysis of reality. They are nothing more than mental gymnastics. However, contemporary economics is rife with fake models.

Chapter 2: Social Philosophy of System Transformation

We have encountered a rare historical moment in which one social system has collapsed and a new one has been constructed. The collapse of one social system at the end of the twentieth century has provided the best chance for analyses of a historical phenomenon for researchers in the social sciences. However, even in the midst of historical change, not everyone is able to take advantage of this precious moment and experience. People lose sight of their historical significance if they are buried in their daily lives. Many people, including researchers, are so blinded by the daily tracking of change that they fail to grasp the historical significance of this change.

Scholars specializing in political science or economics are always trying hard to keep up with the work of the international community, and young researchers are busy writing papers on sub-events to get a research post. The analyses found in these kinds of studies can hardly be expected to capture accurately the significance of historical change. In fact, the conceptual grasp of what is commonly referred to as the “transition from plan to market” and the researchers who follow it have produced little more than analyses which are based on and reproduce stereotypes.

The collapse of the system gave rise to a field of economics called “economics of transition”. The word “transition” sounds good, but what is now unfolding in the former socialist countries is the historical work of creating another society out of the collapse of one society. Can this historical change be captured by the concept of “transition”? If the problem setting of “transition” itself is wrong in the first place, i.e., if there was no such thing as a “plan” which was the starting point of “transition,” then the foundation on which the problem setting depends will collapse. Was the economy that collapsed a “planned economy”? Was the existing socialist society an autonomously functioning social system? It is these socio-philosophical issues that need to be addressed first.

If what collapsed was not a “planned economy,” then what was it? And why did the planned economy not come to fruition? What is a social system that lacks autonomous functioning? Why was its collapse inevitable? Only by answering these questions can we understand the implications of the collapse of the old system and more accurately understand what has been going on since.

However, the academic debate avoids this approach. At the very least, contemporary economics precludes a philosophical approach. But excluding such an approach makes it impossible for us to understand the social changes of the century. Whether we like it or not, philosophical considerations of historical society are essential to an analysis of social changes.

2.1 Impossibility of a National Economic Planning

One of the important aims of classical economics was to illustrate the reproduction of the national economy and to enable analytical processing based on this chart. The F. Quesnay's Economic Table was succeeded by Marx's reproduction schema, and eventually, with the birth of the Soviet Union, it became a practical tool as a method of material balances, which was perfected in the western world as an input-output analysis by W. Leontief. With the birth of the Soviet Union, the Central Statistical Office of the Soviet Union conceived a grid-like production and allocation chart for goods, imitating Quesnay's economic table, and it tried to use this chart as an organizational tool for the systematic allocation of goods. Soviet planning meant, in effect, the management of supply and demand for goods and services by using the material balances. Leontief, who was a student at Leningrad University at the time, turned his attention to this method of material balances, which he eventually developed into an analysis of the input-output relations after he moved to the West.

On the other hand, with the development of such a holistic means of analyzing the national economy, the quantitative measurement of the national economy and the use of linear programming became a major theme in post-World War II economics. In the Soviet Union, the mathematical study of planning by Kantorovich, Nemchinov, and others using the value calculation formula and the linear programming method was intended to provide a theoretical basis for national economic planning. The fact that scholars who were directly or indirectly involved in Soviet planning, such as Leontief and Kantorovich, and scholars who studied planning methods and theories in the Western world, such as Frisch, Tinbergen, and Koopmans, became early winners of the Nobel Prize in economics gives us a glimpse of the trends in economics in the postwar world.

The general equilibrium analysis of Arrow, one of the early winners of the Nobel Prize in economics, is another field of theory that focuses on the equilibrium of the national economy as a whole, and this has inspired the development of theories on the adjustment mechanism of the national economy, such as price equilibrium and quantitative equilibrium. The debate on the feasibility of planning based on socialist price and quantity adjustment mechanisms, such as the mechanisms proposed by Malinvaud and Kornai, was also precisely an application of general equilibrium analysis and linear programming techniques.

Clearly, it is not an exaggeration to say that post-World War II world economics, both Marxist and non-Marxist, shared the aim of planning and quantifying the national economy. Conscientious economists had a bitter feeling that the collapse of the pre-war capitalist economy had led to a world war, and the desire properly to control the national economy became a concern on the minds of many economists.

Thus, many great scholars in postwar world economics focused on planning possibilities and equilibrium existence proofs for the entire national economy. However, despite these theoretical developments, the socialist societies established not only in the USSR but also in Central and Eastern Europe stumbled from the beginning in the planning and management of their national economies. Why was that? What theoretic-

cal economics has revealed is a possibility for analysis under very abstract conditions, and nothing more than that. This kind of analysis was of no use to the concrete management of the real national economy.

The method of material balances developed by the Soviet Union was a truly primitive method of adjusting the supply and demand of goods on graph paper. If the level of supplies to be distributed is around 10, there is no problem. However, it would be presumptuous to call this level of planning a national economic plan. However, if the number of goods to be allocated is any greater, the calculation becomes virtually impossible. There were no computers at the time, and even had a high-performance computer been available, the equations and formulae with which it would have been able to grapple still would not have made it possible to construct such a material balance and allocate goods in a timely manner based on this balance.

For this reason, economic planning in the Soviet Union and the Central and Eastern European socialist countries established after World War II consisted of rationing and quota adjustment for a very limited number of goods (energy resources and key industries) and left other goods to economic management based on very simple indicators. Typical of this was resource-constrained adjustment of goods, and one of the specific methods was, as Kornai made clear, “supply and demand adjustment by shortage indicators”. For example, imports were adjusted to ensure that the average time to wait was not too long or too short for the sale of passenger cars. Simple management control based on this type of shortage indicator has become synonymous with planned control.

Thus, in the absence of any effective theory or method of planning and managing the national economy, what the socialist countries called “planning” was a primitive system of material goods allocation. It is essentially the same as the wartime rationing system that was put into practice in the wartime economy of World War I and was also used by countries in World War II.

The socialist economy as it existed in the twentieth century, from its rise to its collapse, did not change its basic character as a primitive system of distribution of goods. It was an economic society based on a wartime rationing system. The communist dictatorship was not only necessary to realize the principle of the “dictatorship by the working class”. A “wartime socialist system of governance” was also necessary in order to maintain a primitive rationing system. From there, everything was reversed. Since meticulous planning is impossible, “political control of the economy” became the main thesis of socialist economic planning. This thesis is determined by the Politburo. Regardless of the theory and policies of economics, the economic guidance provided by political leaders, i.e., political initiatives, became socialist economic management. And, finally, arbitrary economic guidance by top politicians (the Executive Committee of the Communist Party) became the substance of the planning of the socialist economy.

Thus, “national economic planning” degenerated into a political decision of the Communist Party (Politburo or Executive Committee) without any rational analysis or overview of the economy. This degeneration of national economic planning and management is an inevitable consequence of the “impossibility of national economic

planning”, and a continuously deteriorating society, lacking the conditions for self-sustaining development, inevitably ended up on the path to self-destruction.

The economic system that existed in twentieth-century socialist society, far from being the ideal model envisioned by theorists, was no more than a wartime rationing system. Thus, the collapse of the rationing system did not give rise to any new system. Instead of the old system being replaced by the new system, the old system self-destructed, and the so-called socialist industry simply disappeared. Thus, the system transformation that began at the end of the twentieth century was not simply a “transition from one system to another”, but rather was a process of social change which created something out of nothing. It was not a continuous change, but a change with a rupture. Thus, the notion of a “transition from plan to market” does not accurately capture the nature of social change at the end of the twentieth century.

2.2 System Transformation (Transition): from What to What?

The meaning of the term “system transformation” is not self-evident. What exactly undergoes a transformation, and a transformation from what to what? The political implications are clear. There is no disputing that this is a transition from a one-party dictatorship by the Communist Party to a multi-party parliamentary democracy. However, as already noted, it cannot simply be said that the economic system shifts and converts from “planning to markets”. This is because the economic system that supported the old system cannot be defined as a “planned economic system” at all. Moreover, what kind of transformation (transition) does the society as a whole undergo? Even if we can insist on a transformation “from socialism to capitalism” in ideological terms, we cannot analyze the transformation of real society in ideological terms.

In fact, various “transformations” (transitions) have been discussed among experts. Many economists use the binary oppositions of “planning to market” and some researchers use binary pairs such as “from socialism (communism) to the market” or “from the state to the market”. What are the differences between these provisions? Let’s begin with a discussion of them.

2.2.1 From Socialism to Capitalism

When the phrase “from socialism to capitalism” is invoked in everyday usage, it is not clear whether it is being used in an ideological sense or in the sense of a specific economic system. In general, socialism is represented by two main notions: communist dictatorship and state control of the economy, while capitalism is seen as its opposite (a multi-party system and a free economy). All one-party rule, from feudal dictatorships like North Korea to soft dictatorships like the Kádár regime in Hungary, are lumped together as examples of socialism or communism. But on closer examination, it is not so much the ideology (philosophy) of communism and socialism that allows these dictatorships to be brought together as it is the substance of the one-party (individual-worshipping) dictatorship and economic control by the state monopoly. North Korea is not the only country where the gap between socialist and communist ideals and

reality is tremendous. Almost all state monopoly economic systems under dictatorial power are equated with socialism and communism, even if the substance of domination and the ideology which is used to justify domination are infinitely divergent.

Thus, when the transformation (transition) from “socialism to capitalism” is spoken of, the ideology that underlies society is discussed without a concrete institutional analysis of society. When researchers begin to discuss the specific systems of each country, whether socialist or capitalist, they rarely reach a common understanding. There was no such thing as a pure socialist society anywhere, just as there is no such thing as a pure capitalist society anywhere. It is a well-known fact, though, that infinitely simple individualistic dictatorships do exist.

2.2.2 From Plan to Market

This pair of contrasting concepts refers to the economic system (mechanism), and there is no doubt that system transformation (transition) constitutes a revival and introduction of the market economy. On the other hand, as we have discussed, the stipulation that the old system was a planned economy is not correct. The essence of the old economic mechanism was “a rationing system of material goods through state control of the national economy”. The optimal planned allocation of industry and goods based on national economic calculations, as assumed by economic theory, was an abstract theory that was far from being applied, and it existed only as a conceptualization of scholars, not something that could be applied to real socialist society. The “plan to market” conceptual pair, which has a pleasingly simplistic or self-explanatory ring, is just the kind of abstract contrast that economic theory favors. This kind of abstract grasp does not allow us to summarize the collapse of the national economy and the looting of the remaining state and (Communist) Party assets in a theoretical framework. As will be discussed in more detail later, the actual transformation of the system inevitably led to the collapse of the national economy and the process of initial capital accumulation through the theft (re-distribution) of state and party assets, and it is not be something that can be understood or described with the phrase “from plan to market”. A conceptual pair that does not reflect reality cannot be the foundation of a theory which seems to explain the initial capital accumulation which seems necessarily to have accompanied system transformation.

2.2.3 From Socialism (Communism) and the State Economy to the Market Economy

Some researchers use the conceptual pair of “From Socialism (Communism) to the Market Economy”. This pair consists of two heterogeneous concepts, because the ideology or social system of socialism is contrasted with the economic system of the market economy. Although this conceptual contrast can be criticized as erroneous, the concept pair nonetheless conveys clearly the nature of the transformation. In other words, it reflects the correct social perception that the old system was a socioeconomic

system dominated by ideology and that the system to be striven for is a market economy free from ideology.

Likewise, the conceptual pair of “from the state economy to the market economy” is a heterogeneous conceptual contrast, but it reflects the perception that the old system was an economy distorted by state power and that “transition” means change from this distorted economy to a market economy.

As we have seen, there are several perspectives from which to view transformation (transition). However, none of them precisely captures the essential change of society as a whole. Any genuine analysis of the transformational change which took place at the end of the twentieth century requires first a socio-philosophical analysis which takes into account the changes in the society as a whole.

2.3 Exchange (give and take) and Allocation (give but obey)

As an alternative to the market system, twentieth-century socialist society constructed the rationing system of goods as an economic adjustment mechanism. The system of goods rationing, developed from the economic management of the wartime economy, is a system in which the state decides the distribution of goods produced and consumed in the national economy, rather than leaving distribution to the mechanisms of the market. For the newly born Soviet Union, there was no other means of control that could be applied other than the wartime economic control of rationing. The situation was no different for the socialist governments of Central and Eastern Europe that were established thirty years later. Just as there were peoples’ uprisings in Poland and Hungary soon after the establishment of socialist governments, the deadlock in the rationing system of material goods was evident from the moment the communist dictatorship was established. Even on the basis of the experience of thirty years of Soviet socialism, “planning” in Eastern European socialism did not go beyond primitive material goods rationing systems. However, even thirty years after the Russian Revolution, the Soviet Union’s economic management itself was still in a state of trial and error, and Stalin’s purges and the plunge into World War II left no time for the development of peacetime economic management methods. So it was no surprise that the socialist planned economy degenerated into a system of wartime rationing.

As is clear from the description so far, I do not believe that the conceptual pair of “planning and markets” can capture and explain the system transformational changes. In my 1994 book,¹ I proposed that the fundamental changes in society during system transformation should be understood not in terms of the conceptual pair of “planning and markets” but in terms of a more abstract conceptual pair of “allocation (redistribution) and exchange”. If we are analyzing a major historical change in a social system (such as a system transformation), we can only arrive at a comprehensive understanding of social change if we move to a further level of abstraction from the representa-

¹ The Economics of System Transformation (in Japanese, *Taiseitenkan no Keizaigaku* [Tokyo: Shinseisha, 1994]), Chapter 4, “Redistribution, Exchange, and Communication: systems and economic action” (97–116). The text is translated into Hungarian in Morita 2014, 21–39.

tional concepts of markets and planning and capture the essential changes in the social norms which shape people's overall social behavior.

The word "market" is too vague as a concept. What social meanings do the actions of the parties involved in the "market" have?

The essence of market action is "exchange". Exchange presupposes a relationship of equality between the parties involved. Of course, various supply and demand conditions will change the parties' power relationships, but exchange assumes that the parties are essentially equal. Information emanating from equal relationships is bilateral, and organizations built from equal and bilateral relationships are horizontal. A horizontal relationship is a "mutually beneficial shared" relationship that creates a social norm of give and take, a relationship in which each person acts on his or her own responsibility. Moreover, a system organized on the basis of horizontal relationships is characterized by openness and transparency, and the relationship between the parties is not dominated by a particular authority figure, but is an action relationship which each party is responsible for enacting on its own. A transparent and open organization has the potential to develop itself. When each of us shares our wisdom and makes organizational changes which usually further develop the exchange relationship, the organization increases in complexity and develops autogenously.

In contrast, the essence of the twentieth-century wartime rationing system was "allocation (distribution)". Allocation presupposes a hierarchical relationship between the parties involved. A distinct hierarchical relationship is formed between those who distribute the allocation and those who receive the allocation. Information flows in both directions in these relationships, but there is a strict hierarchical relationship in the authority of information processing. In this sense, the flow of information is unilateral. An authoritarian personality relationship tends to intervene between those who control the distribution and those who receive it. This is because allocation involves discretion and surmisal based on hierarchical relationships, and there is a lot of room for personal relationships to intervene in these hierarchical relationships. Therefore, the social norm of "give but obey" governs the distributional relationship. Hence the need to keep the process secret. Organizations in charge of distribution inevitably form a bureaucratic structure based on hierarchical relations, and the closed nature of that structure inhibits the autonomous development of the organization, and it does not develop with the increased complexity which an open organization would have, and it is easy to fall into a routine of simplification.

From the perspective of such a fundamental act, the self-destruction of socialist society is not so much the collapse of the "planning system" as it is the collapse of the "allocation (rationing) system." In other words, in the most abstract terms, transformational change from the perspective of the economic system is the conversion of the basic functions of the national economy from a system of allocation to a system of exchange. Of course, this is a conceptual grasp at the most abstract level, and it does not mean that one system alone can make a national economy work, but it does capture a shift in the principles and social norms concerning what should be entrusted with the basic economic and social mechanisms of a social system.

Table 2.1. Two basic socioeconomic acts that create social norms

Socioeconomic moments	Fundamental socioeconomic behavior	
	exchange	allocation
1. Communication	informational/bilateral	physical/unilateral
2. Institutionalization	self-organized markets	bureaucracy
3. Personal relationship	depersonalization	personalized dependence
4. Organization	openness and transparency	closedness and secrecy
5. Social behavior	independent/personal responsibility	dependence on Authority
6. Complexity	continuously increasing	increasingly simple
7. Self-development	autonomous and continuous	degrading/self-destructive

From this perspective, Table 2.1. compares and contrasts the respective characteristics of “exchange and allocation” along with their socioeconomic moments. Let us compare the two basic economic actions according to this table.

1. Communication: Whereas exchange is a bilateral act, allocation consists almost entirely of unilateral acts. Thus, the patterns of communication found in each act are also bilateral-unilateral. The more individualized the distribution, the more the communication takes on a physical character (physical instructions concerning how much to whom), and in contrast, as the exchange becomes more generalized, it takes on the character of anonymized universal information (general information with no destination identified).

2. Institutionalization: Exchange autogenously forms the field in which it is organized (the market system), while allocation requires the construction of an organization (the bureaucracy) to implement it. Self-organized market institutions have the elasticity to remake existing institutions into new ones through the development of acts of exchange. In contrast, bureaucracy is characterized by rigidity, in the sense that it lacks the autonomy to remake itself.

3. Personal relationships: Exchange universalizes anonymous information and frees people from a relationship of personal control and subordination to specific individuals. This is the foundation of personal independence and freedom. In contrast, allocation often makes dependence and subordination to a particular organization or individual inevitable, and this tends to fix personality domination and subordination. The development of civilized human relations in a market economy society and the feudal characteristics of twentieth-century socialist society are grounded in the formation of such relations.

4. Organization: The organization formed through the act of exchange is maintained insofar as it facilitates exchange, and if it becomes restrictive of exchange, the organization is modified and transformed into a new organization. The rules of the exchange organization must be clear to all participants, and the information that maintains the organization will be disclosed. In contrast, allocations are closed to the outside world and conservative in terms of information disclosure in order to maintain their own authority and interests.

5. Social behavior: The social behavior of individuals formed through the act of exchange rests on individual behavior based on self-responsibility. In contrast, the social behavior of individuals formed through the act of allocation is characterized by a dependence on authority, which dilutes the idea of personal responsibility.

6. Complexity: Exchange repeatedly self-organizes, and this increases the complexity of the system as a system and also increases the complexity of individual acts of exchange. On the other hand, distribution tends to fall into a routine due to the simplification of the system, and both organizations and individuals fall under the trap of simplification. In this sense, allocation reduces the complexity not only of the organization itself but also of the behavior of individuals.

7. Self-development: Overall, exchange promotes autonomous and continuous development of exchange organizations and individuals, while allocation is self-destructive in the sense that it limits the potential of distributive organizations and individuals and promotes the increasingly simplification and the deterioration of their abilities.

As is clear from the above description, a society based on exchange has moments for self-reliant development, while a society based on allocation (distribution) does not.

It should be further noted that the exchange discussed here is not synonymous with “market” but is used as a concept with a more abstract and universal meaning. Modern civil society consists of individual members of society exchanging their labor with each other on an equal footing. The perspective of exchanging labor for mutual benefit also promotes the development of democratic institutions based on equality. In other words, societies based on exchange inevitably have to develop into democracies.

The “give and take” principle expresses mutual benefit and equality in exchange, while the “give but obey” principle expresses the dominance-subordination relationship between subjects in allocation. The difference between these two principles creates two differences in social structure.

2.4 The Self-Destruction of a Society

The socialist societies of the twentieth century crumbled like a decaying tree. In the years leading up to their eventual collapse, the national communist parties, in their final show of strength, found themselves the “emperor without clothes”. There was no other way out but to let it collapse inexorably, but the elites of the old regime were intent on minimizing the pain of this collapse. Relatively young political elites in the socialist countries of Central Europe, close to the West, sought to prolong their lives by taking control of the regime’s demise. If you cling to power until the end, you will eventually receive a hammer from the populace. So, for instance in the cases of Hungary and Poland, they tried to ride out the transition by leading roundtables that brought in the opposition political power. Many of the old regime elites who succeeded in doing so had no trouble finding their own social posts in the new regime. This quick adaptation was based on opportunism. It was not the militant ideology of wartime that supported socialist governments in peacetime. Particularly in Hungary, opportunism, which had nothing to do with socialist ideals, dominated the actions of the political

and economic elite. That was why there should have been no remorse for adapting to the new regime.

Socialism in Central Europe closed its doors after only forty years. While economic reforms were regularly advocated under the socialist regimes, the reforms that were attempted over and over again did not, in the end, revive the socialist economy. The “planned economy” essentially failed to transcend the wartime rationing system until its collapse. The system of material allocation had been exhausted, degenerated and decayed. The world bore witness to the self-destruction of a society. Based on the analysis in the previous section, the path of this collapse can be described as follows.

1. Arbitrary economic management: A wartime socialist system with rationing at its core has no moments within the system to develop autogenously. Arbitrary management of the national economy by the Communist Party (Politburo) on the principle of “political supremacy over the economy” precludes rational economic calculation and therefore hinders the development of the national economy. The socialist states thus undermined their economic foundation to support society. They were forced to continue their arbitrary control until the power base was lost.

2. Suppression of personal ingenuity and the stagnation of the national economy: Wartime socialism, which banned private business, prevented individuals from being inventive enough to produce and supply services. Instead of starting a business, following the party power became the path to a stable life. People were forbidden to train and exercise their own abilities, which caused the nation’s level of economic activity and power to stagnate at a low level. Stagnation leads to endless degradation. Despite progress and development in the world outside, in the socialist economy, where the national economy remained a stationary economy, the delay in economic development grew increasingly pronounced and eventually was impossible to make up for.

3. Simplification and social degeneration: Thus twentieth-century socialist society followed an endless path of simplification and degeneration, both in relative and absolute terms, to the point where it could no longer progress further by political directives alone. Ironically, socialism became not only a progressive society, but a degenerating one. The wartime socialist system, which had no mechanism or moments for autonomous development, had no choice but to decay. It was truly a tumble down the road of self-destruction.

4. Fostering social discontent: Isolated from the West, the socialist state was forced to isolate itself from the advances of the first world. With the spread of television and the liberalization of travel, the people of the socialist countries became acquainted with developments in the West, and the people who had been forced to live in economies which suffered from stagnation began to realize the incompetence of communist power. Even within the Communist Party, criticism of the old leadership, which was firmly rooted in wartime socialist ideology, emerged, and this criticism encouraged dissident forces in the opposition and fostered popular demand for the abolition of the Communist Party’s one-party dictatorship and the opening up of the country, thus marking the end of the Communist Party’s system of one-party rule.

2.5 Systemic Liabilities

The collapse of the socialist system that occurred at the end of the 1980s resulted in the collapse of the socialist national economy. Immediately after World War II, hyperinflation occurred due to wartime debt mainly in the defeated countries. Similarly, the collapse of the socialist system also gave rise to hyperinflation. The artificial rationing policy of the socialist government made the supply of goods and services at prices that deviated from market value inevitable, and this led to the accumulation of internal and external debt by the socialist state.

Hyperinflation is the result of vastly inflated public debt that the state is no longer able to service. Inflation reset the public debt to zero. Just as the debt was reset for postwar reconstruction, the system transformation reset the debt of the old regime. The government cannot build a new system with a huge debt load. Whether one is speaking of postwar reconstruction or system transformation, a new national economy can only be rebuilt by relieving the public debt of the past.

The collapse of the state means that society can no longer bear the accumulated debt of the past. Of course, debt in this context is not only financial debt, but also various types of social debt. The more massive the social debt that the government has accumulated, the more the government has to be released from that debt at some point. In this sense, we can call a debt that is so great that it makes it impossible for a society to survive a “system liability”. In other words, if we think of system liabilities as “the accumulation of debt to the extent that it becomes impossible to maintain an existing system and the creation of a new one becomes necessary,” then the collapse of the socialist system is also a social phenomenon in the same way that wartime debt led to the collapse of the state after World War II. A society in which one regime has stalled and collapsed can only proceed to build the next one through a social reset. Only when we are freed from the system liabilities accumulated by the old regime can we move on to build the next system.

When a social collapse occurs due to system liabilities, continuity from the old society is cut off. Until new social construction begins, society will be in a kind of chaos. Everything comes to a standstill. As long as people continue to live in such a society, they need to get out of this chaos. But this is not easy, because so many things have been reduced to nothing and society must be remade again. Of course, not everything can be reduced to nothing, but you cannot create something new by using the old as it is. Herein lies the difficulty of building a new society from the collapse of a social system. In particular, the twentieth-century socialist state lacked the “assets” that would have served as the foundation of a future society, i.e., the elements which would be necessary to build a market economy. The difficulty of system transformation from the collapse of twentieth-century socialism lay in the fact that it lacked the elements that would serve as leverage to build up future society.

2.6 A Society not Functioning Autonomously

With these considerations in mind, the question arises as to whether the theory of the Gesellschaftsformation (social formation), as assumed by conventional Marxist theory, can be used to analyze twentieth-century socialist society. The socialist construction of the twentieth century was based on the politically driven principle that the political superstructure influences the economic foundation. Was the society constructed on the basis of this notion an autonomously functioning and viable social and economic entity? This is the issue to be considered here.

Twentieth-century socialism was an attempt by political power to build suitable economic foundation for the new society by destroying the old economic foundation. But was it possible to destroy the old foundation and create a new one? The destruction of market economy created the wartime rationing system and nothing more. The rationing and allocation system may be a powerful way to promote large national projects. However, collective labor, based on the denial of individual initiative, ingenuity and independent capacity, stifled the flowering of individual creativity and ability and severely restricted the social division of labor. The promotion of the national project produced temporary results, but instead of increasing the level of the social division of labor, it forced the division of labor to be reduced or simplified. As a result, the vitality of the national economy as a whole and the level of social division of labor and creativity followed a path of degeneration. Having lost the means to deal with the exhausted state of the economy, the socialist power destroyed itself and the socialist society collapsed.

Twentieth-century socialism, except for the temporary exuberance of early collectivization, was not progress and development, but a regressing and degenerating economic society. It was a system that did not have a built-in mechanism to develop. Such a society, and one that had to disappear after only seventy years (USSR) or forty years (Central and Eastern Europe), should be seen as a “socialist experiment that emerged briefly and ended in failure in the historical transition of the century from the age of the enlightened absolutism to the age of the republic”. It cannot be said to have been an independent Gesellschaftsformation.

I consider the twentieth-century socialist state “a temporary socioeconomic state constructed by socialist ideology”. A community built on an ideology, not based on an autonomous economic system, makes authoritarian control by power inevitable in order to maintain the system. In fact, both in the Soviet Union and in the countries of Central and Eastern Europe, societies could not have been maintained without authoritarian rule and domination by the Communist Party and the state secret police. Twentieth-century socialism was a society the self-objective of which was degenerated to stifle people’s creativity and to try to maintain the stability of a deteriorating social system. The museum-like example of the North Korean regime offers a specimen of the ruined socialism of the twentieth century, which proves eloquently the correctness of my analysis so far.

2.7 The Self-Collapse of Society: Apoptotic or Necrotic?

The collapse of socialist society raises one socio-philosophical problem: the natural death of a society. We need to consider how to understand the historical fact of one society's self-collapse, instead of bothering to entertain the fictional narrative of the "transition from plan to market". We must also consider the potential changes that people's social norms will undergo with the collapse of society. We can analyze these problems by examining events which actually occur.

Can the collapse of twentieth century socialism be explained by existing theories? Contrary to Marx's assumptions, socialist societies, at least as they existed in the twentieth century, were not societies which progressed and developed, but rather were societies which regressed and degenerated. Can we analyze such a regressive and degenerating society in terms of Marx's "Basis/Überbau (base/superstructure)" and the contradictions between productive forces and production relations? In other words, can Marx's theory explain the collapse of twentieth century socialism?

Interesting in this regard is an analysis of the Soviet Union prepared several years before the collapse of the Soviet Union. A group promoting economic reform in the Soviet Union under the Andropov government compiled a confidential report² on the need to reform the system of economic management. In the report, in accordance with Marx's scheme, it is noted that "Soviet productive relations lagged behind the development of the productive forces, and their contradictions causes the problems of the Soviet economy and society". In other words, the report says that socialist societies also encounter contradictions in their economic basis and superstructure and require a new social framework. However, the report does not use the term "social superstructure" but limits itself to the terminology of "production relations". This is because if it had been termed a social superstructure, this designation would have contradicted Communist Party rule itself. Moreover, according to Marx's theory, the contradictions of socialist society could be resolved by a conscious transformation of the relations of production, which would be the driving force in the development of a communist society. Contrary to its theoretical predictions, however, Soviet society did not dissolve developmentally, but rather necropsied and disappeared. If the contradictions between the "economic basis and social superstructure" led to the disappearance of Soviet society, this is another "paradox of twentieth-century history".

² The confidential report was prepared by the so-called Research Institute of Novosibirsk (The Institute of Economics and Industrial Organization of the Siberian Branch of the Russian Academy of Sciences). Only 70 copies were printed as a study of the department of Social Problems. One copy was obtained by the *Mainichi* daily newspaper and translated into Japanese. The report was published in the Japanese weekly *Economist*, published by the *Mainichi* newspaper on September 13, 1983 under the title "Soviet Economic Society – Conditions for Revitalization". The existence of the report was not widely known even in the Soviet Union at the time. However, the institute itself was known, as was its economic study (led by A. G. Aganbegyan) and its journal *ECO* (Economics and Organization of Industrial Production).

I do not see the problem of socialism as it existed as a contradiction between “productive relations and productive forces” as envisioned by the “Secret Report”. In my assessment, the socialist society of the twentieth century was not a self-sustaining social construct, and therefore the argument concerning such contradictions based on Marx’s scheme is irrelevant. The secret report is interesting as an attempt to understand the fundamental problems of socialist society through official ideology, but it is nothing more than that.

The socialist society of the twentieth century did dissolve not due to the contradiction between “productive forces and relations of production”. From the outset, the system had been on the road to unending degeneration, and the party organization and the people had lost their ability to maintain and develop society, and in the end, the system self-destructed. The society had no moments to maintain and develop its own system, and therefore it was only natural for such a society to follow a path of self-destruction.

What does it mean to say that a society is self-destructing? A recent study in cell biology provides one clue to this question. I draw an analogy here to apoptosis and necrosis. Apoptosis and necrosis are two natural processes by which cell dies, but they are distinct, fundamentally different processes.

The generation of new cells maintains biological functions, but the generation of new cells proceeds in parallel with the death of old cells. Cells that can no longer adapt to the new environment die by apoptosis, or programmed death, leaving their role to the new cells. This active form of cell death ensures the sustained adaptation of the organism to the environment and maintains the vitality of the organism. In other words, old cells sacrifice themselves to encourage the production of new cells. In contrast, necrosis refers to unregulated cell death as a consequence of internal or external stresses. In the case of necrosis, the dead cell just rots and dies, leaving no new cells to help the organism survive.

Can we use these concepts of cell death to understand “the destruction of a society”? Was the self-destruction of socialist society in twentieth century apoptosis or necrosis? If we apply the classification of cell death as it is, the self-destruction of socialist societies in the twentieth century is almost akin to necrosis. This is because it is not possible to find positive developmental moments for the creation of a new society in the socialist society that existed. This collapse can be described as almost total devastation and therefore necrosis. A society that thus destroys itself can be called a necrosis-type society.

Can Marx’s theory of Gesellschaftsformation explain the death of such a necrosis-type society? Marx’s theory of social development assumes that the contradictions in a social system become the seeds of a new society and the old society dies out developmentally. This is an apoptotic theory of social development and thus not a theory that explains changes to a necrosis-type society. In this light, it can be said that conventional Marxism cannot capture the collapse of twentieth century socialism within a theoretical framework.

In a necrosis-type social collapse, the continuity of social development is disrupted, because after necrosis-type death, there is nothing left. How can something new be

born from the necrotic death? If one thinks in this way, the following question arises: “How can a new society be generated from the self-destruction of twentieth-century socialist society?” There must be some transformational jump to make the impossible possible, a jump that can be described as “making something out of nothing”. This is the “Aporia of system transformation” (no way out, an unsolvable problem).

The so-called economics of transition assumes the continuous development of society (apoptotic-type society) and fails to capture the social changes at the end of the twentieth century. The concept of “transition” is a highly representational (superficial) and content-free understanding of society. That is why I use the term “system transformation”, which encompasses intermittency, instead of “system transition”.

2.8 The Aporia of Social Transformation

What dies with the collapse of a society in the first place? One state system collapses when a dictator is executed or escapes. In most cases, those in power may be executed, but that does not mean that the members of the society are eliminated. Sometimes, however, genocide is carried out, as in the case of Cambodia’s Pol Pot regime, but this is both a highly exceptional event and an action that is tantamount to the annihilation of the society itself rather than a social transformation. Modern revolutions have never taken the lives of large numbers of people, even when those in power have been executed. Even in the case of Nazi Germany and Imperial Japan, only a handful of people in the halls of power were executed as a result of the collapse of these two states, and many of the officers who worked for the regimes were ultimately exonerated. In the Czech Republic, which suffered repression during the Prague Spring in 1968, the system transformation was accompanied by the expulsion of Communist Party members from public office. However, even in the case of the Czech Republic, such regulations gradually lost their effectiveness.

Viewed in this way, in social transformation (revolution) the old social system collapses, but the people who made up or even were the pillars of the old society do not die. This is the difference between natural and social phenomena. In natural phenomena, whether apoptosis or necrosis, if a cell dies, it disappears. However, the collapse of a necrosis-type society does not result in the death of the members of the society.

If social transformation (revolution) does not kill off the people who made up society, then what exactly will die off? The death of a society does not mean the death of human beings themselves, but the death of people’s old social relations and social functions. This is why it is possible for a society to regenerate. In other words, old social relations and social functions are destroyed and disappear, but the people who make up a society can regenerate it by forming new social relations and performing new social functions.

Thus, the “Aporia of social transformation” is resolved. Social transformation is achieved by annihilating people’s old social relations and social functions and creating new social relations and social functions. However, a problem arises when the same people occupy the positions responsible for governing state organs in both the old and new regime. An important observation can be drawn from this problem.

Social transformation is the conversion from old social relations to new social relations, but the people themselves are the same individuals in both the old and the new relationships. Changes in social relations change people's social functioning and give the members of society the possibility to regenerate, but as long as the same people who were prominent or influential in a society get new positions in a new society, people's modes of thinking and behavior (social norms) are inherited from the old society. This is where the friction and time lag arise between the social norms required for the new society and the social norms that people inherit from the old society. Moreover, this time lag is not a short time, but a historical time (historical time lag). In new social relations, people are indeed given new social functions and regenerated as social beings, but their attitudes and behavioral norms change only gradually. Therefore, the shift in social attitudes and norms that should accompany social transformation will take a long time. So people's attitudes and norms of behavior do not change quickly even after the social transformation taken place.

This is precisely where the question of change and continuity in social transformation arises. The real process of social transformation is also a process in which people are gradually changing old attitudes and norms in the midst of major changes in social relations. In the new society, however, people can easily adapt to the old inertia as soon as the relationships that existed in the old society are reproduced. This reproduction of social relationships stagnates social change.

This helps one understand why, even after thirty years since the transformation of the system, the countries of Central and Eastern Europe and the former Soviet Union still function in no small part according to the social norms of the old system.

2.9 The Conversion of a Social Phase: "Transition" or "Transformation"

As we have seen, the death of a necrosis-type society means a disruption (discontinuity) of social development. In other words, the germ of a new society cannot emerge from the "self-collapse" of twentieth-century socialist society. The recognition of this point is very important, because it means "discontinuity in social development".

In general, the word "transition" means continuous change, while "transformation" implies a discontinuous change. If the change from the old socialist society to the new one is not continuous, but discontinuous, then the concept of "transition" is not applicable to the system conversion at the end of the twentieth century. This conversion should be understood as a discontinuous change of "social phase conversion".

From the above viewpoint, the present book basically uses the term "transformation" rather than "transition". Of course, that does not mean I do not use the term "transition" at all. I do not use the concept of "transition" in the sense of a historical change of social transformation, but I do use the term "transition" when a partial system or social norm of a society is passed on to a new society and changes gradually.

Changes to the new society bring about changes in all aspects of society, but the most fundamental changes in society do not appear on all the surface layers of society, and therefore superficial changes appear continuous. For example, when we say that Hungary's regime change was a peaceful "transition", this means that an appealing

change took place in which the politicians of the old regime were able to take on new roles and get important functions without being purged. In this case, the term “transition” is used because of the continuity at the level of the individual politician and party succession. Such continuity at the level of the individual, as is evident from the description so far in this book, is derived from the changes and continuity of the role and function of the individual in social transformation. However, these changes of individual position in a society and the fundamental “conversion” of the political system from a communist dictatorship to a parliamentary democracy are two different issues of different dimensions.

From this perspective, when observing historical social transformation, multifaceted analysis is needed to capture concurrently both fundamental conversion (transformation) and representational continuity (transition).

2.10 The Ideology of Social Transformation

In a major social change, there is a preparatory process that is a prelude to a change and uplift in people’s consciousness and emotions. Unless a sense of urgency is created for the existing system, not only among the people and the intelligentsia, but also among government officials and Communist Party officials concerned with governance, no major “swell” of social change will occur. It is precisely the ideology leading the way for change that will pave the way for this social change.

However, ideology did not play a significant role in the collapse of the socialist system at the end of the twentieth century. There was no prevailing ideology or slogan for a new social system to replace socialism. We cannot say that a particular ideology led to social change in each country. On the whole, the driving force behind the reform of the social system was the mass expression of discontent: “There is no future for this system. This system is no longer viable.” Kornai’s “apocalyptic message” provided a theoretical basis for this sentiment.

Even among the rulers (the Communist Party and the government), who were helpless in the economic stalemate, a sense of urgency was beginning to fill the relatively young leaders that there was no way to get out of this critical situation. When popular discontent exceeds a certain level, it creates a potentially explosive state. The explosion of social discontent was perceived as a major crisis by young political leaders who were sensitive to the development of social discontent. This was the beginning of the conflict within the Communist Party between the conservative leaders, who could only defend the old official view, and the reformist leaders, who believed that the crisis should be dealt with by changing the status quo.

In several countries, some attempts were made to change ideology and the ruling system by the reformists within the ruling Communist Party. The reformers had no ideology to guide them. Compared to the magnitude of social change, the role of ideology in guiding systemic change was small. At most, the revival of the market economy and the multi-party system became common slogans, with little discussion of the new social system to be built. Under these circumstances, there was a theory that had a fair

amount of influence among intellectuals. That is the theoretical work of Hungarian Kornai, who was fundamentally an economist.

Kornai's theory is not a theory of a future social system, but a theory that deals with the mechanisms of the old system. However, Kornai's *Economics of Shortage* was translated, and published legally or illegally in the Soviet Union and Central and Eastern European countries and became the bible for many intellectuals and economists. Only a limited number of people have read through this voluminous book. In spite of this, people's slogans were born from the title of the book. What we read from the title is the apocalyptic message that as long as socialism continues, shortages will be reproduced forever. This convinced the Soviet Union and Central and Eastern European intellectuals of the need for regime change.

Apart from this theory, there was no other influential ideology that had a universal impact on intellectuals in the Soviet Union and Central and Eastern Europe, and Kornai's theory in itself described only the mechanisms of the old system, not the mechanisms of a new one. Discussions about the new social system would not take place until long after the social transformation was underway. However, with the very sparse theoretical analyses or summaries of the old regime, it was impossible to provide a clear vision for a new society.

With the collapse of socialism, there was no ideology or theory pointing to a new society. Rather, political democracy (multi-party system) and market economy became the sole objectives. There was no in-depth discussion of why a market economy is necessary. There was no discussion of why it was wrong to repress market relations in a socialist economy. There was a tacit understanding that a capitalist economy would be created after the collapse of the socialist economy, but no one talked about the specifics of this capitalist economy. This also confused the construction of the economic system during the period of system transformation. Kornai himself wrote of capitalist economies with praise, but he offered no further effective recommendations.

2.11 Post-Socialist Ideology

The social transformation in Central and Eastern Europe at the end of the twentieth century was, in terms of basic economic action, a shift from a system based on allocation (distribution) to a system based on exchange. As it proved impossible to plan the national economy, the economic system had to be transformed into a system based on exchange supplemented by social distribution. This is the idea of the Western social-democratic system, clearly distinguishable from Soviet-style socialism, which is based entirely on distribution.

The transformation of the social system began with the opening up of the country to the outside world and the change of ownership. To open the country to the world meant to liberalize all communication with the world, and to change ownership meant abolition of the state corporate management and the granting of permission for private corporations to pursue their own activities. In this great transformation, a social disparity was created between those who were able to take advantage of the conversion

to increase their wealth and those whose were struggling to work and live. Although this was, to some extent, an inevitable result of the transition to a market economy, it meant the arrival of a heterogeneous society for those who had been protected by a socialist social security system. Although the impact of social change is not so simple that it can be easily divided into the winners and the losers of social change, political parties developed fierce ideological competition for power. Everywhere in post-conversion societies, the ideology of promoting marketization and privatization and the inward-looking ideology of protecting the weak and defending ethnic interests came into tempestuous conflict.

Let's mention here a distinctive and naive argument in this discussion of transformation (transition).

Tamás Bauer, the ideologue of the Hungarian political party the Alliance of Free Democrats (SZDSZ), asserted that "the system transformation is a shift from bureaucratic coordination to market coordination, as Kornai has argued." He therefore argued that the tasks involved in systemic change were to marketize and privatize the social system as much as possible. He argued strongly for the privatization of the social insurance system from this perspective. Similar short-sighted arguments were put forward in the other countries of Central Europe. The argument that reform can be achieved by privatizing the health insurance system at once was a leading ideology prevalent in Central Europe in the first decade of the new millennium. Interestingly, when the introduction of universal health insurance was on the table in the United States, the push for the privatization of health insurance in Central Europe became a major trend. However, this neo-liberal idea created a breakthrough in political parties backed by conservative public opinion in the 2010s.

In an essay for the Hungarian weekly magazine *Élet és Irodalom* entitled "Nem minden változtatás reform" (Not all changes are reforms),³ I criticized the arguments of Bauer as a fundamentalism based on a "false dichotomy". Bauer's argument is a very simple dichotomous argument, forcing us to choose between the state and the market. His fundamental mistake lies in the fact that he attempts to apply abstract theoretical analysis directly to real-world social institutional reform. The conversion from a system of allocation to a system of exchange is the most abstractly grasped principle of fundamental economic action. However, it would be naive to think that this essential understanding can be directly applied to real-world institutional reform. This is the same mistake made Rossers, as discussed in the first chapter.

There is a large, unfillable gap between the fundamental and policy arguments. Nevertheless, if we insist on only the essential "truth", it becomes a kind of "fundamentalism". In fact, the argument of Bauer and others, which has been named "neo-liberalism" in Hungary, is itself a naive fundamentalism that argues for policies based solely on essentialism while discarding the concrete. Interestingly, such market fundamentalist arguments can be generally observed in the former socialist countries of Central Europe in which conservative and nationalistic political power rose to power in the 2010s.

³ Morita Tsuneo, "Nem minden változtatás reform", *Élet és Irodalom* LII, 11 (March 14, 2008). The article was included in Morita 2009.

Another naive argument is the contention that market economy can be achieved by maintaining the old socialist system of social security as it is as a necessary cautious measure in the development of a market economy. The social security systems of the former socialist countries needed to be reformed to fit the new era. For former socialist countries that have a large disparity with the level of development of the western market economy, it is necessary to reassess radically the government's redistribution system and increase individual disposable income in order to create and activate the market economy. Without this, a competitive market economy cannot be established. However, nationalist parties with a pledge to maintain socialist social policies have gained power by appealing to the notion that the level of market development is already at a stage of "ruthless capitalism". However, the market economies of Central and Eastern Europe are still in the early stages of development, and unless they achieve several levels of development in the coming years, they will not be able to get out of the "multinational corporate subcontractor state".

Anyone who is at a lower level of a sporting competition understands that if the goal is to reach the top level in the world, they have to train harder than the top level athletes. Anyone can understand this self-evident truth. Many people, however, want to work as little as possible while maximizing the benefits of the various social security programs inherited from the socialist era. Therefore, opposition parties are always look for a "pork-barreling" policy to draw on these vain aspirations of the populace and influence the ways in which the populace votes. The practice of exploiting this naive sentiment is a populist strategy, a political behavior that has become a significant force in all the countries of Central Europe.

The conversion from an allocation-based society to an exchange-based society requires a much longer time frame than the opposite conversion. The conversion to an allocation system was accomplished by simply banning market economic activity which could be realized in a relatively short period of time with power control. On the other hand, the conversion to an exchange system is achieved only when the participants are integrated into the new system through the learning process in the long process of creating and activating exchange activities. In this sense, the two conversions - from allocation to exchange and from exchange to allocation - are "asymmetric social shifts". To use an everyday metaphor, the transition to simplicity can be accomplished relatively quickly, but the transition to complexity takes an incomparable amount of time. After all, while it is easy to be lazy, it is much harder to be diligent.

The acquisition of new social norms in the new social system implies a break with the old social norms and customs. This shift in norms and behavior can only be accomplished through personal activities and experiences in the long process of learning new social rules. This is not an easy task for everyone, and it is a historical process which involves a great deal of sacrifice and learning. Whether one likes it or not, this is a process in which the behavioral patterns trapped in the customs and norms of the old regime must undergo gradual change. It is also a process of overcoming the conflicting contradictions between social change and continuity.

Chapter 3: The Economics of System Transformation

Capital Accumulation during the Economic Crisis

With the lifting of the isolation policy and the opening of the countries of Central Europe and the former Soviet Union to the rest of the world, the national economies of these countries fell into a general economic crisis. Socialist industries, which had been protected from competition in the world market, were destroyed when the domestic markets were opened up to the world. The countries immediately faced an unfillable production and technology gap with the advanced capitalist countries. Western market economies had undergone constant technological innovation for decades since World War II. It was impossible for the socialist industries to compete with almost no innovation with the western companies in the world market. For those industries which lost the old socialist market and had nothing which could be sold competitively on the world market, there was no solution other than to declare bankruptcy. The situation was similar to the situation after the end Second World War II. The national economies simply collapsed.

3.1 The General Economic Crisis Induced by the System Collapse

3.1.1 The Destruction of Industrial Production

The degree of collapse of socialist industry was more severe in countries farther away from the European market, and in particular the collapse of the machinery and equipment manufacturing industry was more serious than that of the food processing industry. In the case of the food processing industry, even when the former socialist market was opened up to the rest of the world, for a time the market continued to function in the former COMECON countries. For the machinery and equipment manufacturing industry, there was no way to prolong the life of this industry, and the people involved had to accept its “sudden death”. And in time, as consumer goods flew in from the West, the old-fashioned food-processing industry was gradually pushed out of the market and “euthanized”.

Even in the countries of Central and Eastern Europe, with the exception of some food processing industries, the industrial sector was devastated. Furthermore, it was inevitable that the socialist industries of the Balkans and the Soviet Union, which produced products only for the COMECON market, would collapse.

In my book *The Economics of System Transformation* (published in Japanese in 1994), I presented the concept of the “General Economic Crisis of System Collapse” as

the antithesis to Kornai's "transformational recession".⁴ The situation should be characterized not as a simple "recession" but as a serious crisis associated with the collapse of the socialist economic system. Therefore, it can be named the "Crisis of Transformational Depression". The antediluvian economic management of the socialist economies decoupled and isolated the national economy from the development of the world economy. The socialist industry, detached from market competition, was incorporated into the international division of labor within the COMECON. Companies that lost their incentive to develop production technology were accustomed to produce commodities based on obsolete technology over a long period of time. During the forty years of separation from the West, the socialist countries lost all incentive for technological and product development and their economies stagnated. In contrast, the countries of the West had made constant progress in technological innovation and the development of new products. The opening up of the national economy clearly revealed the development gap between the two economic worlds. The disparity was so great that it was impossible to fill it, and the socialist enterprises were not in a position to compete in terms of capital, technology and management. There were really no entities which could compete with the western companies. It was only natural that the former socialist companies would go bankrupt one by one and be liquidated. This was not a kind of temporary recession seen in business cycles, but a literal "Systemic Collapse" and the "General Crisis of the national Economy".

As soon as the country was opened to the West, the national economy collapsed as if Taro Urashima⁵ had opened Pandora's box. Some of the leftovers could manage to emerge as adequately competitive to survive because of injections of capital, but most of the socialist industrial companies were destined to collapse within a few years of the transformation. The countries of Central and Eastern Europe struggled to reconstruct their national economies in the 1990s, but the Balkan countries and the Soviet republics suffered from more prolonged devastation. Particularly in the countries located in the east, the political system did not even change, and without the inflow of foreign capital, recovering from the collapse remained a challenge for more than a generation.

⁴ János Kornai, "Transformational Recession: The Main Causes", *Journal of Comparative Economics* vol. 19, no. 1 (1994): 39–63. Kornai was so conscious of orthodox economics that he avoided the "crisis" concept, which had strong Marxian economic nuances. He hesitated to use the term, as he knew it might annoy orthodox economists. Thus, most of the scholars on the economics of transition uncritically followed Kornai's concept. To assume that a notion is "right because Kornai prescribes it" seems a bit authoritarian.

⁵ There is an interesting Japanese tale. A fisherman named Taro Urashima encountered a child bullying a turtle on the beach. He bought the turtle and released it into the sea. A few days later, the turtle appeared, and as a thank-you, it put Taro on his back and took him to the underwater Palace. Otohime, a palace princess, welcomed Taro. After some time had passed, knowing Taro's intention to return home, Otohime handed him a Ball Box and said, "Never open the lid of the box." When Taro rode on a turtle and returned to the original beach, no one knew him. Taro forgot the warning he had been given and opened the ball box. White began to pour from the box, and Taro turned into a wrinkled man with gray hair, for little had he realized how many years had passed since he had first been taken to the underwater palace.

As can be seen from Table 3.1., in the countries that faced system transformation, the industrial production plummeted by 30 to 50 percent. Correspondingly, GDP also shrunk significantly. As we move eastward from Central Europe, we can see that the national economies of the countries farther to the east were in a severe state of collapse. By anyone's standards, this is not a "transformational recession". Rather, it was a "General Economic Crisis" caused by the system collapse and depression.

In later years, industrial production and GDP statistics were repeatedly revised, and they showed somewhat milder changes in economic data, but the figures published at the time expressed the confusion and crisis situation of the system transformation.

3.1.2 A Surge of Prices and Production Factors

The collapse of socialist industry resulted in a spike in consumer prices. The surge in prices during the collapse of the system can be understood from two aspects.

The first is the price hike caused by the decreasing supply of goods due to the crisis. As a result of the drastic reduction in supply, the prices of even old quality goods rose. This was a temporary and short-lived phenomenon, but it was unquestionably one of the major phenomena associated with the collapse of the system.

The second is that the influx of Western goods due to the opening up of the economy caused the domestic market prices to rise. This is because the exchange rate under the old regime had been artificially high, not reflecting the realities of the national economy. Therefore, the opening up of the country to the outside world led to a continuous correction (devaluation) of the local currency, and the prices of imported commodities continuously rose. The effects of currency correction alone caused import prices to rise several times in a short period of time (Table 3.2.).

Building a new industrial base is not easy. The existing socialist companies had gone bankrupt, and there was a continuous influx of Western goods, and this created a synergistic effect which raised consumer prices considerably. Even in the Central and Eastern European countries it was Poland, which had accumulated external debt and debt rescheduling programs, that encountered hyperinflation. With the exception of Poland, the price increases in Central and Eastern Europe were contained within a scope of several times, but in the East and Southeast European countries, hyperinflation was observed widely.

In particular, prices began to soar in 1989 in Serbia as Yugoslavia began to break up and the civil war broke out. In 1990, the country entered a state of hyperinflation. When I took a trip to Dubrovnik in May 1990, \$1 was worth 1.5 million dinars. With the start of the civil war, inflation became more extreme. A huge amount of banknotes was issued to cover the costs of the war, and in January 1994, the Yugoslavian dinar suffered hyperinflation of $3.13 \times 108\%$ per month, an unprecedented monthly rate in human history.⁶ Price increases in Romania and Bulgaria were hundreds of times higher,

⁶ Steve H. Hanke, "The World's Greatest Unreported Hyperinflation", *Globe Asia* (May 2007). The Yugoslavian dinar's hyperinflation was the result of Milosevic's appropriation of the National Bank. How could this kind of social destruction occur in a state which had functioned

and price increases in the former Soviet republics were several thousand times higher in the years following the system transformation. Thus, comparable to the situation in the immediate aftermath of World War II, the former socialist countries were hit by hyperinflation in the first decade of system transformation. This was not a simple “recession”. Rather, it was a “crisis” caused by the collapse of the social system.

We should be careful to note that there are two distinct periods of transition. One is the transition period from chaos to stabilization during the collapse of a system, and the other is the transition period from stabilization to economic reconstruction. The price increases in the two periods are different in character.

The former period is dominated by a sharp rise in prices due to the correction effect of commodity prices associated with the opening of the market to the world, while Poland, the countries of Southeast Europe and the former Soviet republics fell into a state of hyperinflation. It took several years for the states in question to handle this situation.

On the other hand, the latter period bore witness to a price spike in the factors of production due to the influx of foreign capital. This was a long-term process in which the prices of land and labor were corrected to meet market values, depending on the level of economic development.

Price corrections had different effects in the different transition countries. In other words, opening up to the outside world in the early stages of the transition causes the price of imported goods to rise sharply, but in the later stages of the transition, a process of price correction of production factors occurs, which continues through a long period of convergence between the East and West. In response to the degree of foreign capital inflow, land prices and wages, which had been artificially suppressed under the socialist system, were gradually and continuously corrected to meet the market value.

However, this phenomenon took place only in the markets and regions where there was a flow of foreign capital. The degree (convergence to the West) depended largely on the degree of capital inflow, the location of the country in question, and the quality of the labor force.

3.2 The Aporia of the System Transformation

3.2.1 The Aporia of Privatization

The collapse of twentieth-century socialist society has imposed on each society the historical task of creating another society. Building a political system (legal system) is not so difficult (it is difficult to build the substance of the system), but the creation of a new economic system is far more complex. How can a new economic system be created when the socialist industry has been destroyed?

under socialist self-management, even if the country was in a state of civil war and faced the accompanying UN sanctions? How do those who admired self-managed socialism analyze the destruction of society and the national economy?

Table 3.1. Levels of production and consumer price after the transformation
(% at the end of 1993)

Central European Countries					
	Czech Republic	Hungary	Poland	Slovakia	Slovenia
Industrial production	61.8	70.3	73.3	53.3	66.1
GDP	78.9	80	86.2	74.3	82.1
CPI	234.5	262.2	2263	241.6	867.9

Balkan Countries			Baltic Countries			
	Romania	Bulgaria	Croatia	Estonia	Latvia	Lithuania
Industrial production	51.2	44.8	51	45	40	26
GDP	71.8	71	46	58	60	46
CPI	2,527.3	1,807.2	27,600	6,900	4,900	10,400

Slavic Countries			Central Asian Countries					
	Russia	Ukraine	Belarus	Kazakhstan	Uzbekistan	Turkmenistan	Kyrgyzstan	Tajikistan
Industrial production	62.6	78	80.5	71.7	98.6	93.9	55.6	58.8
GDP	58.2	63.4	78.6	65.6	82	142.4	65.2	49.9
CPI	21,000	81,200	39,500	29,600	15,600	30,000	31,100	29,300

Source: Database of the WIIW and the OECD.

Note:

- 1 The data concerning the Central European and the Balkan countries are based on the 1989 criteria, and the data concerning the former Soviet Union countries are based on the 1990 criteria. The price data concerning Slovenia and Croatia are based on 1990. The level at the end of 1993, with each base year as 100.
- 2 The GDP data concerning the former Soviet Union countries are based on NMP (Net Material Products).
- 3 The reliability of the data is not high, because the confusion in the transition societies disturbs the collection of statistics, and the GDP statistics themselves were in a state of transition to the SNA system in the early 1990s. However, we can perceive the depth of the depression of economic activities.
- 4 The reliability of the statistics is particularly low in those countries in which the rates of inflation are very high. However, we can perceive the collapse of the national economies.

Almost all economists who work far away in Washington and London proposed that state-owned enterprises should be privatized. But the idea of privatization is premised on an economy in which the market economy exists with a certain degree of maturity and there has been some capital accumulation in the domestic market. In an economy in which there has been no domestic capital accumulation, there is no technology capable of competing on the international market, and there is no managerial class with the experience necessary to operate a company in a market economy, it is impossible to achieve privatization as understood in the West. A scheme to privatize a state-owned enterprise that was dying was impossible to execute from the outset. The notion that “privatization of state-owned enterprises can solve the problem” is merely the wisdom of the outside observer. It is an idealistic view that ignores the reality of the collapse of the socialist economy.

Table 3.2. The CPI in the first half of the 1990s (% , at the end of the year)

	1990	1991	1992	1993	1994	1995
Czech Republic	19	52	13	18	10	8
Hungary	33	32	22	21	21	28
Poland	249	60	44	38	29	22
Slovakia	18	58	9	25	12	7
Slovenia	105	247	93	23	18	9
Croatia	136	250	938	1149	-3	4
Bulgaria	73	339	79	64	122	33
Romania	38	223	199	296	62	28
Estonia	na	304	954	36	42	29
Latovia	na	262	959	35	26	23
Lithuania	na	354	1,161	189	45	36
Russia	na	144	2,501	837	217	132
Ukraine	na	161	2,730	10,155	401	182
Belarus	na	93	1,558	1,994	1,990	243
Kazakhstan	105	137	1,984	2,169	1,160	60
Uzbekistan	na	169	910	885	1,281	117
Turkmenistan	na	155	644	9,750	1,328	1,262
Kyrgyzstan	na	170	1,259	1,363	96	32
Tajikistan	na	204	1,364	7,344	1	2,132

Source: EBRD, *Transition Report 1997*, 118. WIIW database.

In my 1994 book, I identified the “Aporia of Privatization”, and described the following seven points.

First, the number of companies subject to privatization amounted to 70–80 % of state enterprises (a large proportion). Second, with the collapse of the regime and the opening up of the market, most state enterprises faced financial difficulties, and this led to a continuous depreciation of assets. Third, domestic capital accumulation was insufficient and the conditions for the public and domestic businesses to purchase state assets were lacking (there was a lack of capital and a lack of a self-sustaining management body). Fourth, there was a lack of a legal basis for privatization, including clarification of ownership (lack of legal system). Fifth, there was a lack of market valuation criteria for assets for privatization (a lack of market valuation). Sixth, there was a lack of a capital market in which shares could be offered to the public even if the company was converted to a joint stock company (a lack of capital market). Seventh, there were no social norms to maintain social justice in the sale and distribution of assets (lack of social norms).

How can “privatization” be achieved in a national economy which has collapsed and all socioeconomic conditions for privatization are lacking? In the first place, can the road to building a market economy be taken from a point of departure where there is no capital, no technology, and no management capacity in the country? This is an

almost impossible task, because it is a task of “making something out of nothing”. Thus, the system transformation has posed this unsolvable “Aporia” to all transition countries. Without recognizing this aporia, it would be naive to think that the privatization of state-owned enterprises would lead to the creation of a capitalist economy.

3.2.2 The Redistribution of State and Party Assets – Initial Capital Accumulation

Throughout the 1990s, the countries undergoing post-socialist transformation suffered from privatization of state-owned enterprises on the verge of bankruptcy. It is not only impossible but also meaningless to privatize a state-owned enterprise the value of which was essentially reduced to nothing. However, companies have a small amount of assets, such as land and building assets, so if they can liquidate them, they will get some money. The assets left in the transition countries were land and buildings and financial assets left in financial institutions. By disposing of them, a company or entity could obtain the capital to start a new small business. But this was not privatization as it had been envisioned by many western economists.

Privatization as understood and expected in the western market cannot be realized unless fresh money comes from abroad. However, even after the transformation process had been underway for several years, the capital inflow from the West was extremely limited. Therefore, the battle for state and communist party assets intensified throughout 1990s. In the midst of the chaos of the transformation, significant real estate holdings and financial assets held by the communist party, state companies and banks were looted by insiders of the old regime. These plundered assets became the starting point for the wise men’s entrepreneurship, which led to the creation of newly emerging businessmen. It was precisely the scramble for state and party assets, i.e., the redistribution of public assets, which formed the initial capital accumulation in the system transformation.

In the midst of the chaotic system transformation, by obtaining large loans from commercial banks and acquiring state-owned companies on the verge of bankruptcy, certain individuals and groups got their hands on huge amounts of state and party assets. Obviously, these people were high ranking government and party officials from the old regime who had information on state and party assets as insiders. As a result, public assets were plundered and transformed into private assets as a result of the looting and appropriation of public assets.

Most of the pillaging was skillfully concealed and never became public knowledge. The complete leakage of assets of the Central- Wechsel- und Kreditbank (CW Bank), the Vienna branch office of the National Bank of Hungary, finally became public knowledge in 1998, when the Fidesz government was established. However, it was already too late to act, and most of the assets had been looted in the early 1990s. The bank was used by the dummy companies of communist parties in Central and Eastern European countries for their shady businesses. After the collapse of the socialist system, the customer companies withdrew large loans by using connections to the old regime, and the companies which had received large loans went bankrupt or disappeared. Consequently, most of the loans had already become non-performing when

the Hungarian government made its decision concerning the CW Bank. It was reported in the Hungarian Parliament that the accumulated losses were in the range of HUF 80-85 billion.

In 1998, Zsigmond Járαι, acting as finance minister for the Fidesz government, sent an open letter to György Surányi, the governor of the Hungarian National Bank, accusing him of having been responsible for the supervision of the Vienna branch. The Hungarian government only sued the CW Bank's managers at that time and could not recover any property at all. There was no way to recover the assets. In the 1999 National Bank Annual Report, there are dozens of pages of open letters between Governor Surányi and Minister Járαι. This open letter section is completely removed from the PDF version of the annual report archive.

After the system transformation, all commercial banks which were separated from the national banks accumulated bad debt due to chaotic and irresponsible financing. The notion that bank loans were state subsidies, an attitude and practice inherited from the old regime, remained strong, and few people had much of a conscience about repaying debt. It was only when these commercial banks were bought by foreign banks that they were able to be transformed into decent commercial banks in the Central and East European countries. This took place around 2000.

At the end of August 1998, when the Fidesz government was established, Postabank was placed under state control. Special armed forces surrounded the bank headquarters with masks and rifles and entered the president's office. The Postabank president Gábor Princz then fled to Vienna, but when he returned to Hungary, he was eventually acquitted after having been made to pay a small fine. People who had committed cleverly executed economic crimes during the period of system transformation were acquitted, in part because there were no laws to punish them and in most countries, no arrests were made. Princz died in Vienna in 2018, and both the fraudulent loans made by Postabank to specific business and politicians and Princz's inexplicable relationship with the CW Bank have remained buried in the darkness of history.

There was a similar case in the Czech Republic, when the IPB Bank owned by the Nomura Securities Group was taken over by the government in 2000. Special forces entered the president's office of the bank and held the president at gunpoint.

Both Hungary's Postabank and the Czech Republic's IPB Bank were privately owned commercial banks, but the fraudulent loans and heavy losses to banks triggered state control. Ten years after the system transformation, even Hungary and the Czech Republic, which were and are considered advanced countries among the transition countries, failed to develop a banking industry that functions on market principles.

3.3 Coupon Privatization and Foreign Direct Investment

3.3.1 Coupon Privatization as a Transitional Capital Accumulation Scheme

Throughout the 1990s, with the exception of Hungary, the transforming countries adopted the coupon (voucher) privatization scheme as a method of privatization. No fresh money from outside these countries entered the state enterprises that were on

the verge of bankruptcy. In the early 1990s, companies in the West did not pay a great deal of attention to state enterprises in Central and Eastern Europe. In order to break through the deadlock, the IMF and EBRD advisors⁷ urged the states to introduce privatization by coupon (voucher), an approach which was inspired by the temporary success of coupon privatization in the Czech Republic. Although there are various specific methods of coupon privatization, the common aim is to scrape together a small amount of money to privatize state enterprises at a stage when fresh money is not coming in. Most of the state-run companies were on the verge of bankruptcy, and their corporate values were very low, so it was relatively easy for any company to acquire them. Therefore, here too, those who could get bank financing or take advantage of personal connections with the elite of the old regime or those who could get into the coupon privatization implementation entities as insiders succeeded in getting a large benefit from coupon privatization. In all the transition countries in which coupon (voucher) privatization was implemented, the state assets were redistributed through spectacular insider trading. However, among the companies acquired in this way, only a few had marketable value, and in many cases it was difficult to run the coupon privatized companies without a significant investment of capital. Therefore, in almost all these cases, coupon privatization was really just a means of acquiring the company's real estate. As a consequence of the privatization-by-coupon schemes, the ownership of many state-owned enterprise assets was converted, and some of the companies became personal assets.

Unlike the direct looting that occurred immediately after the system transformation, the coupon privatization scheme had certain legal guises which made the method seem fair. However, there was plenty of room for all kinds of insiders to get into the scheme, and with the support of the old regime forces, shrewd individuals could become emerging entrepreneurs, the new oligarchs of the new era.

I should note that the Russian voucher privatization system and Czech (Slovak) coupon privatization system were fundamentally different.

Russia's privatization by voucher was a blatant attempt to plunder the assets of the giant companies which access to valuable resources. The old political forces had teamed up with young, talented Komsomol leaders and engineers to use cheap money from emerging commercial banks to transform national assets into private assets. In contrast, the coupon privatization system in the Czech Republic was based on the conversion of coupons into shares through investment funds established largely by the state financial institutions. Of course, private funds also functioned, and they became a source of wealth for the fund owners. But the state-run financial institutions managed the majority of the state enterprises.

The coupon privatization system in the Czech Republic was a mechanism for state companies to change their handlers, i.e., change the ownership relationship among them. However, it was not possible to revive and develop the state enterprise through ownership reorganization alone. In fact, coupons were converted into shares, and a

⁷ They praised the scheme of Czech coupon privatization as the "Czech Miracle".

Table 3.3. Schemes of the coupon (voucher) privatization

	start year	methods of issue	anonymous, transferable	investment to funds is allowed, recommended or compulsory?
		continous or stepwise		
Albania	1995	continous	anonymous	recommended ¹
Armenia	1994	continous	anonymous	allowed ²
Bulgaria	1995	stepwise	not transferable	recommended ³
Czech Republic	1992	stepwise	not transferable	recommended
Estonia	1993	continous	transferable ⁴	allowed ⁵
Georgia	1995	continous	transferable	allowed ²
Kazakhstan	1994	stepwise	not transferable	compulsory
Kyrgyzstan	1994	continous	anonymous	allowed ⁶
Latvia	1994	continous	transferable	allowed ⁵
Lithuania	1993	continous	not transferable	allowed ⁵
Moldova	1994	stepwise ⁷	not transferable	recommended
Poland	1995	stepwise	transferable	compulsory
Romania ⁸	1992	continous	anonymous	compulsory ⁹
Romania	1995	stepwise	not transferable ¹⁰	allowed
Russia	1992	continous	anonymous	recommended
Slovakia	1992	stepwise	not transferable	recommended
Slovenia	1994	continous	not transferable	allowed
Ukraine	1995	continous	not transferable	allowed

Source: Saul Estrin, "Some Reflections on Privatisation in Belarus", *Economic Trends Quarterly Issue Belarus* (July–September 1999).

Note:

1 Only one or two funds received voucher till July 1996.

2 Legally allowed, but practically regulated.

3 The first voucher auction was cancelled on March 1995, and the fund licence was suspended.

4 Not transferable initially, but cashing was legalized in 1994.

5 To exchange voucher to flats and land was also allowed.

6 Voucher can be invested to flats and livestock. Vouchers can be sold to the fund, but there is no formal mechanism for selling it.

7 The scheme was invented mainly for sellong companies.

8 The scheme introduced in 1991 was to distribute deed of the five funds ownership. In 1995 complementary shcheme was introduced to exchange coupon to shares of companies, or cxchanged through funds to shares of companies.

9 Deed of ownership of companies could be exchanged to shres under certain conditions.

10 Deed of ownership fo companies was anonymous and coupon was registered and not transferable.

securities market was established, but it worked only formally. Throughout the 1990s, stock trading had been a place for domestic insiders to play an active role, but fresh money from outside the country never arrived. Though numerous companies were listed, they could not be valued, and shares could not actually be traded. There was a limited number of stocks that could actually be bought and sold instantly. Many stock trades were executed either in the OTC or in a black box-like computer system (RM system). Usually, it took days to conclude a trade. This kind of opaque trading

Table 3.4. Concentration of the fund group in the first coupon privatization in the Czech Republic

Fund Group	Number of funds retained	investment points collected (million points)	concentration of the investment points (%)
Ceska Sporitelna	1	950	15.60
IPB Bank	12	724	11.90
Harvard Group	8	638	10.50
Obecná investiční banka	1	500	8.19
IKS Commercial Bank	1	465	7.62
České pojištění	1	334	5.47
Slovenská investiční společnost	1	187	3.07
Slovenská spořitelna	4	168	2.76
Creditanstalt	2	166	2.72
CSOB	12	145	2.37
total of top tens	43	4,311	70.06
grand total of incetment funds	429	6,772	100.00

Source: Shuichi Ikemoto, "Note on the Coupon Privatization in the Czech and Slovakia", *Ikkyo Ronso* (December 1995): 1050 (in Japanese).

business did not allow foreign investors and brokerage firms to enter the stock market. Furthermore, it was impossible for Czech financial institutions, whose old-fashioned management was widespread, to revitalize and develop the companies coming under their control.

The coupon (voucher) privatization systems in Russia and the Czech Republic offer examples of two extremes, and the coupon privatization schemes adopted in the other countries of the region fell between the two.

The important thing in considering coupon privatization is that unless fresh money flows in from the outside, coupon privatization is nothing more than a "Monopoly game". It is a closed virtual game in which the competitors compete to sell and buy companies. It amounted in the end to a redistribution of existing assets, and this resulted in the re-accumulation of capital within a given county.

In fact, there are no real examples of companies acquired through coupon privatization being able to function in the global markets, except for Russian companies with access to natural resource. Most of them ended up in a game of redistribution of domestic assets. Fresh money from the West was still needed even for the coupon privatized companies to function in the global market. Until the fresh money began to arrive from outside the given country, coupon privatization was no more than a Monopoly Game.

Major commercial banks in the Czech Republic were also privatized according to a coupon scheme, but that does not mean that they become private companies. As seen in table 3.5., the coupon privatized commercial banks were still state-owned. They were simply changed to a form of sharing company among the various institutions of the state. Although the management of the "coupon privatized" commercial banks took the position that foreign investment was not necessary for them to survive, even after

Table 3.5. Privatization of the Czech main banks (1997)

Bank	Year of privatization	Onwership structure
Ceska Sporitelna	by coupon in 1992	State Restitution Fund 45 %, local governments 14.75%, legal entities 37%, individual 3.25 %
Komerční Banka	by coupon and property restitution fund in 1992 direct sale in 1995	State Restitution Fund 48.7 %, Bank of New York 9.99 %, Property Restitution Fund 4.2 %
IPB Bank	by coupon in 1992	State Restitution Fund 31.48 %, Charouz Fund 11.9 %, Bankovni Holding 10.55 %
CSOB	under consideration	Czech Central Bank 26.5 %, Slovak Central Bank 24.13 %, Ministry of Finance 19.6 %, State Restitution Fund 19.6 %

Source: Shuichi Ikemoto, "The Situation and Problem of Marketizaion in Czech Republic", *Russian Kenkyu* (April 1998): 136 (in Japanese).

this "privatization", the rate of non-performing loan remained high in these institutions. The problem posed by the large non-performing loans owned by the Czech commercial banks was eventually solved by selling banks to foreign banks around 2000.

In other words, without the help of foreign banks, the Czech banks could not operate according to international standards. The Czech government finally decided to sell its commercial banks to foreign banks, and the sale amount, which was discounted to compensate for bad debts, was paid into the state treasury.

The problems posed by coupon privatization schemes were not limited to financial institutions. The assets of the industrial companies that were privatized according to a coupon scheme could be converted to cash only when fresh money from outside the country became available to the companies. In other words, by selling coupon privatized companies to foreign capital, the seller was free to dispose of the funds and could use it as capital to develop new businesses. In addition, companies that were sold to foreign capital were finally able to get an infusion of capital, technology and management know-how which would enable them to become functioning enterprises in a market economy. This is why re-privatization was inevitable in case of the companies in the Czech Republic that were privatized according to the coupon privatization schemes. Indeed, privatization actually only took place once these companies, which had been "privatized" by coupons, were again "privatized" by foreign capital. Thus, "pri-

Table 3.6. The rates of non-performing loans in the Central European countries
(% to the total amount of loans at the end of year)

	1991	1992	1993	1994	1995	1996
Czech Republic	2	19	23	38	35	35
Hungary	–	11	29	22	17	13
Poland	16	27	31	29	20	13
Slovakia	–	3	12	30	42	32
Slovenia	–	–	19	15	10	–

Source: EBRD, *Transition Report 1997*, 85.

vization” in the Czech Republic, the leading country in coupon privatization, was finally solved by re-privatization with foreign capital.

In summary, until fresh money came in, the privatization underway in the failed socialist economies was merely formal. The companies could not be revitalized. Coupon privatization was not so much a method of privatization as it was a scheme for the distribution of existing assets among domestic players, and true privatization was only possible with the introduction of foreign capital. This is a historical fact of coupon privatization.

3.3.2 The Role of Foreign Direct Investment (FDI)

It should be noted that in the period of the early 1990s, politicians and even economists in the Central and Eastern European countries were unable to understand the distinction between foreign financing and foreign direct investment. Especially in the Czech Republic, there was a strong tendency to reject both funding and direct investment together from abroad, and Prime Minister Klaus himself declared many times that the Czech Republic did not need any foreign money and could create a market economy by itself. The massive privatization by coupons was seen precisely as bearing the promise of enabling the country to establish a market economy on its own. The Czech Republic, which was in a better state from the perspective of its national treasury than Poland or Hungary, was convinced it could create a workable market economy without foreign capital.

However, as described in the previous section, the companies privatized according to the coupon scheme could not carry out restructuring or bring fresh money to revive their businesses. Around 1994–1995, I visited the major Czech commercial banks on several occasions, and I knew that the commercial banks all had high rates of non-performing loans, reaching as high as 30 percent and even 40 percent. Top management at the banks was unconcerned by this and asserted that there was no need for help from foreign banks except for assistance with the computerization of banking.

Prime Minister Klaus made it clear in 1993 that he would give priority to domestic capital by abolishing preferential treatment for foreign investment, but regardless of Klaus’s wishes, direct investment began to flow into the Czech Republic from around 1995. Subsequently, there was a shift in the direction of preferential treatment for major investments on a case-by-case basis.

In contrast to the Czech Republic, from the beginning of the transformation, Hungary welcomed foreign capital, both in terms of financing and direct investment. Hungary did not have any other choice but to receive foreign capital in any form because of a shortage of capital accumulation and a large external debt. In the 1994 debt crisis, the Hungarian government narrowly avoided rescheduling its debt by issuing state bonds on the Japanese market (Samurai bonds), which were underwritten by Nomura Securities and Daiwa Securities in a total of six issues in 1995 (three each, for a total of 160 billion yen). Thus, Hungary avoided the debt crisis. On the other hand, Hungary was forced to keep domestic taxation levels high at all times in order to repay its debt, which caused Hungary’s redistribution rate to remain high.

Table 3.7. FDI Inward to the Central and East European countries in the first half of 1990s

	1994	1995	1996	stock (1989–1996)	per capita USD
	millions USD			millions USD	
Hungary	1,097	4,410	1,986	13,260	1,300
Czech Republic	1,024	2,720	1,264	7,120	692
Poland	542	1,134	2,741	5,898	142
Romania	347	404	210	1,186	52
Slovenia	131	170	180	743	372
Estonia	212	199	110	735	477
Latvia	155	165	230	644	258
Slovakia	178	134	177	623	117
Croatia	98	81	349	615	129
Bulgaria	105	82	100	425	51
Albania	53	70	90	298	93
Lithuania	31	72	152	285	41

Source: EBRD, *Transition Report 1997*, 126.

Hungary played a leading role in receiving foreign direct investment (FDI) in Central and Eastern Europe in the early 1990s. However, both Poland and the Czech Republic gradually came to understand the importance of FDI, and this was a departure from their previous stance. From the late 1990s onwards, the battle to attract FDI began among Hungary, the Czech Republic, and Poland. Poland's large domestic market was always attractive to multinational companies, and the Czech Republic had become increasingly important as a production base for the German market. In this context, Hungary's dominance in attracting FDI was gradually lost.

FDI brought in fresh money, technology, and management know-how all at once. I referred to these three items as the "three kinds of sacred treasures" with which to break the "Aporia" described in my book. The "Aporia" of privatization could be solved only with the "three kinds of sacred treasures" brought in by multinational corporations.

In the late 1990s, politicians in all the transition countries finally came to recognize that industrial reconstruction was impossible without FDI by multinational corporations. Thus, even in the Czech Republic, privatization was ultimately achieved through the sale of the coupon-privatized companies to foreign capital.

Economists at the IMF and the World Bank also finally recognized the limits of coupon privatization at the end of the 1990s. They were ashamed of themselves for having praised the Czech coupon privatization as a "miracle".⁸ The "Miracle" became "Mirage". However, there are still many economists who once raved about coupon privatization but who have kept silent on their past statements.

⁸ David Ellerman, "Lessons from East Europe's Voucher Privatization", RBEC/Bratislava Policy Paper No. 1, UNDP/RBEC/IPC, 2000; "John Nellis, Time to Rethink Privatization in Transition Economies?", Paper Number 38, IFC: International Finance Corporation, 1999. "Waving goodbye to the Czech miracle" (<https://www.politico.eu/article/waving-goodbye-to-the-czech-miracle/>).

3.4 Barren Debates with Fake Models

3.4.1 Radicalism vs. Gradualism

An issue that has attracted the interest of theoretical economists is “radicalism” (shock therapy) vs. “gradualism” in the speed and methods of privatization in the transition countries. However, as I argued in 1994, this is a fictitious and sterile argument.⁹ System transformation, a qualitative change in society, requires a long historical time. Even if a wise policy could shorten the process somewhat, the truth that system transformation is a long-term process is unassailable. It is an unsubstantiated claim to believe that “shocks can make the transition process short and rapid”. In search of a theme for articles, neoclassical economists have tried to make models to contrast shock therapy with gradualism. Numerous pedantic comparison models have been constructed. However, a misguided analysis of reality has nothing to teach us. First and foremost, the argument concerning the “contrast between shock therapy and gradualism” is based on a serious misrepresentation of historical facts. This renders the model debate sterile. As already noted, this debate as a historical argument on privatization was already settled at the end of the 1990s, and it becomes clear that there existed no “alternative strategies” for privatization in Central and Eastern Europe.

Without recognizing the specific history of radical policies or shock therapy in privatization, it is impossible to understand the nature of the problem. Some economists confused the strategy of privatization with the shock therapy approach used in Poland, which was introduced to suppress hyperinflation in the midst of the chaos of the collapse of the old regime. Shock therapy as used in Poland had nothing to do with privatization. It was a “shock therapy type of treatment” that was worked for a short period of time in order to stabilize the national economy. The coupon privatization scheme, in contrast, was deployed on a large scale in the Czech Republic and adopted by other regime-change countries to break up the deadlock of privatization. It is a “radical” privatization strategy of “transformation”. The two shock therapies should not be confused.

What drove Poland’s radical policy was the severity of the national economic collapse. Since the days of the old regime, Poland had suffered serious economic problems due to shortages of goods, especially meat and vegetables. In addition, Poland, which had been receiving financing from the West during the socialist era, was deeply in debt throughout the 1980s, and the national economic management was in crisis.

The demise of the Communist Party government based on the Round Table Conference in 1989 made it an urgent task to deal swiftly with the serious problems facing the national economy. The transformation caused a loss of confidence in the currency zloty and rampant inflation consumers in 1989; prices rose at a rate of about 900 % (as a year-end comparison). In 1990, they rose at a rate of 250 %. Inflation hit the economy. This was an anomaly not seen in Czechoslovakia or Hungary.

The Polish government (with Minister of Finance Barcelowicz) took the advice of Professor Sachs of Harvard University. It froze wages and energy prices from Janu-

⁹ In my Japanese book, *The Economics of System Transformation*, 135–36, 174–75.

Table 3.8. Inflation in Poland in 1990

The average of inflation in 1990 was 787.09 %			
monthly based inflation rate		annual based inflation rate	
January 1990 – December 1989	79.41 %	January 1990 – January 1989	916.67 %
February 1990 – January 1990	22.95 %	February 1990 – February 1989	1,150.00 %
March 1990 – February 1990	4.00 %	March 1990 – March 1989	1,200.00 %
April 1990 – March 1990	7.69 %	April 1990 – April 1989	1,100.00 %
May 1990 – April 1990	4.76 %	May 1990 – May 1989	1,000.00 %
June 1990 – May 1990	3.41 %	June 1990 – June 1989	1,037.50 %
July 1990 – June 1990	3.30 %	July 1990 – July 1989	944.44 %
August 1990 – July 1990	2.13 %	August 1990 – August 1989	700.00 %
September 1990 – August 1990	4.17 %	September 1990 – September 1989	525.00 %
October 1990 – September 1990	6.00 %	October 1990 – October 1989	341.67 %
November 1990 – October 1990	4.72 %	November 1990 – November 1989	282.76 %
December 1990 – November 1990	6.31 %	December 1990 – December 1989	247.06 %

Source: <https://www.inflation.eu/inflation-rates/poland/historic-inflation/cpi-inflation-poland-1990.aspx>

ary 1990, and it took steps to restore exchangeability and fiscal austerity measures, including price liberation. This was Poland's so-called "shock therapy". It was like an emergency measure similar to the policy of containing hyperinflation which could be observed in many countries in the immediate aftermath World War II.

Emergency (austerity) policies to halt the endless economic collapse in Poland were different in their nature from the longer-term institutional reforms like privatization. It is meaningless to think of the two therapies as an identical radical therapy, because the two measures are different in their objects and the dimensions of the social policy they involve. It is a leap of logic of neoclassical economists to identify things only from the perspective of speed while ignoring historical fact and background.

Throughout the 1990s, the "shock therapy" favored by IMF economists did not refer to the temporary emergency policies adopted by Poland in the wake of regime collapse, but rather to the "massive and fast-paced privatization" by coupons, as represented by the Czech Republic. Economists at the IMF and other international organizations which recommended coupon privatization even praised the Czech Republic's "radicalism in privatization" as a "miracle" and criticized the "slow privatization" seen in Hungary, where "slow privatization" awaiting autogenous privatization by foreign capital (buyouts by foreign capital) was seen as gradualism. In the mid-1990s, economists in international organizations, including the IMF, believed that large-scale, bold privatization, as exemplified by the Czech Republic, was the way forward for the transition countries.

As already discussed, large-scale privatization, known as coupon or voucher privatization, was nothing more than a redistribution of existing assets and did not produce any capital, technology, or management to reform corporate management. Coupon-privatized Czech companies did not have the ability to revive their companies on their own, and in the late 1990s, the companies were bought out by one Western company after another. Companies that were supposed to have been formally privatized through

Table 3.9. The weight of foreign banks (in % to the total bank assest)

	1999	2001
Estonia	62	97
Latvia	66	97
Czech Republic	48	93
Croatia	31	89
Albania	63	87
Slovakia	–	83
Lithuania	45	81
Bulgaria	47	75
Poland	56	69
Hungary	65	62
Macedonia	12	53
Slovenia	11	16

Source: Evan Kraft, “Foreign Banks in Croatia: Another Look”, paper presented to the Zagreb Seminar of “A New Dialogue between Central Europe and Japan, 2002”.

coupon privatization were “re-privatized” by foreign capital and were transformed into companies that could function in a market economy.

By 2000, the Czech companies privatized according to the coupon privatization scheme, including commercial banks, were being bought by one foreign company after another. Only at this stage did economists in international organizations, including the IMF, recognize the limits of coupon privatization. The glory of the Czech coupon privatization scheme, which was even hailed as a miracle, faded in less than a decade.

In the midst of the economic (capital, technology, and management) disparity between the East and the West, the Central and Eastern European countries had to wait for the second opening of the country, which came with a massive influx of foreign capital (the first opening was due to the collapse of the system). In the first opening of the country, the opening of the country to the outside world through trade liberalization was implemented, but the influx of capital was strictly regulated.

Ten years after the transformation of the system, the second opening of the country has finally begun in Central and Eastern Europe. Without an understanding of this historical development, we cannot understand the “privatization” of Central and Eastern Europe. It is a misrepresentation of historical facts and a leap in logic to portray the process of transition as if there were two strategic conflicts.

3.4.2 The Fake Model – The Desk Argument

As in many of the neoclassical models, neoclassical economists take only the formal framework of a real problem and try to make a mathematical model to assert the “validity” of a specific proposition. Formal discussions that discard content are a kind of pedantic game.

As discussed in Chapter 1, there are major limitations to analyzing an object from a distance. Moreover, it is arrogant to think that we can understand the nature of events by speculation alone, without tracing the historical course of events in countries we have never visited.

As described in the earlier sections of this discussion, it is a mistake to think that there was a rival strategy between radicalism and gradualism or that a strategic debate even existed. It is true that arguments praising Poland's emergency shock therapy and the privatization of coupons in the Czech Republic existed. Not only are these two policies of completely different dimensions, but it is a mistake to regard the Polish policy development as a long-term strategy for system transformation.

However, in the modelling so favored by neoclassical economists, it does not matter whether the target event (the problem setting) is true or false. Interesting ideas and tips emerging from analyses of the real economy are sufficient for model building. Irrespective of the historical process and the phase of the problem, it is enough for economists if a game-theoretic model of "radicalism vs. gradualism" can be constructed. Any model that ignores history and facts is a fake model, and to think that one can understand a complex reality with a fake model is a delusion.

There is an important study that has produced a database of articles related to the transition and has revealed interesting facts.¹⁰ The database devotes a chapter to the argument concerning "gradualism vs. radicalism", too. It shows that, of the total of 196 authors of the 137 basic extracts on this topic, 160 are at academic research institutions, 16 at international organizations (such as the IMF and World Bank), and 11 at think tanks. While 77.6 % of the authors, or 152 people, are based in North America and Western Europe, only 29 authors (14.8 %) are based in one of the transition countries. What is interesting here is that the topic is primarily discussed not in the transition countries, but rather in an external world far away from the countries involved. This is consistent with my experience. At least in the countries of Central and Eastern Europe, "gradualism vs. radicalism" has never been a major topic of discussion. People in these countries were aware that such issues were being raised by economists in international organizations, but it was rarely an issue in the countries concerned. Such abstract strategic alternatives were never contested, and such discussions were never thought to have any intrinsic meaning.

As discussed in the previous section, economists at the IMF and the World Bank, which had a major influence on the privatization strategies adopted by the transition countries, criticized themselves for overestimating the Czech coupon privatization system, which required the re-privatization of the country by foreign capital, and they confessed that what they had praised as a "miracle" had been an illusion. At this point, the misguided debate among economists at international organizations about "criticizing Hungarian gradualism and glorifying Czech radicalism" has been settled. There-

¹⁰ Ichiro Iwasaki ed., *The Economics of Transition – Developing and Reforming Emerging Economies* (Routledge, 2020), Chapter 2: "The Transition Strategy Debate: Gradualism Versus Radicalism".

fore, since then, it is only natural that very few researchers in international institutions have dealt with this topic.

In the world of neoclassical economics, however, regardless of the historical course of events, even after 2000 there has intermittently been an ongoing debate to model the strategic conflict between “gradualism vs. radicalism”. According to Iwasaki et al., in the two years between 2009 and 2010, the twentieth anniversary of the fall of communism, the debate gained notable momentum. “Radicalism vs. gradualism” may have been chosen as a theme that is easy to build a model around, independent of history and reality. It is also interesting to note that most of the authors are researchers from academic institutions.

For researchers who are not interested in real historical processes and who think at their desks, the specific facts and realities of Polish shock therapy and Czech coupon privatization are outside the scope of the analysis. To neoclassical economists, only the hints and ideas on which witty and elegant models can be built are of interest. If one assumes that there is a strategic conflict between gradualism and radicalism and one can summarize the advantages and disadvantages of each into a concise model, then research results can be generated. That is all that is of interest. This type of study never considers the historical and realistic process of the transition because the specific content of the model’s subject matter is not intrinsic to the model. The comparison model of “gradualism vs. radicalism” can easily be converted into a model of the health effects of “fast walking (6 km/h) vs. jogging (9 km/h)”, the measuring criteria of which could be more clearly set by physiological indicators than that of contentless comparison by economists, so much so, indeed, that the “gradualism vs. radicalism” argument is infinitely more contentless.

Researchers are free to create models, but it is a fallacy to think that we can understand reality on the basis of a model created according to speculative thought instead of constructing models on the basis of reality. If you confuse a speculative model with reality and pose a problem that does not exist, then the model is fake. It is meaningless to solve model problems created on the writing desk. This type of model analysis should be referred to the “economics of economics”, an economics which studies speculative and deductive economic models and theory. It is not an economic study of real economies.

3.5 Corruption during the Early Stage of the System Transformation

Neoclassical economics cannot capture social phenomena such as corruption. Corruption can be classified into several types, but these types vary from country to country, region to region, and time to time. However, neoclassical thinking believes that social events can also be captured in an abstract model based on market equilibrium. It is a naive imperialism of neoclassical economists to think that every social event can be analyzed on the basis of market equilibrium models.

Real-life corruption is very diverse, and there were corruption phenomena inherent in the transition countries under system transformation. Most crimes and instances

of corruption in the historical process are buried in darkness. It is difficult to imagine a figure more naive than the theoretical economist who does not know the concrete reality of corruption. Researchers have no way of tracking the reality of corruption and have no knowledge or information about how corruption is actually carried out. Nevertheless, economists attempt to explain corruption with a simple, *priori* simple model, and they seem to believe that tasteless, empty, contentless generalities can shed light on the phenomenon of corruption. This strikes me as the height of ignorance.

The various forms of plundering, looting, and unfair methods that occurred or were used in the process of the privatization can be classified into typologies only by analyzing concrete examples of corruption. Any attempt to apply the speculative, neoclassical model analysis, which compares revenues (profit) and costs (loss or punishment), to the analysis of the social phenomenon of corruption yields only stale conclusions. Instead of trying to understand corruption deductively from a speculative model, we should analyze the concrete examples of corruption that occurred or are occurring in reality and obtain general propositions from them. Only this will offer us some grasp of the nature of the corruption phenomenon during the process of system transformation.

3.5.1 Looting and the Defrauding of Bank Assets

In the period between the fall of the communist dictatorship and the establishment of a new government, a political vacuum was created in the transition countries. Even after a new government was established, it took a considerable amount of time to take control of the bureaucracy and sort out the residue of the old regime. During period in which this political vacuum prevailed, behind the scenes of the political arena, some forces of the old regime were implicated for their interests and their erasure of the past.

One of the first assets to be taken care of was an asset owned by the Communist Party. Financial assets and real estate owned by the Communist Party fell prey to the high-ranking bureaucrats of the former Communist Party. It was the Communist Party of the Soviet Union that held the largest assets, supposedly amounting to \$9 billion. Five days after the failed 1991 coup, Nikolay Kruchina,¹¹ who controlled the huge assets of the Soviet Communist Party, “committed suicide”, and Georgy Pavlov, who succeeded him, “committed suicide” six weeks later, although many officials did not believe their deaths was suicides. Furthermore, between 1989 and 1991, 1,000 tons of the 1,500 tons of gold owned by the Federal Central Bank of the USSR were sold, but their whereabouts are not known for certain.¹² When Yegor Gaidar became acting prime minister in 1992, he asked the CIA to investigate the whereabouts of the Soviet

¹¹ Paul Klebnikov, *Godfather of the Kremlin: Boris Berezovsky and the Looting of Russia* (San Diego: Harcourt, 2000).

¹² *Ibid.*, 65–66. In 2008, it was revealed that American businessman Leo Emil Wanta had huge financial dealings with Russian banks and had been arrested in the US and Switzerland, and some of the Wanta documents seized in the investigation were leaked to the internet. Among them are documents related to Hungary, which can be viewed on the Internet (https://bodoky.blog.hu/2008/12/09/a_kgb_aranya).

Communist Party's overseas assets, but he was rebuffed. In November 1990, it was revealed that the USSR Central Bank and the KGB used a company called Fimaco, set up in the tax haven island of Jersey, to manage and operate foreign funds, and that it managed \$50 billion in assets. It was also revealed by Price Waterhouse that the \$12 billion loan from the IMF to the Russian Central Bank was transferred to Fimaco.¹³ It has been said that Khodorkovsky might have been involved in the secrecy and laundering of foreign assets of the Central Bank and the Communist Party, but the truth of this allegation is lost in the maelstrom of history. The Hungarian Socialist Workers Party owned far fewer and far less valuable foreign assets than the Communist Party in the Soviet Union, but funds were transferred to the Vienna branch of the National Bank of Hungary (CW Bank) and to yet another Western financial institution via the CW Bank. The CW Bank, which was used to evading COCOM regulations, had become a transit point for funds from black companies associated with the communist parties of various countries. It was mainly the financial managers of the respective communist parties who knew that the bank was the transit point. As already noted, the CW bank became a target for defrauding in the immediate aftermath of the system transfor-

This is document on András Szász, the alleged mastermind of various fraud schemes in Hungary, and the material was about the purchase order of 500 tons of gold bars, dated September 13, 1989. The seller's group was a Texas-based company, and the intermediary group was a Hungarian resident of Canada with a commission of 0.3333 % and 0.3333 % respectively. Wanta is listed as the buyer group's representative. The order was issued in the name of PLAN-TORONIK GmbH, registered in Vienna, and the signatory was the head of the company at the time, András Szász. This transaction was apparently part of the process of transferring 500 tons of gold from Russia to a Swiss bank and of the process by which some of the Federal Central Bank's gold was sold to Swiss banks through a number of intermediaries. Of course, this document is a documentary alibi operation unrelated to the actual gold shipments.

Leo Emil Wanta is also said to have been a U.S. agent against the Soviet Union, while András Szász worked in the COMECON trade under the former regime and was a KGB intelligence officer or was very probably a double agent with Hungarian intelligence officers. At the very least, he is said to have been a KGB representative in Hungary (which he does not deny). 500 tons of gold is worth over €10 billion, and that is not something a normal company can handle, even if it is only on paper. Even this deal, involving numerous KGB contacts and former Western intelligence officers, would not be possible without the trust and approval of the KGB.

The deal is speculated to have been part of a laundering operation that involved the transfer of 500 tons of gold from Russia to Switzerland. The Hungarian resident in Canada, who is listed as an intermediary group in the contract, is a dentist. The multiple layers of intermediaries were used to prevent the initial seller of the gold from being identified.

The Hungarian online news company index.hu interviewed András Szász in 2009, and he testified that the purchase order that was circulated online was genuine (news delivered on February 4, 2009, <https://index.hu/belfold/arany7243/>).

András Szász, who has been named in various economic crimes from the 1990s to the present, was sentenced to three years in prison and given a huge fine on March 1, 2019, after being sentenced to a second trial for conspiring with the former president of MVM (Hungarian Electrical Works) István Kocsis to drain the company's assets out of the country.

¹³ Klebnikov 2000, 61.

mation. On the other hand, domestically, financial assets accumulated in commercial banks had been subjected to fraud. All the commercial banks where the old nomenclature occupied positions in the top management had suffered an outflow of assets until Western banks had acquired the ownership of the banks at a discounted price for their non-performing loans (accumulated debt).

László Máté, head of finance at the central headquarters of the Hungarian Socialist Workers' Party, bought the state trading company (Kossuth Kereskedőház) in the midst of a transition thrust and opened an office in a prime location in Budapest. I was invited by a member of the Socialist Party to visit Máté's office, which had been gorgeously renovated in 1991. I was told that he was an excellent businessman and that he imported ostriches from South Africa, raised them in Hungary, and sold them as meat. Later, Máté became one of Prime Minister Horn's arms when the Socialists took power in 1994, and he was nominated to serve as the deputy leader of the Socialist Party. His business was so prosperous that when he found out that a sumo performance was coming to Vienna, he was so well-funded that he wanted to invite it to Hungary as well. Although the details concerning his business connections to the party are hidden in the dust of history, there is no question that the launch of his business was funded by using some of the assets of the old Socialist Workers Party. He was one of the few high-ranking party bureaucrats who knew where the party's financial assets and real estate were.

Máté later founded the Nádor 95 Rt. and became known for his various fraud schemes. Nádor 95 Rt. began to commit various cases of fraud and deceit, with András Szász serving as president of the company. Nádor 95 Rt. teamed up with BCL, a one-man Vienna-based trading company, in 1998 and tried to acquire a stake in Hungary's Postabank. The Postabank president Princz was exploring ways to bring in outside private capital to avoid state intervention in the troubled bank's management. So he teamed up with Máté to try to turn a trick. With Nádor 95 Rt. intermediation, the BCL transferred HUF 2.5 billion (\$12,000,000 at the exchange rate at the time) to fund the purchase of the additional Postabank stock. However, BCL's acquisition of shares was voided when the deadline for the capital increase in early May 1998 was not met. This is because the funds that were supposed to be used to acquire the shares were planned to be defrauded from Postabank, and it took too much time to get the defrauded fund. In short, they tried to pull off a magic trick of converting the defrauded funds into a capital increase, but they failed.

The details of the fraud scheme:

The \$12 million was initially obtained by Nádor 95 Rt. in the form of a letter of credit from Postabank, purportedly for the purchase of steel from BCL. Nádor 95 Rt. handed the letter of credit to BCL, which withdrew the fund from Komerční Bank, the letter of credit addressee, where the BCL had an account.

To initiate this transaction, BCL gave the fake warehouse securities to Nádor 95 Rt. A letter of credit was issued by Postabank as collateral to the Czech Republic's largest bank, Komerční Bank. The BCL had a business relationship with Komerční Bank due to the fact that the company owned a steel company in the Czech Republic. The fund was obtained from the bank based on a letter of credit. However, it took a long time for

the BCL to withdraw the fund from Komerční Bank, and it failed to meet the deadline for the capital increase.

Komerční Bank sold the letter of credit on the secondary market to two German banks and the CW Bank, the Vienna branch of the National Bank of Hungary. Then, in November 1998, when these banks got to the stage of claiming payment from Postabank, the new management of Postabank, which had been revamped after the formation of the Fidesz government, refused to pay. In August, before the issue became public, special armed forces rushed to the headquarters of the bank on various breach of trust charges, as previously described.¹⁴ The steel purchase was a fictitious story and was intended to extract funds from Postabank. It was an international scam perpetrated by Postabank President Princz, Máté, and Szász of Nádor 95 Rt. and Barak Alon, the owner of BCL, who ran various fraud schemes in Vienna. The fraudulent scheme tricked Postabank into issuing letters of credit to the underwriter, Komerční Bank. In the scheme, the company withdrew funds from Komerční Bank and used them to underwrite a capital increase in Postabank. It was a typical case of “making wealth out of nothing” fraud. The scheme could only be carried out with the prior conspiracy of Princz, Máté, Szász, and Alon.

Two German banks holding claims against Postabank have filed a lawsuit against Postabank demanding payment. Ultimately, Postabank lost the case and had to pay a reduced amount, while the Hungarian government, which temporarily nationalized the bank, sued the former management and the company, which it audited. In February 2009, the asset mismanagement trial against Princz was concluded, and he was acquitted with a small fine. The Hungarian government’s claim for HUF 152 billion in damages against Deloitte’s accounting firm, which audited Postabank, was concluded in April 2009. Deloitte was acquitted of all charges. Many politicians, regardless of the ruling and opposition parties, had enjoyed various benefits from Postabank. All those involved in the Postabank case were also acquitted, and many of the economic crimes committed in the transition period were overlooked.

In this case of fraud, not only the Hungarian bank but also the Czech bank was involved. Inexplicably, in its dealings with BCL, a one-man Viennese trading company with a capital holding of 500,000 shillings, Komerční Bank set up a \$100 million line of credit in 1996 and raised it the following year to \$150 million and then to \$200 million in 1998. In addition to that, the deposit requirement was reduced from 35 % to 25 % of the loan amount. Such a good line of credit can only be obtained by a very good customer. Obviously, there should have been some special connection between BCL’s Barak Alon and the upper echelons of Komerční Bank (Czech politicians). As of 1998, BCL had already used 90 % of its line of credit, and in a panic over the Postabank incident, Komerční Bank tried to draw down and start collecting the loan, but BCL has no intention of repaying the debt of 8 billion koruna (approximately \$200 million)

¹⁴ For an account of the scandal surrounding Postabank, see Péter Kende, *Bank Bianco – A Postabank és Princz Gábor* (Budapest: KendeArt Kft., 1999). A PDF version is available on Péter Kende’s website (www.kende.hu).

which it had already taken out as loans. The whole amount turned to be bad debt for Komerční Bank.

Both in the Czech Republic and in Hungary, even a decade after the system transformation privatized commercial banks had lax loan reviews and politicians could intervene to influence banking transactions. In the Czech Republic, Finance Minister Ivo Svoboda was allegedly involved in setting up an unusual credit line for the BCL. BCL's Barak Alon is said to have made the acquaintance of András Szász, the head of Nádor 95 Rt. in a COMECOM business of the socialist era. There should have been a Czech counterpart of Alon and Szász who had political power to influence key figures in the Czech government.

Thus, a major international scam had been unfolded involving the former Hungarian Socialist Workers' Party treasurer Máté, Postabank Chairman Princz, the Czech Republic's Komerční Bank and Vienna's CW Bank. The link between these players was the international collaboration among the intelligence services of the old regime. Barak Alon, head of the BCL Corporation, is said to have been an Israeli intelligence officer, and András Szász had been both a KGB agent and a Hungarian intelligence agent. In this international scheme, András Szász is believed to have been a key person to connect the other players. Under the old regime, the commercial attaché delegated to the embassies had performed a spy-like task, and it is easy to imagine that they also had close relationships with their counterparts in the given countries. When the old regime collapsed and the strings with the Communist Party and the intelligence services were broken, the intelligence officers began to cooperate with one another over the distribution of not only Communist Party assets, but state assets, too. Thus, they used their cunning to accumulate private wealth and became the "Red Maffia".

Commercial banks in Central and Eastern Europe continued to lend improperly, accumulating non-performing loans, until they were taken over by foreign banks (Table 3.6.). As we have seen in Table 3.9., around 2000, commercial banks in the transition countries were sold to foreign banks. Thus, a little more than a decade after the transformation began, the privatization of the banking sector finally was completed as a result of a takeover by foreign banks. The foreign banks acquired the commercial banks at a purchase price that was discounted for the bad loans. Most of the non-performing loans were never recovered, and the state assets were looted by those amounts.

This looting (through fraud) of bank assets could be observed in all the transition countries during the system transformation, and it lasted until the banks were bought out by foreign banks, which introduced a severe loan review and monitoring system based on international standards. There were reasons why bank assets had been targeted for looting.

First, there had been no financial discipline and or financial ethics in the socialist economy. The distinction between financing and state subsidies for state-owned enterprises was blurred, and even if money which had been borrowed could not be paid back, the companies never went bankrupt. In this sense, the economic and ethical compulsion to repay loans was extremely weak in the transition countries.

Second, under the old regime, it was common practice for politicians to be involved in bank lending and to receive lucrative loans. This is because the economy was subordinated to politics, and the false notion of political initiative in the economy had permeated politicians' thinking. The politicians' dictates were not contrary to the social norms of the old system.

Third, there was a shortage of domestic capital accumulation, and the quickest way to get cash was a loan from a bank. There was no other way to defraud the commercial banks of cash.

Fourth, both the police and the prosecution had never dealt with financial crimes before, and they did not have the ability to investigate new types of crimes. Moreover, they were powerless to investigate or prosecute international financial crimes across multiple countries. Neither the Czech Republic nor Hungary could obtain the support of Austrian prosecutors to pursue changes involving the looted funds.

Fifth, the essence of this plundering of the assets of the commercial banks was the looting of the public's deposits and taxes. The reason why the rate of taxation of personal income in Hungary remained high throughout the 1990s is not solely because of the external debt. It was also a consequence of the ways in which such large amounts were looted from the assets of the commercial banks.

3.5.2 The Cheap Sale of State and Party Assets

In the system transformation in Russia, the young activists of Komsomol, the Communist Party youth organization that had won Gorbachev's support in Perestroika, turned one by one into businessmen. This phenomenon was not confined to Russia. In the countries of Central and Eastern Europe, leaders of youth organizations, with the support of the reformist wing of the Communist Party, had also been able to become businessmen by moving the Party assets and receiving government subsidies.

A trading company founded by former activists of Komsomol in Ukraine once consulted with me on the transfer of foreign currency made from the import and export business to a Western financial institution. This was in 1992, when Ukraine's government and central bank were in a transitional period, with both the government and the central bank being replaced by young leaders. \$1,000,000 deposited in the central bank had been transferred to western financial institutions through the formalities. This was before Ukraine's economy was in turmoil, so it was relatively easy to extract a million dollars.

At the time, the opening up of the country to the outside world was underway, and western goods could be easily sold in Ukraine by importing them. When goods were being trucked from a bonded warehouse in Vienna to Ukraine, armed off-duty police officers would put at the Ukrainian border to transport them to Kiev. There were frequent incidents of trucks and entire freight cars being intercepted by robbers in transit and stolen.

In addition to the route of accumulating wealth through legitimate trading businesses, the top leaders of youth organizations sold off assets owned by the youth organizations and acquired prioritized privatization deals, and this helped them emerge

as businessmen. Hungary was no exception. Imre Nagy, chairman of Budapest Committee of the Hungarian Communist Youth League (Magyar Kommunista Ifjúsági Szövetség, KISZ), and Ferenc Gyurcsány, deputy chairman, offer classic examples of successful businessmen who emerged in the midst of the system transformation.

Ferenc Gyurcsány, who was prime minister of Hungary from September 2004 to April 2009, rose to the position of secretary of the KISZ Central Committee before the transformation, and he was elected deputy chairman at the 1989 KISZ reorganization convention. He fell in love at first sight with Klára Dobrev, who was known to be a good-looking KISZ activist, and brought an end to his second marriage and entered into a third marriage in 1995.

Klára is the granddaughter of Antal Apró, a member of the Hungarian Socialist Workers Party's Political Committee who had supported General Secretary János Kádár for a long time. The Apró family, which lived next door to the Kádár family, was home to Antal Apró and his daughter Piroska, with her daughter Klára. Although Antal Apró had an older son who held a key position in the former secret police and then ran a private security company, the Apró family needed a talented young man to take over the family. When Antal Apró passed away in 1994, Gyurcsány's ambition and his love for Klára coincided with the intentions of the Apró family. In 1995, Gyurcsány was welcomed into the Apró family.

At that time, Piroska Apró was in the position of chairman of the management committee of Magyar Hitelbank, a major commercial bank which had been spun off from the National Bank. After the dissolution of the Hungarian Socialist Workers' Party, Piroska Apró continued to live in Budapest's second district, in an exclusive residential area known as "Rose Hill", in a house with a garden provided by the Socialist Workers' Party (159 square meters of floor space on a cite that was 1,422 square meters). Although the ownership of the house had already been transferred to the Budapest second district municipality, Klára bought the property for just under HUF 9 million (just under \$50,000 at the exchange rate at the time) in 1996. If the property were purchased today, it would fetch no less than \$1,000,000. Ten percent of the purchase price was to be paid in cash, and the rest was to be paid in installments over 25 years, a repayment program which was financed by a loan from Magyar Hitelbank, where Klára's mother was the chairman of the management committee. It is unclear what interest rates were attached to the loans, but under the Socialist government of the time, domestic commercial banks prepared special rates of interest¹⁵ for VIPs (mainly

¹⁵ With the change of government and following an investigation into Postabank in 1998, various information became public. This included the existence of VIP rates on bank loans and deposits; Postabank offered special rates of interest to politicians, artists and athletes. Part of the VIP list was made public in the weekly *Élet és Irodalom* (August 27, 1999). According to the report, since 1989, in Budapest alone, nearly 600 people had received benefits, i.e., the deposit interest rates were 10-15% above the normal deposit rate and the loan rate was 10% (less than one-third of the normal lending rate). The VIP list was said to be held by most commercial banks (commercial banks spun off from national banks), not just Postabank.

for politicians). Throughout the 1990s, low interest loans were profitable for borrowers in Hungary, where prices were rising at 20-25 % per year.

The Apró family was on the upswing again with the arrival of a talented son-in-law named Ferenc Gyurcsány. Gyurcsány's mother-in-law Piroska founded Altus Kft. (Ltd.) (1992) as a strategic company, and Gyurcsány joined the company in 1995 and started in the asset management and consulting business, and he began to receive public orders and acquire privatization projects.

The first job was to acquire the Financial Experts Training Program of Finance Ministry of the Horn government (Socialist Party). When the Horn cabinet was formed, Piroska was appointed to the position of chief-of-staff in the Prime Minister's Office. The minister of finance at the time, Péter Medgyessy, was Piroska's boyfriend from the Karl Marx University of Economics. Therefore, there was no obstacle to acquiring the Financial Experts Training Program from the Ministry of Finance. To run the business, Piroska acquired the financial training company Perfekt Plc. and entered the financial professional training and consultancy business through this company. Moreover, the governmental bulletin publisher (Magyar Közlöny Lap- és Könyvkiadó) was purchased by Altus. After only four months since the appointment, Piroska moved from the Cabinet Secretariat to the Budapest Airport Management Company (chairman of the Management Committee), but soon after this, she moved to Magyar Hitelbank.¹⁶ Magyar Hitelbank loans became available for Altus to acquire privatization deals as Piroska took over as head of bank management.

The largest privatized property by Altus Kft. was an aluminum manufacturer, MOTIM Ltd. (Magyaróvári Timföldgyár és Műkorund Kft.), and to this day, Gyurcsány's political activities are funded by the executive compensation earned from the company. In this privatization of MOTIM, Gyurcsány and Piroska made bid through Altus. In 1996, Altus moved its offices to Szalay Street in Budapest and opened a Socialist Party parliamentary club in its offices. Many members of Parliament began to use this club. A good deal of information was exchanged at this parliamentary club. At that time, the privatization case was managed collectively by ÁPV Co. Ltd. (National Privatization Organization), and when ÁPV put the MOTIM privatization deal out to bid, the president of ÁPV was the former president of MOTIM Ltd. There was nothing

¹⁶ Piroska changed workplaces one by one. This was the result of a flurry of complaints to Prime Minister Horn, who was struggling to respond to them. When a parliament member of the Socialist Party called to meet Horn, Piroska, who ran the Prime Minister's Office, replied with a bureaucratic attitude and insisted to get an appointment first. Socialist Party members forced Horn to remove Piroska from office. He had no choice but to give her a key position in the airport management company. However, Piroska was then moved to the Magyar Hitelbank. This was because the coalition partner SZDSZ demanded Piroska's ouster due to difficulties working with Gábor Hidvégi, who had been appointed CEO of the airport company dispatched by SZDSZ. In each of the positions she held, she caused conflict by using her connection to the prime minister in order to exert influence. Why did Prime Minister Horn bother to take care of the troublesome Piroska Apró by appointing her to important positions? The answer will be found in the Chapter 6.

to hamper Altus from winning the bid with only two bidders participating. Moreover, the funds for the tender were provided by Magyar Hitelbank.

In this tender, Altus entered into a consortium with GPS Ltd. which was established by the then management of MOTIM to enter the process of privatization. It was a dummy company that worked with Altus Kft. to win the bid. The deal was signed on December 21, 1995. The consortium won the 90 % ownership of MOTIM for HUF 705 million, and the CIB bank gave a loan guarantee, but soon Magyar Hitelbank took it over and provided the consortium with a loan of HUF 700 million. With the conversion of MOTIM Ltd. into a joint stock company on December 30, 1996, GSP relinquished its ownership of MOTIM Ltd. In conjunction with this transfer of ownership, as a reward for their previous cooperation, MOTIM's HUF 340 million goodwill of the company was sold to three GPS owners for HUF 1 million. In 2004, Fidesz filed a complaint about this transaction, alleging that irregularities had been committed in this privatization. This is a charge of breach of duty by management, who were in a position to sell for the highest possible price and failed in their natural duty.

Hungalu Magyar Alumíniumipari Rt., which had integrated Hungary's aluminum industry, was split up and privatized in the late 1990s, starting with MOTIM. Fidesz released seven contracts¹⁷ related to the divisional privatization of the aluminum industry, including the privatization of MOTIM, which was the source of Gyurcsány's asset formation, to draw attention to the irregularities involved in privatization under the Socialist Party government.

The privatization of the aluminum industry in Hungary was an exceptional case realized with domestic capital. The aluminum industry, which consumes a lot of electricity, could only be operated with cheap electricity from the Soviet Union. In the mid-1990s, after the collapse of the Soviet Union, no multinational companies showed any interest in Hungary's aluminum industry. In such a historical vacuum, a classic example of privatization using domestic commercial bank loans was the divisional privatization of the aluminum industry. Privatization using domestic capital was only achieved by providing bank loans at "negative interest" below cost.

In the early stage of transformation, as in this case, personal connections were intertwined with bank lending, and transactions among insiders were openly promoted. Basic social norms such as breach of trust, insider trading, bribery, and illicit trading had not (and still have not) been established, even in the Central European countries.

3.5.3 Fraud and Insider Trading in Coupon Privatization

There have been various frauds and scams over the privatization schemes through the use of coupons (vouchers), and the plundering of state assets was a common practice.

¹⁷ In November 2010, MNV Ltd. (Magyar Nemzeti Vagyongazdálkodási Rt., Hungarian National Assets Management Corporation), which followed the former ÁPV Rt., in response to the government's request, made seven contracts related to the privatization of the aluminum industry in the 1990s available on its website.

In the transition countries, where financial markets did not work, coupon hoarding based on insider information and the acquisition of coupons through false advertising were common. The mechanism for converting coupons into shares and the mechanism for buying and selling shares was a black box, and there was room for arbitrary manipulation. The group entrusted with managing the scheme could team up with politicians and emerging entrepreneurs to convert state assets into private assets. So, in every country, attempts were made to defraud the state and plunder assets using the coupon privatization scheme.

In the Czech coupon privatization scheme, which was clad in the most legitimate guise, the most successful fund was a private fund called Harvard Capital and Consulting. The fund was established by Viktor Kožený, who was born in the Czech Republic and reportedly graduated from an American university. Kožený collected huge coupons with funds raised from American investors. His fund business was developed on an equal footing with major Czech financial institutions. The main reason for its success was the hype through the media. Many citizens were duped by the fund's advertising and entrusted coupons to the fund's management. As a result, the fund succeeded in acquiring shares in a number of state-owned companies, but its founder, Kožený, acquired an Irish passport in 1994 and moved to the Bahamas. Moreover, upon emigration, he cashed out some of his fund-owned assets and moved them to the Bahamas. This was a tragic case of fraud using coupon privatization in the Czech Republic. The Harvard Fund was one of the top three funds in terms of the number of vouchers acquired. This fraud case shocked the public.

However, this type of fraud and cases of coupon (voucher) defrauding took place in every country in which the scheme was implemented. However, there is very little information on such incidents. Though there are many studies which analyze the scheme of coupon privatization in detail, there are very few studies on the actual consequences of coupon (voucher) privatization, i.e. research on the fraud and looting of state assets is lacking in the "economics of transition". Do economists think that this kind of study is not a subject the science of economics, or is there simply a lack of information necessary for proper analysis? At the very least, any researcher discussing "rent-seeking" should take this type of economic and social phenomenon as a subject of analysis. Explanation of the scheme alone does not constitute a socioeconomic analysis.

Table 3.10. Voucher value of Russian companies compared with market value (in million USD)

	at voucher auction prices (1993–1994)	at Russian stock market prices (August 1997)
Gazprom (natural gas)	250	40 483
United Energy Services (electricity)	957	17 977
Lukoil (oil)	704	15 839
Rostelecom (telecommunications)	464	4 172
Yuganskneftegaz (oil)	80	1 656
Surgutneftegaz (oil)	79	6 607

Source: Klebnikov 2000, 135.

Thanks to courageous journalists, not academics or researchers, at least the fraudulent tricks of voucher privatization in Russia have been revealed.

The assets of Russian billionaires are shares in energy and resource companies, including oil, natural gas and precious metals. Less than a decade after the collapse of the Soviet Union, these billionaires privatized some of the assets of the giant state companies. Russia's privatization was set up to exclude foreign investment and ensure that the top managers and engineers (government officials) who cooperated with politicians had the biggest stake in it.

According to *Forbes* journalist Paul Klebnikov,¹⁸ who followed this process closely, in Gazprom's voucher privatization, a public tender was held in a provincial city in Siberia excluding number of potential investors. In addition, management decided in advance that it had the right to invalidate the trading of shares on the secondary market and refuse to register shareholders, which management would not allow. After setting these conditions, through Mikhail Kharshan, owner of First Voucher Investment Fund, the management issued instructions to purchase 530,000 vouchers for the management. Mikhail Kharshan sold these vouchers to the management at twice the market price.

In the privatization of Gazprom, which was carried out in the early stages of voucher privatization, the value of the company's assets was appraised at an alarmingly low level. According to Klebnikov, who valued the assets at the average price of the vouchers that submitted a bid for Gazprom, the value of Gazprom's assets was only \$250 million. As can be seen in Table 3.10., the market value of Gazprom on the Russian Stock Market in 1997, before the Russian crisis, exceeded \$40 billion. This means that the management did indeed manage to acquire a 15 % stake in Gazprom at 1/160th of its market value. Moreover, they got a loan from the bank that was their guru for cooperating in the stock acquisition, so it did not cost them anything in principal. They only had to sell a small portion of the acquired share to repay the cost. They were thus able to get assets of an enormous value for nothing. This is how the assets of the management team under Viktor Chernomyrdin were formed.

This is a classic example of corruption in the privatization of state assets. Whether the ability to make off with such tremendous assets was considered a "perk" or defined

¹⁸ Klebnikov 2000, 130–35. The book by Klebnikov details the process of initial capital accumulation in Russia in the 1990s and gives a clear picture of the people involved in it. One of the reasons behind President Putin's move to suppress emerging businessmen was that the plunder of state assets during the Yeltsin era, which was exposed by Klebnikov, attracted public criticism. It is therefore not hard to imagine that there were many individuals who harbored resentment towards Klebnikov. On July 9, 2004, he was the victim of a commissioned murder shortly after he was appointed head of *Forbes'* Russia office. He had just begun to settle in Moscow, believing that he was less likely to bury political opponents with violence. It was also reported that Berezovsky, who had defected to England, had commissioned the murder, but there were many other people who wanted to kill Klebnikov. Compared to this intrepid reporter, an academic discussing "rent-seeking" at his desk is at ease. It is too easy to think that you can "unravel" corruption by fiddling with the concept of "rent-seeking".

as “insider trading” or “looting,” various forms and provisions can be made, it is clear that these assets were not formed by normal market economic behavior.

It is important to note, for instance in this case, that economic analysis dealing with system transformation must examine the setting as a political economy. Simply describing a voucher privatization scheme, if one does not analyze how the scheme actually works in the real-world socio-economy, offers little more than a list of the specifications of the scheme. It need not mention that there is nothing to be gained by mangling the definition of abstract speculative “rent-seeking”.

Clearly, coupon (voucher) privatization was an inevitable step in the absence of foreign capital. It was one way of reorganizing and regrouping domestic capital (state enterprises). However, this was not enough to revive the companies. The sale of a company to a foreign company or investor not only revitalized the company but also enabled owners to cash out their own assets. No discussion of coupon (voucher) privatization can offer a genuine socioeconomic analysis unless it captures the intense legal and illegal acquisition battles over the redistribution of state assets. Fraudulent or insider behavior in the accumulation of coupons must be viewed as an inevitable phenomenon associated with this scheme.

Addendum - Misconceptions concerning the Transitional Period

Many, including experts, assumed that regime change would lead to the establishment of a market economy relatively quickly and that a capitalist economy would take root. However, as the analysis in this chapter makes clear, these assumptions were wrong. It takes a long time to build a new social system from the collapse of an old social system, and to think that privatizing state enterprises will create a market or capitalist economy is an idealism that ignores reality. History has shown that it takes a long time from the collapse of a system to the construction of a new system, and therefore an economic and social analysis that starts with an analysis of reality is essential. Models and theoretical assumptions conceived a priori cannot replace the analysis of conditions on the ground. A priori models tend to be fake models for problems that do not exist in reality.

The period of the looting (redistribution) of state and party assets, which actually began before the system transformation and continued after this process had largely come to completion, is sometimes described as barbaric capitalism.¹⁹ This type of naive thinking asserts that an overly rapid transition to a capitalist economy brought

¹⁹ Fidesz argues that the liberal economic policies promoted by the Socialist Party ushered in an era of barbaric capitalism. However, what happened in the first decade of the transition was the redistribution (looting) of public assets following the collapse of the old regime. Neither capitalists nor capitalist markets had yet been formed at the time. Even thirty years after the system transformation, neither the market economy nor the capitalists have been soundly nurtured, and economic players are still dependent on the national treasury. The only thing that exists is a distorted market economy (a treasurized economy).

about a “transformational recession” in the early days of the system transformation.²⁰ On the other hand, others feel that multinational corporations further the capitalization of the national economy, and they tend to regard the businessmen who succeeded in plundering state and party assets as healthy market economy players.²¹ But in the 1990s, the states involved were still in the midst of the redistribution of state and party assets, i.e. the initial stage of capital accumulation, and there were still no decent businessmen or capitalists in these countries. The 1990s was truly a transitional period on the way to the establishment of a new system. Such dynamic socioeconomic changes cannot be analyzed according to a rent-seeking model, which is based on a static analysis.²²

²⁰ This is an overly schematic and simple mindset. By failing to analyze the problems of the transitional period, Kornai fell into a dichotomous mindset that simply compared socialism and capitalism. He also adopted a rigid analytical tone that simply denied the merits of socialism and applauded capitalism.

²¹ Gyula Horn, who was foreign minister at the time of the decision to open Hungary’s borders in 1989, is known in Germany as a “reform (open-minded)” politician. In 2007, when Horn was denied the Hungarian State Order of Merit, the German press did interviews with Horn. In response to the question of whether the creation of a vicious businessman during his time as leader of the Socialist Party had tarnished his reputation, Horn answered that, “They are decent businessmen, and the multinational corporations are the capitalists in Hungary”. On the merits and failings of Gyula Horn, see Chapter 6.

²² The rent-seeking theory characterizes initial capital accumulation as a “transfer rent” (see, for example, Mushtag H. Khan and Jomo K.S., *Rent, Rent-Seeking and Economic Development* [Cambridge University Press, 2002]). This is a meaningless definition. The rent concept is based on market equilibrium and cannot be used as an analytical tool to capture dynamic socioeconomic changes. First, the types of rents are classified and the various instances of corruption that occur in reality are described as examples. The classification of corruption should be made through an analysis of concrete cases based on the facts, not on an example based on the rent-seeking models. Reality is much more complex, dynamic, and content-rich than the model, and it should not be classified as an example of the model. The approach of putting model first and reality second is a symptom of confused (or lazy) thinking, which mistakes cause for effect.

Chapter 4: The Economics of Post-Socialism

Conflicts between State and Market

As is clear from the analysis in the previous chapter, the transition to a market economy in the countries which were undergoing system transformation cannot not be easily accomplished, and even ten years after the beginning of the transformation, competent corporate management able to perform on the international market could not be established. The first ten years of the transformation period in Central and Eastern Europe was a transitional period from the redistribution of state and party assets to the establishment of a market economy. The countries had no choice, if they sought to rebuild their national economies by themselves, but to follow the path of reconstruction by importing foreign capital of multinational companies. On the other hand, in the countries that did not succeed in attracting foreign capital, the political power of the old system continues to maintain power and maintain and exploit the authoritarian distribution economy of the previous times, and thus the turmoil continues even now.

In this chapter, I analyze what is happening in a national economy in which foreign capital occupies a dominant position. My focus is on the Hungarian economy, which promoted the market economy model led by foreign capital.

4.1 High Tax Burdens Restrain the Development of a Market Economy

Hungary, which was able to raise funds from the Western financial market under the previous system, suffered from debt repayment pressure after the system transformation. Hungary's redistribution rate remained high throughout the 1990s, as debt servicing forced the government to keep tax revenues high. In order to promote the emergence of a market economy, it is necessary to increase the disposable income of the people and the profits of companies, but since Hungary suppressed the disposable income of the people and increased tax revenues, the development of the domestic consumption market was very limited, and companies that were dependent on the domestic market had scarcely any chance to grow. In the 1990s, the Hungarian government never had, as an aim, the adoption of a policy of increasing disposable income and expanding the domestic market economy.

Personal income tax was levied at a rate of over 30 % on income over \$200 per month throughout the 1990s. In addition, a high rate of value-added tax was imposed on disposable income. Considering these tax burdens, the actual income that can be consumed is less than half of the gross income. This heavy burden on personal income suppressed and suppresses the consumer goods market, and it also limits the growth of domestic businesses.

Table 4.1. Changes of Personal Income Tax in Hungary from 1988

annual income		tax rates	notes	redistribution rate of GDP
			FOREX of US dollar at the end of June	
Era of Strong Progressive and Heavy Burden				
1988	up tp 48,000 Ft	tax exempt	1USD=50.17 Ft	62.6 %
	48,000~70,000 Ft	20 %		
	70,001~90,000 Ft	25 %		
	90,001~120,000 Ft	30 %	equivalent to annual 1,800 USD income	
	120,001~150,000 Ft	35 %		
	150,001~180,000 Ft	39 %		
	180,001~240,000 Ft	44 %		
	24,0001~360,000 Ft	48 %		
	360,001~600,000 Ft	52 %	equivalent to annual 7,200 USD income	
	600,001~800,000 Ft	56 %		
	800,001 Ft~	60 %		
1991	up to 55,000 Ft	tax exempt	1 USD = 77.62 Ft	67.6 %
	55,001~90,000 Ft	12 %		
	90,001~120,000 Ft	18 %		
	120,001~150,000 Ft	30 %	equivalent ot annual 1,556 USD income	
	150,001~300,000 Ft	32 %		
	300,001~500,000 Ft	40 %	Equivalent to annual 3,866 USD income	
	500,001 Ft~	50 %		
1993	up to 100,000 Ft	tax exempt	1 USD=91.62 Ft	73,. %
	100,001~120,000 Ft	25 %	equivalent to annual 1,091 USD income	
	120,001~500,000 Ft	35 %		
	500,001 Ft~	40 %	equivalent to annual 5,457 USD income	
1998	up tp 250,000 Ft	20 %	1 USD=219.11 Ft	50.6 %
	250,001~300,000 Ft	22 %		
	300,001~500,000 Ft	31 %	equivalent to annual 1,369 USD income	
	500,001~700,000 Ft	35 %		
	700,001~1,100,000 Ft	39 %	equivalent to annual 3,195 USD income	
	1,100,001 Ft~	42 %		
Era of Weak Progressive and Medium Burden				
2002	up to 600,000 Ft	20 %	1USD=246.72 Ft	50.8 %
	600,001~1,200,000 Ft	30 %	equivalent to annual 2,432 USD income	
	1,200,001 Ft~	40 %		
2006	up to 1,550,000 Ft	18 %	1USD=221.83 Ft	51.4 %
	1,550,001 Ft~	36 %	equivalent to annual 6,987 USD income	
2010 ¹	0~5,000,000 Ft	17 %	1USD=228.99 Ft	49.3 %
	5,000,001 Ft~	32 %	equivalent to annual 2,1835 USD income	
Era of Single Tax Rate and Low Burden				
2011 ¹	single rate	16 %	1USD=186.40 Ft	49.5 %
from 2013 to today ²		16 %	1USD=282.06 Ft ³	49.4 %~ 46.9 % ⁴

Source: Hungarian Tax Office, Ékes Ildikó, "Adózás 1988–1966", *Statisztikai Szemle*, 1 (1997): 45–57. Eurostat (online data code: gov_10a_main, 21th Januar 2019).

Note: The data of redistribution till 1993 are from the article of Ékes, and others are from Eurostat.

¹ The tax base included not only personal income, but social seurity contribution by employer (27 % of the paid wage), too.

² The tax base is only personal income.

³ The FOREX rate is at the end of June, 2018.

⁴ The figure of 46.9 % is that of 2017.

Table 4.1. shows Hungary's personal income taxation tendency. We can divide the past thirty years into three periods: the strong progressive/heavy taxation in the 1990s, weak progressive/medium taxation from 2002, and single tax/low taxation from 2011. This tendency is also clearly shown in the ratio of fiscal expenditures to GDP (the redistribution rate).

Corporate income tax also remained high throughout the 1990s, and Hungary prioritized securing tax revenue for debt repayment rather than for developing a market economy. As a result, the redistribution rate in the 1990s far exceeded the rate of 50 %, and the redistribution rate in 1994, when the austerity policy was introduced by the Socialist government, reached 73.8 %. This is an unusual situation in which three-quarters of the GDP is delivered to the national treasury. The situation is not much different than the situation in the socialist era. Despite the indispensable challenge of developing a market economy, the redistribution rate has been maintained at the level which prevailed during the socialist era.

Third, since the introduction of VAT, Hungary has maintained the highest tax rate in the world, with a VAT rate of 27 % from 2012 to present. With the introduction of a single tax rate on personal income in 2011, the redistribution rate was expected to decline, but the reduction was only slight. The redistribution rate remains around 45 % of the GDP. Hungary's market economy remains at a low level of development even thirty years after the beginning of the transformation. Unless the redistribution rate is drastically reduced, one can hardly expect a market economy to develop.

Another factor which is increasing the redistribution rate is the social insurance burden on individuals and corporations. As can be seen from Figure 4.1, the combined amount of social insurance contributions made by employees and employers exceeded 50 % of the total wages throughout the 1990s and only fell below 50 % in the 2000s. In the 2010s, it was about 45 %. High social insurance burdens make it difficult for small companies to maintain and increase employment. To develop small and medium-sized enterprises, it is necessary to reduce the burden even further.

Thus, in Hungary, personal income tax and social insurance contributions are deducted from gross wages, and 27 % of value-added tax is deducted from the disposable

Table 4.2. Changes of the Corporate Income Tax in Hungary (in %)

	standard rate	preferential/progressive
Januar 1988 – end of 1989	40 %	50 % over HUF 3 million
Januar 1990 – end of 1990	35 %	40 % over HUF 3 million
Januar 1991 – end of 1993	40 %	–
Januar 1994 – end of 1996	36 %	–
1997–2003	18 %	–
2004–2005	16 %	–
2006–2007	16 %	10 % under HUF 5 million
2008–2009	16 %	10% under HUF 50 million
2010–2016	19 %	10% under HUF 500 million
2017–	9 %	–

Source: Hungarian Tax Office

income when disposable income is directed to consumption. As a result, the net consumable income from individual gross wages remains below 50 %.

On the other hand, in such an economic environment, it is difficult for companies to increase product sales much in the domestic market, and it is more stable business

Table 4.3. Changes of VAT Standard Rate in Hungary (in %)

January 1988 – end of 2005	25 %
January 2006 – end of June 2009	20 %
July 2009 – end of 2011	25 %
January 2012 –	27 %

Source: National Tax and Customs Administration

Table 4.4. List of VAT rates of the EU member states (in %, as of January 2020)

	super-reduced rate	reduced rate	standard rate	parking rate
Belgium	–	6 / 12	21	12
Bulgaria	–	9	20	–
Czech Republic	–	10 / 15	21	–
Denmark	–	–	25	–
Germany	–	7	19	–
Estonia	–	9	20	–
Ireland	4.8	9 / 13.5	23	13.5
Greece	–	6 / 13	24	–
Spain	4	10	21	–
France	2.1	5.5 / 10	20	–
Croatia	–	5 / 13	25	–
Italy	4	5 / 12	22	–
Cyprus	–	5 / 9	19	–
Latvia	–	5/12	21	–
Lithuania	–	5 / 9	21	–
Luzembourg	3	8	17	14
Hungary	–	5 / 18	27	–
Malta	–	5 / 7	18	–
Netherlands	–	6	21	–
Austria	–	10 / 13	20	13
Poland	–	5 / 8	23	–
Portugal	–	6 / 13	23	13
Romania	–	5 / 9	19	–
Slovenia	–	5/9.5	22	–
Slovakia	–	10	20	–
Finland	–	10 /14	24	–
Sweden	–	6 / 12	25	–
United Kingdom	–	5	20	–

Source: EU, VAT Rates Applied in the Member Staes of the European Union, Situation at the 1st January 2020.

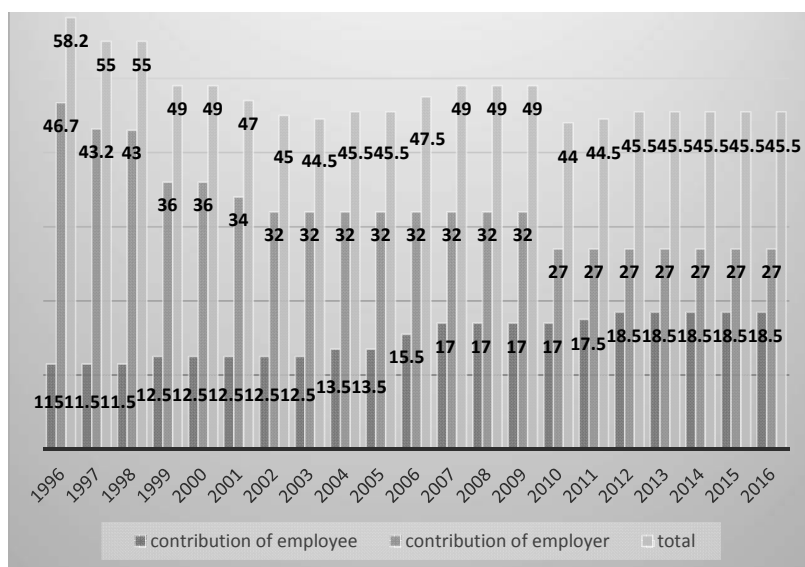


Figure 4.1. Contributions to Social Security (in % to the paid wage)

Source: Based on the data of the National Tax and Customs Administration.

for them to obtain public orders from the national or local governments rather than to make profits from market sales. To obtain public orders is much more efficient than struggling to grow sales in a small domestic market. However, to get public orders, there must be tight connections with politicians and bureaucrats. If you can make partnerships with politicians, you can relatively easily help your company grow. When such a corporate behavior becomes widespread, market competition declines, and the parasitic behavior on the national treasury becomes characteristic. This is a phenomenon that I have named the “treasury economization (treasurization) of the national economy”.

It is worth asking what tendency can be observed in the redistribution rate of the Central European countries. Figure 4.6 shows the changes in the redistribution rate of the five Central European countries.

The fact that Hungary’s redistribution rate is always higher than that of any other transition countries is not due solely to its historically heavy external debt. This is also because successive governments did not set a clear goal of “lowering the redistribution rate, increasing consumer spending, and expanding the consumer goods market.” In particular, the Socialist Party government had no intention of lowering the redistribution rate. On the other hand, economic advisers of the Fidesz government recommended that the redistribution rate should be below 40 % to promote the revitalization of the market economy. Accordingly, the levels of income tax and corporate tax have been reduced intermittently, but the VAT rate has been raised. As a result, the redistribution rate remained at a high level of around 45 % (with a slight drop), the development of the consumer market continued to be restrained, and the stagnation of the domestic market limited the growth of domestic companies.

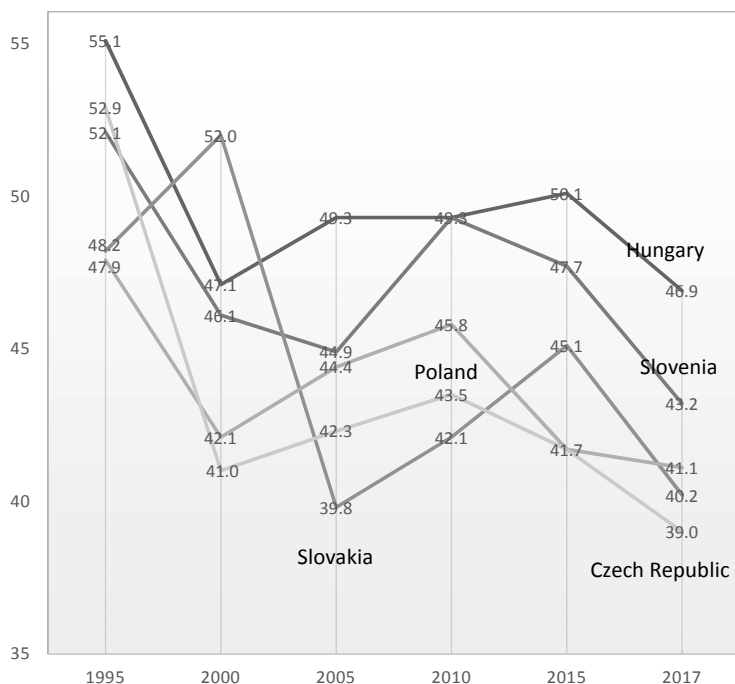


Figure 4.2. Redistribution tendency of the Central European Countries (in % to GDP)

Source: Eurostat (online data code: gov_10a_main, January 21, 2019)

4.2 The Structure of the Borrowed Economy

4.2.1 The Significance of the FDI in Central and Eastern Europe

The socialist industries were almost liquidated in the early process of system transformation in the Central and Eastern European countries. There were absolute limits to the privatization of the state companies by domestic capital, and even in countries that introduced coupon privatization, the rebuilding of domestic industry was accomplished by selling off to foreign companies around 2000. New industrial sectors were created in these countries through foreign direct investment (FDI), particularly in the automobile industry, and thus FDI led to economic recovery. However, in those countries in which there was no influx of foreign capital, it was extremely difficult to rebuild following the destruction of socialist industry.

Among the transition countries, the Central European countries were the first to receive FDI, because FDI flows most rapidly into countries in which legal conditions are guaranteed and where there is good access to western markets.

In the early 1990s, however, Poland and the Czech Republic were very cautious about foreign investment. Poland suffered from the rescheduling of loans from Western financial institutions at the end of 1980s, and therefore there was a widespread rejection of foreign investment itself, regardless of financial loans or direct investment. Hungary also suffered from heavy external debt without rescheduling. Although the

Czech Republic did not have an external debt problem, the situation in Poland and Hungary was thought to be a lesson for the Czech economy, and there was a strong sense of caution about dependence on foreign funding.

In the early stage of the transformation, Polish and Czech political leaders were unable to distinguish between borrowing from international financial markets and direct investment by multinational corporations. In contrast, from the beginning of the transformation, Hungary welcomed the investment of multinational companies and actively worked to attract them. Hungary had no reason to refuse investment by multinational companies that were willing to take the risk and invest in order to revitalize the national economy even under the pressure of external debt. Thus, in the early years of the system transformation, Hungary had the upper hand in attracting FDI, and the country appeared to be the sole winner in this race. Table 4.5. shows the situation of FDI in Central and Eastern Europe and the Baltic states in the mid-1990s.

By the mid-1990s, the leaders of Poland and the Czech Republic had begun to recognize the necessity and importance of rebuilding domestic industry with investment from multinational corporations amid the slow progress of substantial privatization. Thus, beginning in the late 1990s, the three Central European countries, including Hungary, intensified their activities to promote FDI and competed to attract foreign companies.

In the battle to attract foreign direct investment, Hungary gradually lost its initial advantage, because the Czech Republic was adjacent to the German market and had an advantage in cooperation with German companies in producing various commodities for western markets. With the introduction of foreign capital, many of the companies once “coupon privatized” were sold to the foreign countries and “re-privatized”. Poland is also a large country with a large population. Unlike the Czech Republic and Hungary, Poland could be an investment country where there was domestic selling and an export manufacturing base. Thus, the trend of FDI in Central Europe shifted from Hungary to the Czech Republic and Poland in the late 1990s.

Table 4.5. Annual FDI inflow in the middle of the 1990s (millions USD)

	1990	1992	1993	1994	1995	1996	stock at the end of 1996
Hungary	311	1,471	2,339	1	4,453	1,983	14,668
Czech Rep.	72	1,004	654	869	2,562	1,428	8,572
Poland	10	290	580	542	1,132	2,768	5,427
Slovakia	–	–	168	250	202	330	1,361
Slovenia	4	111	113	128	176	186	2,052
Romania	–	77	94	341	419	263	1,234
Bulgaria	4	42	40	105	90	109	446
Croatia	–	13	96	113	101	533	857

Source: WIIW, *Countries in Transition 1999*, WIIW Handbook of Statistics, 436–37.

Note: There are several differences between this table and table 3.7. For more information, see WIIW's handbook.

Table 4.6. shows the trends in the momentum of FDI in Poland and the Czech Republic over Hungary at the turn of the millennium. FDI flowed into other transition countries as well, and this allowed the multi-national companies to take the lead in the industrial restructuring of Europe's transition countries.

FDI in the Czech Republic and Poland further increased after the two countries joined the EU in 2004, and since 2007 the trend in FDI has completely changed: in the decade from 2006 to 2018, the stock of investments in the Czech Republic and Poland doubled, compared to about an increase of only 37 % in Hungary. This change in the trend in FDI has continued up to the present day, and Hungary has fallen behind the Czech Republic and Poland (see Table 4.7.).

Ultimately, the Central European countries of Hungary, the Czech Republic, and Poland were able to revive their industrial sectors through the attraction of foreign capital. Without FDI, the national economies of Central Europe could never have been rebuilt.

What is interesting here is the industrial distribution of FDI in the three Central European countries. In Hungary, manufacturing investment has been the main source of FDI inflows from the early stages, and this trend has not changed. In the case of the Czech Republic, due to its location on the border with Germany, there are many German manufacturing companies, but a large share of this is due to FDI in the financial sector. This is related to the delay in the sale of the financial sector to foreign capital as a result of the bypassing of coupon privatization by domestic capital. The financial institutions that were privatized with coupons only changed their ownership structure and failed to rationalize or modernize their management. Mere change in ownership structure did not solve the problem of non-performing loans, which hindered the modernization of the financial industry in the Czech Republic. To solve this problem, the sale to foreign capital was accelerated from the turn of the century. This is evident in the high weight of FDI in the financial sector. In addition, Poland's domestic consumption market is larger than that of the Czech Republic and Hungary, which has led

Table 4.6. Tendency of FDI Inward Stock in the Central European countries (millions EUR)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Hungary	16,285	17,760	23,041	24,578	31,045	34,575	38,329	45,881	52,370	62,350
Czech Republic	8,367	12,255	17,479	23,323	30,717	36,884	35,852	42,035	51,424	60,624
Poland	13,205	19,231	25,947	36,792	46,686	46,139	45,896	63,505	76,645	94,603

Source: WIIW, *Handbook of Statistics* 2008, Table VIII/3.

Table 4.7. Stock of FDI in the three countries after 2010 (millions EUR)

	2010	2015	2016	2017	2018
Hungary	68,126	78,957	78,093	78,026	83,163
Czech Republic	96,153	107,129	115,627	130,042	–
Poland	161,378	170,257	178,294	199,053	199,790

Source: WIIW, *Handbook of Statistics* 2019.

Table 4.8. Shares of FDI by activities (in %, 2018)

	Manufacturing	Financial	Wholesale-Retail
Hungary	42.0	11.0	10.9
Czech Republic	36.1	27.0	8.8
Poland	31.4	18.5	14.6

Source: WIIW, Handbook of Statistics 2019.

Table 4.9. FDI inward stock (in % of GDP)

	2000	2010	2015	2018
Czech Republic	34.9	61.4	63.6	65.2
Hungary	48.0	68.8	70.4	62.2
Poland	19.7	24.3	39.6	40.3
Slovakia	22.9	55.3	53.0	56.9
Slovenia	14.2	22.0	29.9	33.1
Croatia	12.8	53.4	50.2	47.2
Serbia	0.2	52.9	74.8	81.2
Romania	17.2	41.0	40.2	40.0
Bulgaria	20.2	88.5	87.5	76.4
Estonia	46.0	78.3	81.5	78.4
Latvia	26.0	45.9	55.4	52.1
Lithuania	20.1	41.1	39.0	37.6

Source: WIIW, Handbook of Statistics 2019, Table I/29.

to greater investment in the wholesale and retail sector. On the other hand, manufacturing investment in Poland faces difficulties not only in terms of location, but also in terms of labor management,¹ which leads to a relatively smaller weight of investment in manufacturing than in the Czech Republic and Hungary.

FDI from the West to the transition countries has increased over the years and is now of such weight and importance to almost all the countries in question that it would be impossible to talk about their national economies without it. Table 4.9. shows the weight of FDI in the transition countries.

As can be seen from the table, between 2000 and 2010, all the countries undergoing transformation increased their share of FDI significantly. On the other hand, the trend from 2010 to the present shows that Poland and Serbia have seen a significant increase in investment, while Hungary and Slovakia have reached a somewhat saturated level. Investment in Bulgaria and Romania has also stagnated.

The surge in investment in Poland can be explained as an acceleration of investment in the 2010s, because Poland has lagged behind direct investment in the Czech

¹ In terms of the number of labor disputes, the number of disputes in Poland is outstanding compared to the numbers in the Czech Republic and Hungary. Difficulties in labor management are an important factor which discourages investment in the manufacturing sector in Poland.

Republic and Hungary in recent years. The surge in investment in Serbia also indicates that some companies are moving to Serbia and other countries in search of even cheaper labor. It is noteworthy that many countries have FDI stocks which amount to more than half of their respective GDPs, with Bulgaria, Serbia and Estonia being the most heavily weighted.

Nowadays, it is impossible to talk about the national economies of the transition countries without the investment of multinational corporations. Most national economies are in a state of a “piggyback ride” on the multi-national companies. As already mentioned, without FDI from multinational companies, the economies of the transition countries on the verge of collapse could not have been rebuilt. Whether in terms of capital, technology, management, markets or labor management, the presence of the multi-national companies is essential to all the countries undergoing transition.

4.2.2 Borrowed Economy

In my 1994 book, I wrote that “the key to the escape from Aporia is direct investment. It is the foreign direct investment that brings the three kinds of sacred treasures of economic development.” That is, the multinational corporations bring with them the three requirements of capital, technology, and management that are lacking in the economy undergoing transformation. In contrast, a national economy which cannot attract direct investment from multinational companies will be greatly delayed in its recovery and development after the collapse of the national economy.

As described in the previous section, the multinational corporations might be gods of salvation, but they are not almighty gods. When the multi-national companies come to occupy the industrial sector of the national economy, a new problem arises. The industrial multinationals use cheap labor in the transition countries and utilize the countries as bases for export to the western markets. They contribute to the economy of the country by paying workers’ wages, corporate income tax and social security contribution. However, they do not contribute much to the development of the social division of labor in the given country. It was expected that a parts industry would emerge in the domestic market, but the subcontracted parts companies accompany the investing companies from their home countries, and therefore the subcontractors also withdraw when the investing company leaves the country.

Thus, the multi-national companies form a vulnerable part of the national economy. Nevertheless, the weight of foreign capital is increasing in all the countries undergoing transition. Figure 4.3. shows the weight of foreign-affiliated companies in the total value added of manufacturing industries in EU member countries. In Hungary, it is as high as over 50 %, which clearly reveals that most Hungarian manufacturing is carried out by multinational corporations. Slovakia and Romania, where foreign-affiliated companies are also prominent, also show high numbers. Eight of the ten countries showing numbers above 30 % are transitional countries. Among them, the dependency rate of Hungary on foreign-affiliated companies is particularly outstanding, and the Hungarian manufacturing industry can no longer be maintained without foreign-affiliated companies. In other Central and Eastern European countries, the situation is the same or similar.

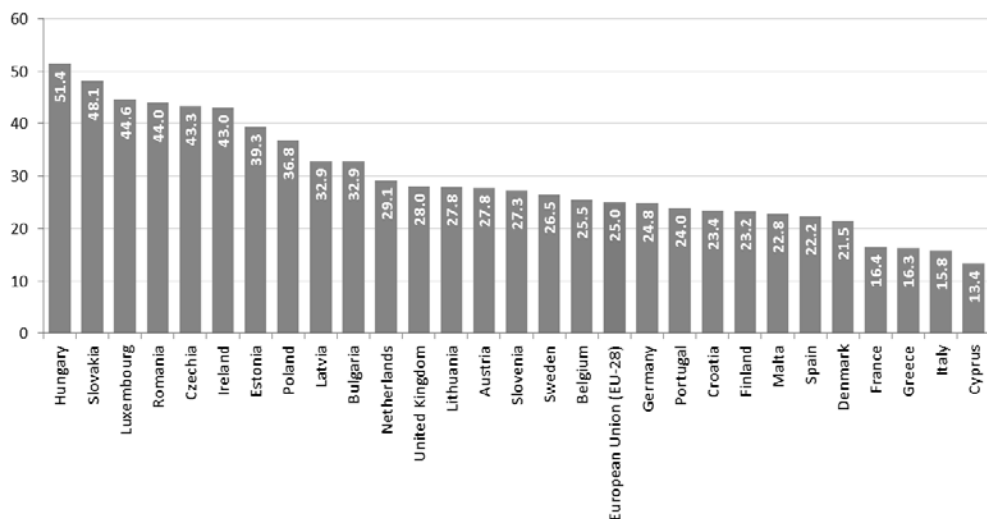


Figure 4.3. Share of value added by foreign-controlled enterprises in the non-financial business economy, 2016

Source: <https://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20190411-1> (April 11, 2019)

Note: For Greece data are provisional.

While direct investment is the “goddess of salvation” for transition countries, it leaves the fate of the national economy to the hands of multinational corporations. As a result, the Hungarian economy is more like an “economy depending on others” than a “national self-economy”. Hungarian politicians and elites obtain their wealth by living as “parasitizes” off multinationals, and workers live in unique ways with multinational corporations which we examine later.

Thus, Hungarian society, which was swallowed up by the global economy, faced unique problems. They included unfounded optimism for its own national economy and life. The “syndrome of dependence” on multinational corporations and the global economy has brought “new diseases” to Hungary.

Entsuiji Temple in Kyoto is known for its “borrowed landscape”. When you sit on the temple stand, you can see Mt. Hiei shaped like “Fuji” over the gate fence. It stands on the canvas above the gate wall as if it were for this temple. This “borrowed landscape” reminds me of the current state of the Central and Eastern European economies. The current state of the Central and Eastern European economies might be referred to as a “borrowed economy” which consists of industries transplanted by multinational companies. The national economies of Central and Eastern Europe have become the “borrowed economies” which provide a place for foreign-affiliated companies and entrust the fate of the national economy to these companies. Ultimately, the production base relocated by a multinational company is nothing more than a rental item. It is not a company (industry) created by privatizing a state-owned company. Most of the old state enterprises went bankrupt and disappeared. The new industry was just brought

in at once in a lump. Of course, that is the result of the opening of the national economy to the external world due to system transformation.

Like the “borrowed landscape”, the “borrowed economy” is not its own property. If a high-rise building is built between Entsuji Temple and “Fuji,” the “rented view” will disappear. You cannot prevent this. The same applies to the “borrowed economy”. Once a multinational company decides to withdraw, the production base will disappear without a trace. Employment will disappear, and tax revenues to the national and local governments will be lost.

In fact, IBM’s hard disk factory, which began manufacturing in Székesfehérvár, Hungary in 1995, was once a large manufacturing base with more than 7,000 employees. However, due to the change of IBM’s global strategy (in response to changes in the global market), the Hungarian base was closed in 2002, and everything disappeared without a trace.

Sony’s Hungarian factory, which was built in 1996 in the town of Gödöllő about 30 km from Budapest, was closed in 2010 due to the consolidation of audio products into Malaysia, and it disappeared like a mirage.

Thinking in this way raises the simple question as to whether we can talk about the national economy in the Central and Eastern European countries, where multinational companies form the backbone of the national economy. Economists in each country make macroeconomic forecasts as if the “national economy” stood on its own. But is such an analysis reliable? Is it possible to analyze the development of the national economy correctly while ignoring the character of the “borrowed economy”? In addition, the dependency structure which accompanies the entry of multinational companies may create a “syndrome of dependence”, which may be a major obstacle to the development of society. We will see the phenomenon in following paragraphs.

4.2.3 The Guest Worker Phenomenon

There is a common problem among manufacturing companies that have expanded into Central and Eastern Europe. It is the high absentee rate of workers. The labor protection system inherited from the old socialist era not only guarantees generous paid leave but also a few weeks of sick leave. Since the old days, workers and employees have become accustomed to taking vacations. Since paid vacation is used for the summer vacation, sick leave is often used for daily absenteeism. Illness is recognized if there is a doctor’s certificate from the clinic in the area where you live. Workers can easily take sick leave and do. Generally, sick leaves are reported on the morning of the workday. A doctor’s certificate will be presented later. However, management staff has difficulty reallocating workers before the start of the production line if several workers are missing every day. It is a typical headache faced by management in the manufacturing companies which can be universally observed in all the countries undergoing transition. This kind of absenteeism is not a typical problem for Japanese companies, but it is generally observed in Western companies as well.

When Panasonic built a factory in the Czech Republic (in the city of Plzen) in 1998, the daily absentee rate was over 30 %. Hungary’s general absenteeism rate is in the range

of 15-20 %, which is a level that causes problems in organizing production lines, even if it is not as high as the rates Panasonic saw in 1998. Recently, the sick leave acquisition rate has declined, and the situation is said to have improved, but this kind of data is confidential as it is related to the image of the company² and will not be disclosed. If there are several multinational companies in the same area, workers easily move to companies offering higher wages. The migration rate of local management staff as well as workers is high. Therefore, in order to make up for the labor shortage, there are daily interviews for recruitment and training sessions open for newcomers every week. Even if there is no company that pulls away workers in the neighborhood like Suzuki Motor Co., Ltd., it is the highest order to hire Hungarian residents in Slovakia for maintaining labor discipline. In the case of Alpine, which has a factory in the suburbs of Budapest, the turnover rate of workers is higher than in rural towns. Therefore, the company has built a dormitory facility for the workers recruited from Romania and thus tries to stabilize the movement of the workforce.

The high absenteeism rate is due to the large number of vacation days. For example, in Hungary, paid leave for new graduates starts at 20 days a year, and one extra day is added for every 1.5 years of natural aging. When someone turns 45 years old, he or she can take 30 days of paid annual leave, but the paid leave will increase with natural aging regardless of work experience. Adding 15 days of paid sick leave³ to this, even new graduates can get up to seven weeks of leave per year. If all employees “completely consume” this number of days off, the factory lines cannot be maintained. If the companies want to avoid disturbances in production, they need to hire 20 % to 30 % more employees than they would ideally need.

Workers employed by companies with low wages are more likely to get sick leave easily. For this reason, some of the leading Japanese manufacturing companies even visit workers on sick leave to verify whether they are actually sick or not.

At the time of the Lehman shock in 2008, the number of people who took sick leave increased rapidly in many manufacturing companies. Since it is legally prohibited to dismiss a worker during sick leave, there was a phenomenon that workers fearing dismissal hastened to take their sick leave.

How should we characterize this approach to work? I call this the “guest worker phenomenon”. Guest workers are usually workers who work abroad and hunger for more, but what one observes in Central and Eastern Europe is the phenomenon of “behaving like a guest in your own country”. Moreover, this “guest worker” does not have a hunger for more. On the contrary, the prevailing work ethic makes the worker see

² I requested the submission of absentee rate data from major Japanese companies when I took the position as lead manager of the Japanese Chamber of Commerce in Hungary in 2010. Not all companies cooperated, but we received data from two large-scale manufacturing companies and one small-scale manufacturing company. Figures 4.4 and 4.5 show the processed data submitted at the time.

³ The employer must guarantee 15 days of paid sick leave per year. 70% of the basic wage (2018) is paid during this period. In the case of illness lasting more than 15 days, pay will be replaced with a sickness allowance covered by the social insurance program.

him or herself as a kind of “guest”. This is more a “customer” ethic transplanted into the workplace, an ethic according to which you work when you want to and you rest when you want to. This is the “guest worker phenomenon” in Central and Eastern Europe. It can be named the “Central and Eastern European Symbiosis Phenomenon” of workers with multinational companies.

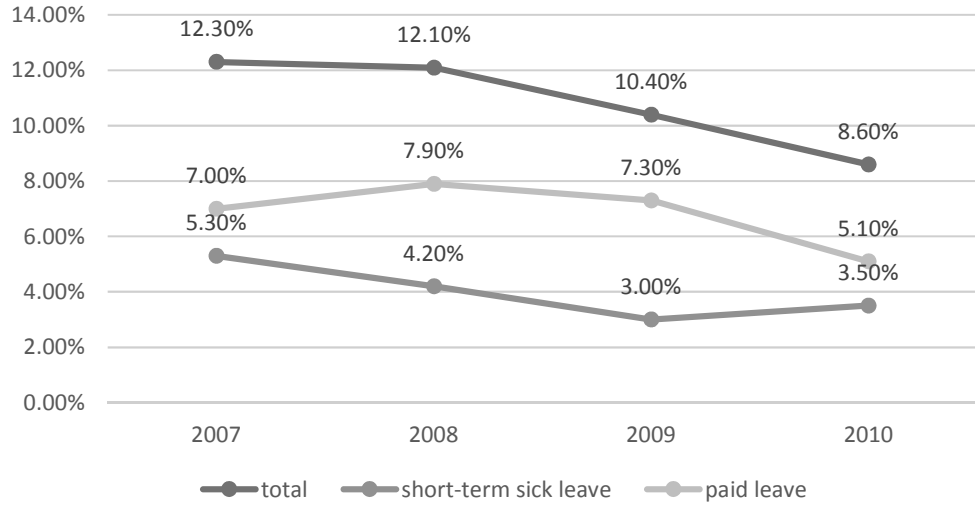


Figure 4.4. Short-time leaves at a Japanese manufacturing company

Source: Japanese Chamber of Commerce in Hungary.
 Note: The company employs more than 1,000 workers.

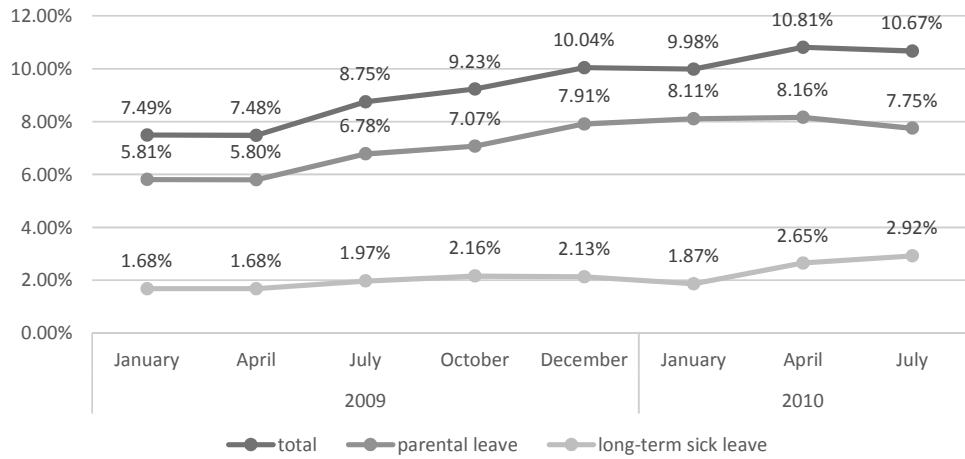


Figure 4.5. Long-time leaves at a Japanese manufacturing company

Source: Japanese Chamber of Commerce in Hungary.
 Note: The company employs more than 1,000 workers.

What is the cause of this phenomenon?

One cause lies in the protections provided for workers under the former socialist system, protections which essentially have been inherited as is. The worker protection system cuts off channels that are sensitive to harsh shifts in the market economy, so a hunger for more is not fostered. Excessive protection laws undermine the working spirit of workers in an era when the countries must catch up with the economic standards of developed countries.

Second, the shortage of workers became normal due to the large amount of direct investment that flowed in within a short period of time, and the seller market for workers was formed. This spurred easy labor ethics. The sense of security which is created by the impression that a job can be found at any time diminishes loyalty to the workplace.

The third factor is low wages in the manufacturing industry. Central and Eastern European countries are much more economically wealthy than the poor countries of Asia. There is no urgency to work long hours for low wages. If hard work does not lead to a significant increase in one's income, it makes more sense to take a proper break or take leave to devote time to a part-time job to earn money to cover living expenses. If a company with higher wages is established in the surrounding area, a worker will easily leave his or her job.

Fourth, all the important matters are handled by a foreign manager dispatched by a multinational company, and there is no delay in paying wages. Therefore, "you should exercise your rights to the maximum extent and fulfill the minimum obligations so that you will not be dismissed". Passive behavior becomes dominant. This is true not only for workers, but also for the local management staff.

Fifth, since the headquarters of the company makes important decisions and the managers dispatched from the parent company discuss their policies and create action guidelines, even local managers are excluded from decisions that affect the fate of the company.

Sixth, workers and local managers do not regard multinational companies as their own. Local companies may create a sense of belonging, but in the end, the foreign companies are not theirs.

Thus, in a multinational company, whether one is a worker or a manager, the feeling of being a "customer" who has lost the sense of belonging to the company can easily spread. The market economy is advancing, but the mere presence of multinational companies does not automatically mean that the work ethics and management techniques necessary for the development of the market economy will naturally take root. There are some discussions that multinational companies will develop subcontractors and thus the domestic market economy will develop, but many subcontractors are also accompanied by their parent companies from their home countries, and therefore the development of the local subcontracting parts industry is uncommon. Most of the products and technologies provided by subcontractors will withdraw and disappear when the parent company withdraws.

In December 2018, the Hungarian government increased the annual overtime limit from 150 hours per year (up to 250 hours under the agreement) to 400 hours per year (based on the agreement). In addition, the adjustment of overtime work (seasonal ad-

justment) was extended from the previous one year to three years. These changes are in line with repeated requests made by BMW, which has settled in Debrecen, a town in eastern Hungary. The legislative revision was passed without adequate discussion, and it was proposed by a ruling-party politician from Debrecen, who suddenly submitted it to the parliament. In protest against the changes to the law without debate, the opposition party and the union called for abolishment of the “slave law” and called for protests in the street, but the protests were blunt.

The overtime limit according to the amended law is still under the EU regulation (415 hours a year). In addition, the conventional limit of 150 hours per year (12.5 hours per month) is too unrealistic to compete with Asian countries. For many years, the prospect of lifting excessive restrictions on overtime has been raised by multinational corporations. Furthermore, workers are hoping that overtime will increase their incomes, and the interests of the union leaders and workers do not overlap in this.

However, although the conventional seasonal adjustment of overtime hours was allowed within the range of one year, the adjustment period has suddenly been extended to three years. Perhaps BMW wanted to have three years to adjust overtime related to building a plant, but the extended period would be disadvantageous to workers. The government failed to explain this point.

4.2.4 Wage Labor and Bargaining Power

One of the topics discussed by experts is that income convergence in Central and Eastern Europe is far less advanced than expected. Even thirty years after the beginning of the process of system transformation, it is around 50 % of the income level in Western European countries, and convergence has progressed very slowly. Research is being conducted on the possible causes.

Table 4.10. shows changes in GDP since 2000. It should be noted that the GDP of Bulgaria, Romania and the Baltic States has increased 5-6 times in the last seventeen years, but that does not mean that labor productivity has increased. Due to the inflow of foreign capital after 2000, the market value of production factors has been reevaluated, and the existing production factors, which had received low valuations, received a new market valuation.

On the other hand, in the Czech Republic, Poland, and Hungary, where the inflow of foreign capital continued, the process of revaluation of production factors proceeded through the 1990s, and the effect disappeared by around 2005, thus the increase in GDP depends mainly on increases in labor productivity. Therefore, the growth rate of GDP in these countries is smaller than in other countries. Slovakia, where the inflow of foreign capital has not progressed, is an intermediate case among the Central European countries.

Overall, although GDP in Central and Eastern Europe is steadily increasing, it cannot be said that the income gap with Western countries has narrowed significantly even 30 years after the process of system transformation began. Still, the apparent presence of income disparities has caused a large amount of labor migration from Central and Eastern European countries to Western European countries (see Chapter 5).

Table 4.10. GDP per capita in the Central and East European countries (EUR at market price)

	2000	2005	2010	2015	2017	2018 (PPP)	
						GDP	hourly labor cost
Bulgaria	1,800	3,100	5,100	6,300	7,300	15,500	5.4
Romania	1,800	3,800	6,200	8,100	9,600	19,900	6.9
Croatia	5,300	8,500	10,500	10,600	11,800	19,500	11.0
Slovenia	11,000	14,600	17,700	18,800	20,800	27,000	18.1
Czech Republic	6,500	10,700	14,900	16,000	18,100	28,000	12.6
Hungary	5,000	9,000	9,900	11,300	12,700	21,700	9.2
Poland	4,900	6,500	9,400	11,200	12,200	21,900	10.1
Slovakia	4,100	7,300	12,400	14,600	15,600	24,000	11.6
Estonia	4,400	8,300	11,000	15,700	18,000	25,100	12.4
Latvia	3,600	6,100	8,500	12,300	13,900	21,700	9.3
Lithuania	3,600	6,300	9,000	12,900	14,900	24,900	9.0
average of 11 countries	4,200	6,600	9,500	11,200	12,500	22,655	10.5
average of Euro area	21,900	25,800	28,500	31,100	32,900	32,800	30.6
average of EU 28	19,800	23,400	25,500	29,100	30,000	30,900	27.4

Source: WIIW, *Handbook of Statistics 2018*, November, 2018. Eurostat, Purchasing power adjusted GDP per capita (June 27, 2019 updated), Eurostat, Estimated hourly total labour costs, 2018.

Note: Hourly labor cost includes not only wage, but employers contribution, too.

Labor experts are looking for causes and weakness in income convergence due to the slow rise in wages in the manufacturing industry. Behind that, there is a decline in the bargaining power of trade unions. Table 4.11 compares the penetration of collective agreements in Central and Eastern European countries with penetration in Western European countries.

Characteristically, the former Yugoslav countries, which have experience in self-management of workers, have a relatively high degree of penetration, but it still tends to decline gradually. In Central and Eastern Europe, where foreign capital was introduced early, the figures are low across the board. Poland, where union power was extremely strong in the old days, still surpasses Western countries in the number of strikes, but it is noteworthy that these strikes have little influence from the perspective of collective union agreements.

What is the cause of the diminished influence of unions in Central and Eastern Europe? As we saw in the previous section, the “guest worker phenomenon” of workers has transformed the behavior patterns of traditional workers who rely on the union’s power. For rural people who do not have good employment, the entry of foreign-capitalized companies with capital power is a unique opportunity to stabilize their lives. Small local firms with weak financial resources have a high risk of bankruptcy and cannot offer high wages. Therefore, if a large foreign-affiliated company expands, not only will income be stabilized, but social security for illness and childbirth will be legally guaranteed. Even if one has to put up with some wages, it is important to be employed by a large company. As the number of foreign enterprises increases, the range

Table 4.11. Degree of coverage by collective bargaining agreement (in %)

	2000	2008	2013
Bulgaria	40	35	29
Croatia	–	60	53
Poland	25	16	15
Romania	98	98	35
Slovakia	51	40	25
Slovenia	100	92	65
Czech Republic	48	50	47
Hungary	37	37	23
Austria	98	98	98
Germany	68	61	58
France	98	98	98
United Kingdom	36	34	30
Greece	90	88	59
Italy	80	80	80
Portugal	79	84	72
Spain	85	81	80

Source: Vasily Astrov, “Solving the Mystery of Weak Wage Growth in EU-CEE”, *WIIW News Letter*, July 26, 2018.

of choices and job changes expands, but despite a labor shortage, wages for non-skilled workers remain low.

Thus, it is a much higher priority for workers to secure a workplace for a long time, rather than to have strong organizational power to place high demands on management.

Another reason for the wage level of workers being sluggish is that the development level of the market economy in Central and Eastern Europe is still rather low. As will be seen in Chapter 5, many talented engineers, craftsmen, and technical experts have essentially fled the countries of Central and Eastern Europe to the West since the system transformation began. People who do not have the opportunity to reach a high-income level in their homeland due to the lack of expansion of the domestic market move to the west in search of better jobs and higher incomes. High-quality labor outflows are holding back rising levels of wage labor among those who remain in the country.

The above points can be summarized as follows.

First, except in Poland, the formation of labor unions and the activities of labor unions within multinational companies are extremely low.

Second, as a result of the low formation of labor unions, the rate of collective agreements between companies and labor unions is extremely low, and therefore the number of strikes is also extremely small (excluding Poland) compared to the western countries. Occasional strikes are noted, but they do not affect other companies. Workers working for multinational corporations prioritize their personal lives and refrain from acting in solidarity.

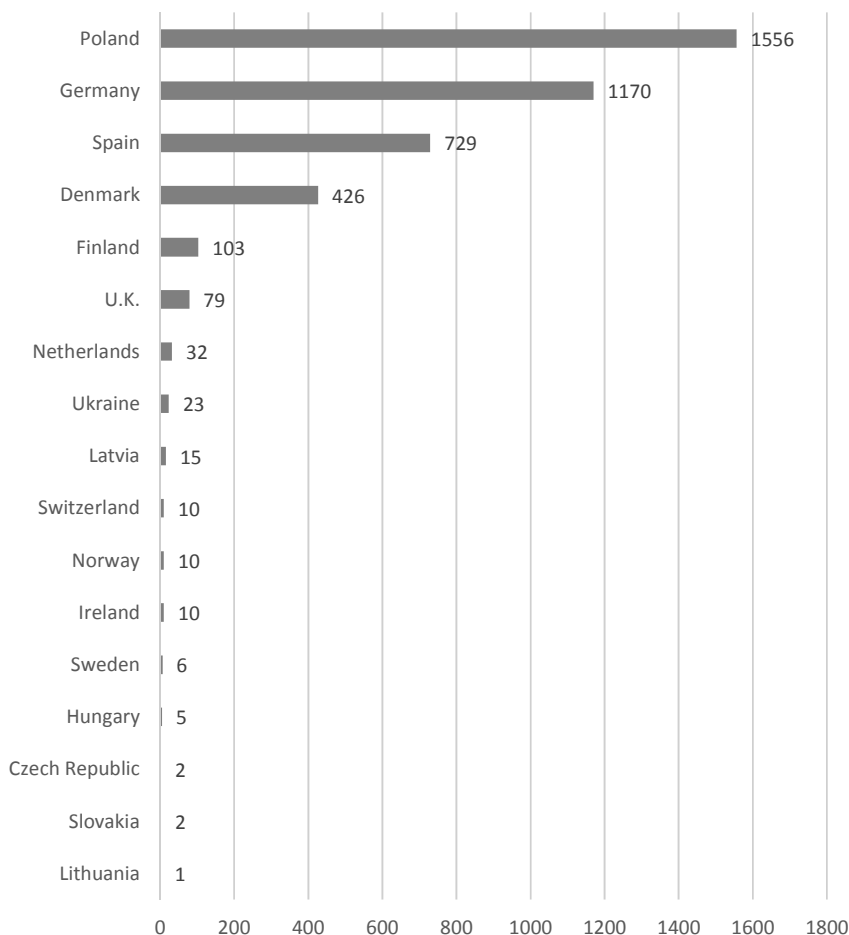


Figure 4.6. Strikes in European countries (2017)

Source: ILO, Number of strikes and lockouts by economic activity, ILOSTAT, 2019.

Third, the unemployment rate in Central and Eastern European countries is low, making it difficult to hire cheap labor. For example, BMW decided to build a factory in the town of Debrecen in eastern Hungary in 2018, 200 km east of Budapest. If you go far away, there is still a cheap labor force. At the request of BMW, the Hungarian government raised the upper limit for overtime work, but workers' protests were very limited. Rural areas need a stable workplace, and workers welcome overtime as an income supplement. There is a structure to cover low wages with overtime pay.

Fourth, Japanese companies in Hungary are worried about labor shortages, but that does not lead to higher wages. Accepting Hungarian workers from the rural areas of Slovakia and accepting Hungarian female workers from Romania has curbed the tight labor market wage increases. The labor outflow from Poland is supplemented by cheap labor from Ukraine, and the outflow of labor in Bulgaria is supplemented by the inflow

of labor from Turkey. Therefore, the circumstances are not structured to compete for domestic labor and raise wages. If you must pay higher wages for simple wages, moving to Asia will save you money, so even if domestic employment is tight, there is a mechanism in which wages do not rise. Workers can easily quit if there is a company that pays higher wages than the union demands. Therefore, both companies and workers have a structure that prioritizes advantages on the individual level.

Fifth, direct investment that manufactures products only for export does not lead to the development of the domestic market. No matter how much exports increase, these increases do not contribute to the development of the domestic market economy and do not serve as a force to boost the income of the national economy.

Sixth, under such circumstances, where domestic income levels do not rise continuously, people with abilities and skills leave in search of higher incomes in countries in the West. The outflow of skilled workers and experts has been observed even thirty years after the beginning of system transformation.

4.2.5 Problems Faced by Non-Manufacturing Industries

The “guest worker phenomenon” observed in multinational corporations can be said to be a typical symbiotic phenomenon of workers with multinational corporations, but from another perspective, it can also be said to be a phenomenon of “indulgent dependence on others”. Is not the same phenomenon seen in the financial and IT sectors?

In the IT sector, the pay-per-work compensation system is well established, and since it is a business close to individual business, there is no irresponsible absenteeism like the absenteeism found in the manufacturing industry. However, it cannot be denied that the level of IT engineer compensation has risen to an unrealistic level due to the entry of many multinational companies aimed at IT engineers in Hungary during the 1990s. The indirect responsibility of subcontracting development obscured the relationship between results and rewards, creating the illusion of groundless high rewards for IT engineers.

While IT companies, which are being squeezed by market competition, are trying to survive at stake, the engineers responsible for subcontracting development are not responsible for the success or failure of the commercialization of the development. It is not the responsibility of the subcontractor developers. How to sell the developed product is the responsibility of the company that requested the development. Foreign IT companies try to secure excellent IT engineers in order to develop products that will hit the market, while Hungarian engineers who subcontract and develop demand high rewards regardless of the success or failure of the product. The severity of market competition can only be indirectly transmitted to subcontractor IT engineers. Whether or not the developed product can be sold, it is “natural” for IT engineers to get a high reward for their work and input. This can also be referred to as the phenomenon of “indulgent dependence on others” in IT companies.

The financial sector situation (management elite) is more like a bubble. At the time of the system transformation, there were no specialists in commercial finance in the

former socialist countries. Working experience at a national bank does little for commercial finance. Nevertheless, the young staffs at the National Bank were appointed to serve as executives of foreign-affiliated banks, financial consulting firms, and accounting firms, and thus they received high compensation. To compensate for the absolute shortage of professionals, multinational companies offered Western-style remuneration to hospitalize staff with at least some “banking experience.” From the perspective of building relations with the government, politicians and bureaucrats who had been engaged in financial administration under the old system were appointed to the top of foreign-affiliated banks, and they were treated with compensation equivalent to that of the executives at western banks. This phenomenon could be observed in all the countries undergoing transition. From then on, the unfounded illusion of overestimating one’s ability spread among those engaged in the financial sector.

In general, the profitability of the banking sector in Central and Eastern Europe is high. Compared to Western countries, the margin is set higher and various fees are higher. The industry has wide margins in order to maintain high-paying remuneration packages and secure corporate profits.

In Hungary, where the country is small, immediately after graduating from the Department of Finance at the Economic University, a student can immediately become the head of section at a bank/securities or accounting firm or a consulting firm. A few years after graduating from university, he can become the manager of the department, and if he can show that he is more competent than his peers, he will be appointed to serve as general manager even though still in his 20s. Even if you do not have a lot of work experience, you can run on the path to success at an unbelievable speed if you show your ability.

Péter Oszkó was appointed minister of finance by the Bajnai government established in 2009 at the age of 36. Oszkó graduated from ELTE (Eötvös Loránd University) in 1997 and ten years later, in 2007, he was appointed president of the Deloitte Accounting Office in Budapest and then served as minister of finance. He sprinted down the path to success like a triple jump. It was revealed soon after his appointment as minister of finance that Oszkó had assets in Cyprus for securing private assets. His source of income was the remuneration paid to the president position of the accounting firm. The clients of major accounting firms are all multinational corporations, and the major accounting firms themselves are also multinational corporations. If you enter the business circle of the multinational companies and are assigned to act as a president of the company, you can earn so much money that you must manage assets overseas.

For these reasons, after the system transformation, it became popular among students to get jobs in foreign-affiliated financial companies and foreign-affiliated IT companies to earn high incomes. More than 80 % of the students who enroll in the Budapest University of Economics chose the Faculty of Business, and most of them aim to get jobs in the financial field. Traditional theory and economic policy departments have fallen. The IT department has become the most popular subject among students in the largest electronic engineering faculty at the Budapest Technical University.

The demand for IT engineers has already declined and IT companies can easily obtain engineers in other countries in Central and Eastern Europe, and the level of IT

engineer compensation has stopped rising, but it remains high. In addition, IT engineers continue to change the company, as they aim to garner higher rewards. Although IT companies cannot offer packages as attractive as the rewards they once offered, engineers cannot disabuse themselves of the illusion of high rewards. Therefore, they are often changing their workplace or seeking jobs in Western countries. Of course, highly skilled engineers and technicians full of ideas can always get high rewards, but even ordinary engineers also continue to demand high incomes. However, the days of foreign IT companies paying high wages and competing to obtain IT engineers are over. This also creates an outflow of talented IT engineers.

4.2.6 Aristocrats in the Era of System Transformation

The top executives at foreign-funded financial and consulting companies receive far more exorbitant rewards for their abilities and jobs. Almost all multinational corporations have designated large accounting firms as auditors, therefore the remuneration of auditor companies remains remarkably high. Like Finance Minister Péter Oszkó, András Simor was appointed governor of the National Bank in 2007. He also moved to the post from the president of Deloitte Hungary. As a top executive of Deloitte, Simor could amass enough assets to hold more than \$4,000,000 in Cyprus at the age of fifty. As a governor, he was generously paid.⁴

According to the September 26, 2009 issue of the weekly economic magazine *HVG*, the monthly income of the head of MKB Bank (formerly the Hungarian Foreign Trade Bank),⁵ which is owned by the Bavarian State Bank, was HUF 13,000,000. Similar salaries were paid not only by foreign banks, but also by international accounting firms and securities companies. At the time, Governor of the National Bank András Simor was forced to resign after the establishment of the Fidesz government when it was revealed that he had assets in Cyprus (2010). It became clear that those who were in the position of protecting the Hungarian currency and national interests were trying to protect their private assets by moving their assets abroad. However, the conservation of assets abroad is also a phenomenon commonly observed by political parties, privileged politicians, and senior managers of highly paid foreign-affiliated companies in countries undergoing transition. Whether a politician belongs to the right or left wing, the preservation of private property is of greater concern than the national interest.

⁴ The monthly income of the governor of the National Bank in 2009 was HUF 8.1 million (\$40,000). It is by no means less than the salary of a central bank governor in the West. In addition, in Hungary, in order to make the amount of compensation appear low, various benefits and bonuses are paid in addition to the prescribed compensation, which are not treated as compensation. In Hungary, the practice of paying large bonuses to the top executives at public and budget companies has arisen, and most enterprises provide 80% of the prescribed annual remuneration as a bonus. However, it is explained that the national bank governor's remuneration will be supplemented with 5% voluntary medical and pension insurance, but no bonus.

⁵ In the 1990s, top foreign bankers used exorbitant rewards to build a villa on the shores of Lake Balaton, and with the company's money, they took a female employee and enjoyed an elegant yacht. Indeed, they became aristocrats in the era of system transformation.

I consider the system of disproportionately large rewards found among the top executives in the financial sector is another example of the phenomenon of “indulgent dependence on others”. Surprisingly, the “syndrome of dependence” has a great influence on the compensation system of the budgetary institutions. According to a report by Hungarian TV in July 2009, the annual salary of the rectors at a national university could reach a maximum of HUF 54,200,000 (\$250,000). Considering the income level of the people and the level of the national economy, I cannot help saying that remuneration rules for the rectors are unfair to put it mildly.

When such high-paid rewards are discussed in the media, scandals of the same kind will appear one after another. A former executive of the Budapest Transportation Corporation (BKV), which is owned by the city of Budapest, sued for full payment of his retirement in July 2009. The court ordered BKV to pay HUF 100,000,000 (approximately \$500,000) as a severance payment based on the existing employment contract. The BKV is a public enterprise that produces a large deficit each year and receives subsidies from the state budget (HUF 30 billion in 2009). It was revealed that the public corporation had a contract to pay a large retirement allowance when inviting directors. According to reports in the public media, the BKV paid a large severance payment in previous two years leading up to 2009 amounting to HUF 2 billion.⁶ The Budapest city council at the time had the ruling party with the Socialist Party and SZDSZ (Alliance of Free Democrats). This was an example of long-lasting corruption by the local government led by the socialist party. Further corruption in the BKV will be examined in detail in the latter part of this chapter (Section 4.4).

In Hungary, where the national and local governments are suffering from chronic deficits, disproportionate compensation and huge retirement payments are paid to people in public organizations, and thus public money is being eaten. The phenomenon has its root in the waste of the budgets of ministries and public agencies. The ruling parties, which have taken power, divide the ministers under their jurisdiction

⁶ István Kocsis, who was appointed to serve as the new president of BKV in the midst of confusion created by corruption in 2008 was soon charged with malpractice concerning the outflow of company assets when he was the president of the MVM (Hungarian Electrical Works) in 2005–2008. The trial has been going on for almost ten years, but has recently shown rapid development. The second trial of this case has been taken over by the Pécs court, and the judgement was announced on March 1, 2019. According to the court, as the main offender, Kocsis was sentenced to five years in prison. András Szász, an accomplice who is notorious for his active involvement in various economic crimes, was sentenced to three years in prison. They were also ordered to pay HUF 48 million for various damages and €5.5 million for damages of the MVM within 15 days. The first trial judgement on money laundering has also come to a conclusion for Mrs. Kocsis, who is suspected of having served as an accomplice. The lawyers for Kocsis and Szász filed an immediate appeal, bringing the case to the Supreme Court. The Supreme Court finally issued a five-year prison sentence on November 26, 2019. This is a rare case of economic crimes on which final judgement has been passed. Many economic crimes which were committed during the period of system transformation were and are overlooked without any attempt to bring the perpetrators to justice, not only in Hungary, but in all the countries undergoing transition.

among the coalition parties so that one party can decide the minister and directors of each ministry. This is to allow the ministry budget to be freely disposed of without the intervention of other parties. The Hungarian ministerial bureau has a great deal of authority over spending on provincial budgets, and it has created a mechanism for distributing ministry budgets to the outside through subsidies, public orders, various voluntary contracts, advisory contracts, or camouflage foundations of political parties.⁷

A significant portion of revenue is tax revenue collected from the economic activities of multinational corporations. The multinational companies contribute a large amount of GDP production. While collecting taxes that can make private businesses hold their breath in anxious frustration, politicians and business people near politicians are wasting public money, as if it were money in their wallet. Such a tremendous amount of waste cannot occur if you are aware that you have earned money yourself by your own sweat.

Thus, the politicians and elites who amass wealth while remaining entirely dependent on multinational corporations arguably are a bit like the grasshopper in Aesop's fable. Almost all of Hungarian society, including the "guest workers", tend to be dependent on other forces and prefer to consume the fruits of labor without doing the hard work. This is typical "indulgent dependence on others" like the "Grasshopper". It is an inevitable phenomenon brought about by the "borrowed economization" of the national economy.

4.3 The "Treasurization" of the National Economy

Is the national economy with the characteristic of a "borrowed economy" described in the previous section included in the category of the capitalist economy? Can an economy in which the government (the national treasury) controls most of the national economy be called a market economy? I believe that the current Hungarian economy is a kind of market economy, but its development level is very low and local capitalists have not grown up, and it is a lagging market economy the development of which is suppressed by the state. For many economic players, competition in the domestic market has a limited role, and a significant part of business success depends on public business orders and subsidies given by national or/and local governments. There are major limits to the business expansion for domestic companies that cannot obtain public orders or subsidies.

I stipulate that an economy in which public orders and subsidies from central and local governments determine the success or failure of a business is neither a market

⁷ An advisory contract is the simplest way for a public company executive or ministerial office to disburse funds. During the first Fidesz administration, former Prime Minister Viktor Orbán, i.e., the Prime Minister's Office, had an advisory contract with a tennis coach. This type of abuse of the advisory contract is considered to be a part of the fringe benefits attached to the position in Hungary. Also, each political party has established several foundations to diversify political party activities, and subsidies can be given to such foundations relatively easily.

economy nor a capitalist economy, but a “treasurized economy”. The “treasurization of the national economy” is a special phenomenon born in a small country in Central Eastern Europe.

4.3.1 The Double Structure of the National Economy

As discussed in detail in “wage labor and bargaining power” in the previous section, most of the foreign-affiliated manufacturing companies operating in Hungary do not target the Hungarian domestic market for product sales, and almost 100 % of the products are exported to the West European market. Most of the materials and parts necessary for the production are imported from abroad, and almost all parts procurement in Hungary is also from subcontractors who expanded abroad and accompanied the multinational companies. In other words, the product manufacturing of the foreign-affiliated industry functions as a closed system that is separated from other areas of the national economy, and it contributes only to the development of the national economy by employment of wage labor and the payment of taxes and social insurance.

Thus, the Hungarian national economy consists of two relatively independent areas that have little interaction with each other. On the one hand, there is a foreign-affiliated manufacturing industry with high-tech large-scale employment, and this business area forms a concession within the national economy (borrowed economy). On the other hand, there are domestic capital SMEs that are responsible for the production of consumer goods and construction work, relying exclusively on the Hungarian domestic market. These domestic companies are heavily dependent on public orders and subsidies. No matter how much the concession area develops, there is no economic tie that connects these two areas.

This shows that the national economies of Central and Eastern Europe have an extremely distorted double structure. One is a “borrowed economy” and the other is a “treasurized economy”. The double structure of the Central and Eastern European economies is a unique, non-developable, and highly distorted structured economy. Without analyzing these structural characteristics, it is very complacent to assert that “the transition has created capitalist economies in Central and Eastern European countries”. Such a conclusion is not based on any analysis of the facts. It is merely an idea conceived at the desk in the laboratory.

4.3.2 The Trap of the Treasurized Economy

Once the national economy has fallen into the trap of the treasurized economy, it is not easy to bail it out. If the market economy does not develop dynamically enough to break through the framework of the treasurized economy, the national economy continues to remain in the trap of a “treasurized economy”. Once having fallen into the trap, economic players abandon market competition and try to get subsidies and public orders. This hampers the development of the domestic market and forces businesses to seek subsidies and public contracts again. It is not easy to break out of this vicious circle.

Kornai characterized the former socialist state as the “welfare state born as a premature baby” (koraszülött jóléti állam, premature welfare state).⁸ This means that the socialist states tried to build a welfare state only in form without economic development that supports the level of the social security system. In the former socialist society, the welfare state and system were not supported by material wealth, but by giving workers free time (leisure time). In other words, it made workers think that the socialist state expressed its concern for workers and the value of workers by giving workers free time. The argument that workers in these societies were “materially poor but spiritually rich” had some persuasive power as an ideology.

However, travel to the west was gradually eased, and through the television and radio, people became familiar with the daily lifestyles of the citizens of western countries. If everyone is poor, people do not feel poor, but as they become aware of different levels of consumer life, their longing for a rich consumer life will grow stronger. When they are convinced they are poor because of the failure of the socialist economy, people’s social consciousness changes, and the social magma that causes a drastic social change is formed.

System transformation provided an opportunity to develop a “welfare state born as a premature baby” into a “welfare state born of a normal childbirth”. People never thought about what should support the welfare (social security) level, nor did experts indicate how to build Hungary’s social security system. People simply thought that Hungary would develop into a welfare state on par with developed countries after joining in the European Union. We can see here again the phenomenon of “indulgent dependence on the other”.

In both the era of the old system and the new era after the system transformation, it is the development of the national economy that supports the level of the social security and welfare system, and a high level of development of the national economy can be accomplished only by hard work. With the development of the market economy, the level of material wealth of the national economy will rise, and it will be possible to devote a large part of this income to social security and welfare. Not only the people, but also politicians and experts failed adequate to recognize this fundamental fact. The self-evident fact that “social security can be supported only by activating the basic economic activities of the people themselves” is not understood even today. Neither politicians nor experts can inform society that only the fruits of peoples’ labor could maintain the quality and quantity of social programs.

During the socialist era and even during the era of system transformation did people keep in mind that “welfare is provided by the state”. During the socialist era, the Communist Party provided welfare, and after the start of the transformation, the optimistic expectation remained that the EU would raise the welfare standard to the levels found in Western Europe. The groundless optimism concerning the allegedly imminent transformation from an “immature welfare state that shares poverty” to a “Western-style welfare state guaranteed by the EU” was widespread in the countries undergoing transition, but soon people were disappointed when it turned out not to be true. However, no one

⁸ János Kornai, *By Force of Thought* (Cambridge, MA: The MIT Press, 2007), 368.

knows how this change could be accomplished, because governments never say that the welfare state can only exist if it rests on a foundation of hard, dedicated work.

The successive governments, both right and left, are deploying “give but obey” policies without even questioning the “common sense” belief that a welfare state should collect and dispose of the majority of the GDP. The state only redistributes the income it collects without discussing what should be done to raise the level of social security. In 2003, the Socialist Party’s government promised pensioners a “13th month bonus” as it aimed to get the votes of pensioners. In the general election campaign in 2006, the opposition Fidesz promised a “14th and 15th month bonus pension”.

Neither before nor after the system transformation, did politicians discuss the issues necessary to raise the standard of welfare. As already mentioned, when Fidesz was the opposition party, economists around Fidesz proposed reactivating the market economy by decreasing the rate of redistribution to under 40 %. However, when the party came into power, the Fidesz leaders excluded economists who proposed unpopular policies, and it continues today to use the high redistribution policy as a means of maintaining the ruling power of the party.

In this way, the optimistic reliance on a treasurized economy which led to general poverty during the Kádár era has been passed down to the governments after the system transformation, too. The policy of sharing limited pies continues at the expense of revitalizing the market economy, which should be the material foundation of the welfare state. It is not easy to escape from the trapped “treasurized economy”. This is because it is the highest order for politicians and the party in power to secure the means of distribution and allocation in order to remain in power as long as possible.

4.4 Corruption in Post-Socialist Society

Approximately ten years after the beginnings of system transformation, the plundering of state assets and former Communist Party assets was widespread, but due to foreign direct investment and the re-privatization of the banking sector, overt plundering of the state-party assets began to slow. However, in public enterprises where strict business management is not thorough, corruption is flourishing. Politicians and related persons prey on public enterprises with loose corporate management. A typical case in Hungary is the large-scale corruption case of the Budapesti Közlekedési Vállalat (BKV, Budapest Transportation Corporation), on which I touched earlier.

Since Hungary became an EU member state in 2004, new types of economic misconduct have become frequent. These forms of economic malfeasance tend to involve the illegal receipt of EU subsidies by insiders. According to the European Anti-Fraud Office (OLAF), Hungary’s fraud rate is the highest in the EU countries. This creates a new type of corruption.

Furthermore, under the second Fidesz administration, which is a de facto dictatorship that occupies two-thirds of the parliament, the act of defrauding the national budget by using state mechanisms has been skillfully designed. The sale of “national bonds with the right to settle”, which started in 2013, can be handled only by intermediary companies registered in tax havens, and the handling company is decided by a

negotiated contract without bidding. The bond sales, which guarantee a higher yield than the market interest rate, and the handling fees, which can be freely set by intermediary companies, have created tremendous profits for intermediary companies. Clearly, ruling politicians and their stakeholders are behind the implementation of this scheme. This is a breach of trust that drains national assets.

The ruling politicians have joined forces with entrepreneurs who support political parties to place orders for public works and receive various benefits in return. Even thirty years after the beginning of the process of system transformation, Hungarian society has no social norms concerning bribery, and therefore it is not considered a serious crime.

As the ruling government became increasingly dictatorial, this led to various kinds of corruption.

4.4.1 Defrauding and Breach of Trust Using Public Corporations – The Corruption Case of the Budapest Transportation Corporation (BKV)

Most commercial banks in Central and Eastern Europe countries settled bad loans by selling to foreign capital by around 2000 and then relaunched themselves as foreign banks. This made fraud through banks extremely difficult, so fraud then moved to the public transport and public enterprises that produce and distribute electricity and gas. This took place in part because these corporations have large assets and large funds and are dominated by old-fashioned and loose management which lacks methods and mechanisms to ensure compliance.

The Budapest Transportation Corporation (BKV: Budapesti Közlekedési Vállalat, since 2006 Budapesti Közlekedési Zrt.) is a public corporation which manages all transportation in Budapest and is owned by the city of Budapest. It is a huge company with approximately 13,000 employees and an annual operating budget of HUF 380 billion in 2017. The company has been constantly in the red, and the subsidies taken from the national budget in 2017 amounted to HUF 15 billion.

There are many ways in which an outflow of funds can occur in huge public enterprises. By setting a relatively small amount for a subcontracting order, you can arbitrarily select the vendor. In the case of BKV, there are as many as 3,000 subcontractors, but the system for constantly checking each business contract (contract details and the results-reward relationship) is extremely loose. If a bid is big, the situation is not so simple, but if it is a small amount private contract, it is difficult to inspect each contract and verify that the contract has been fulfilled. This blind spot allows fictitious contracts to be used to drain company money. However, it requires internal collaborators and those who have the power to back it up. It is not difficult to find a mechanism to drain a certain amount of money if you can involve the person in charge of accounting.

In July 2009, the then anti-government newspaper *Magyar Nemzet* reported that Mrs. Eleonóra Szilágyi Szalai, BKV Human Resources development manager, had received HUF 86 million in retirement payments in March 2008. Even after her retirement, she reportedly received a monthly fee of HUF 1.5 million for her advisory work. At the exchange rate at that time, the retirement allowance was \$500,000 and

the monthly salary was just under \$10,000. In Hungary, where the income level is low, this is not an amount that should be paid by public corporations operating in the red. Moreover, it was reported that the person in charge carried out the procedure for transferring the retirement allowance herself. The accounting practices at BKV were this loose. She had the confidence of BKV President Attila Antal at the time and therefore was able to take such bold measures.

However, this issue concerning severance pay was not the only problematic affair concerning BKV. The retirement payments of successive executives were investigated, and it became clear that BKV, a deficit company, paid exorbitant retirement payments one after another, as noted earlier.

Furthermore, this BKV problem spread to the alleged injustice of ruling party politicians in the city of Budapest. BKV is a company 100 % owned by the city Budapest, and the management of BKV is overseen by members appointed by the Budapest City Council. Miklós Hagyó, vice-chairman of the city council and deputy leader of the Socialist Party of the City of Budapest, was appointed to serve as supervisor of public enterprises in the city of Budapest in 2006.

Hagyó took over the role of director of BKV in 2006, and at the same time he made Attila Antal president without any open recruitment, and Antal wiped out the previous management team at the same time. At the time, Eleonóra Szilágyi Szalai became one of the president's arms. On the other hand, Hagyó, who was behind the scenes, flaunts his authority and acts like the real BKV manager. At the time, many petitioners stood in a long line in front of the office of Hagyó at the Budapest's Town Hall, and Hagyó's secretary Éva Horváth oversaw accepting role of petitioners.

The direct suspicion leading up to the arrest of Antal was business negligence and embezzlement. There are about 300 contracts subject to the investigation, among which the case was on "contract to check the status of the copy machine in BKV", spending HUF 19.2 million, and on another contract with Éva Horváth as advisor which amounted to HUF 24 million.

In addition to these contracts, there were various scandal suspicions immediately after Antal taking office. Initially, Antal tried to implement various policies to increase BKV's income, but gradually he began to embezzle BKV funds. The first case was a bid for a used bus purchase in late 2007. Only Alfa Busz bid for the deal, but the company was found to have Antal's son involved, and due to media criticism, the bid was void. In addition, Antal signed a five-year advisory contract with AAM, a consulting company, on the construction of the subway Line 4 in early 2008. The exorbitant payment regulations (a monthly payment of HUF 9 million, maximum total payment of HUF 2.5 billion) were also revealed. It is believed that Hagyó, Antal's boss, directed the contract, but it was an opaque contract that was taken up as one of Hagyó's charges. As we will see in the next section, a report from OLAF, which checks for fraudulent activity on subway line 4, also stated that the contract was inappropriate.

Furthermore, after Attila Antal resigned, Hagyó temporarily appointed (February 19 – August 31, 2008) Zsolt Barrow as president of the BKV. Barrow made an explosive statement that he handed HUF 70 million to Hagyó as back deposit, which was revealed in the interview done by the *Magyar Nemzet* and Hír TV in March 2010.

Hagyó took responsibility and resigned as the supervisor of the public enterprise after the outbreak of the BKV incident, but that was not end of the story. Prosecutors arrested Hagyó and Ms. Horváth on May 17, 2010 and detained them for nine months.

After several twists and turns, Hagyó was found guilty in January 2016 by the Kecskemét court for on one charge, and in addition to a two-year prison sentence, he was also given a four-year suspended sentenced. Hagyó and Barrow were also jointly ordered to pay a fine of HUF 39.6 million. However, trials against Miklós Hagyó and his accomplices are still ongoing.

4.4.2 Misconduct in the EU Subsidy Project (1) – Corruption in the Construction of Budapest Metro Line 4

A huge public project is a unique opportunity for politicians and businesses related to make huge profits. Not only does the company that wins the bid profit, it is a heaven-sent opportunity for politicians who mediated the business, senior bureaucrats who hold and reveal insider information, and engineers who cooperate with them to accumulate private wealth.

Budapest had the first continental metro line (Line 1) in Europe, which was built in the early twentieth century. There is also the subway line 2 which goes under the Danube River between Buda and Pest, and line 3, which runs north and south, roughly parallel to the river on the Pest side. The latter two routes were made with Soviet technology, and the vehicles were also made by the Soviet Union (Russia).

The construction of subway line 4 extending from Pest to the southern part of Buda was planned from the 1970s, but it was not realized until the end of the twentieth century. This is because the cost of subway construction has risen every year, and the project eventually became too expensive.

Due to the result of various speculations, the Budapest City Council decided to build Subway Line 4 in 2004 on the premise of EU subsidies and government support. The current Line 4 runs through the section from the Eastern Train Station and the Kelenföld Train Station, going under the Danube from Vám Square on the Pest side to Gellért Square on the Buda side. This is the so-called Phase 1 section of line 4. As the second stage construction, a section extending from the Eastern Train Station to a new residential area to the east and a section extending from the Kelenföld Train Station to a new residential area to the west have been envisioned, and construction costs for the first and second periods have been calculated.

According to the initial plans, in 2004, it was estimated that the construction cost for the first phase would be HUF 195 billion, and the total construction cost, including the second phase, would be HUF 264.4 billion. However, the estimated amount increased year by year, and in 2008, it was calculated that the construction cost for the first phase was HUF 366 billion, and the total construction cost including the second phase was HUF 533 billion. Finally, the construction of the second phase was postponed indefinitely, and in 2012, the construction cost of the first phase alone was estimated at HUF 425 billion.

The project was delayed, but the final deadline for EU subsidies spent in 2009–2013 was approaching at the end of 2015, and so the line was opened for operation in March 2014. With the opening of the subway line, the EU Commission announced that the results of the survey, which would check to ensure that the construction had been done according to the rules, would be shown in 2017. The European Anti-Fraud Office (OLAF) notified the Hungarian government of the inspection results⁹ on December 14, 2016, and the government held a press conference in January 2017 to clarify its outline.

The targets of the survey in this report are Budapest City (Subway Project Management Committee, DBR Metro Projekt Igazgatóság), Alstom Transport SA, and former Prime Minister Péter Medgyessy. It is suspected that problems were found in most contracts signed by the subway project committee, and that domestic and foreign companies which were commissioned to fulfill various construction orders paid bribes to get the contracts. Regarding Alstom's selection, a company owned by Péter Medgyessy (former prime minister) had an advisory contract with Alstom, which was suspected of having bribed him.

OLAF-inspected contracts related to subway construction are classified into the following four categories.

First, construction of electrical equipment such as subway power supply equipment (a contract signed by Siemens).

Second, underground excavation work and related work (a contract related to BANCO, Strabag consortium).

Third, selection of subway cars (contracts tied to Alstom).

Fourth, construction of ten station buildings.

The Siemens Group undertook the power supply-related electrical work, the Strabag Group received the underground excavation work, and the French Alstom received the order for the subway train. The station building work was assigned to the companies participating in the bid.

The OLAF summary reports:

“In January 2012 the Court of Auditors notified OLAF about its serious concerns in relation to the implementation of Project Budapest Metro No. 4 (KOZOP-5.1.0-07-2008-2001), which was the most expensive EU funded project in Hungary for the period 2007–2013. Later the Directorate General for Regional and Urban Policy of the European Commission also informed OLAF about serious irregularities established within this project and which had already resulted in the exclusion of 11 contracts from the EU financing. The beneficiary of the project was the Municipality of Budapest.

The total final cost of the project as declared was 452,554,224,000 HUF (approximately 1,747,313,606 EUR), of which the Cohesion Fund amounted to 696,490,000 EUR. Two EIB loans totaling 530,500,000 Euro also contributed to the project financing.

⁹ This survey was conducted in 2012 and could not be viewed until the Hungarian government was notified in 2016. The document number of the 104-page survey Final Report is OF/2012/0118/B.

The body that was responsible for the project implementation was the BKV Zrt. (Budapest Transportation Corporation Plc.), more precisely the DBR Metro Projects Directorate in the BKV Zrt. The BKV Zrt. is 100 % owned by the city of Budapest.

During its investigation OLAF has established that serious management irregularities and errors affected the project. Some of these matters are very serious, such as conflict of interests, breach of the principles of non-discrimination and equal treatment of bidders and some may be regarded as fraud.

The total financial amount of the contracts affected by the different types of irregularities is EUR 1,053,372,541 (HUF 272,823,488,215). The total estimated financial impact of the irregularities established is EUR 644,780,920 (HUF 166,942,383,356) (calculated by recovery rate recommended by Commission Decision taken into account each type of irregularity).

Out of the total estimated irregular amount of EUR 644,780,920 established, following the different audits and irregularity procedures, the Hungarian State already agreed to exclude from EU financing more than EUR 230 million and also exclude another EUR 92 million of irregular complementary financing (Hungarian State + Municipality of Budapest). From the EU budget perspective the estimated financial impact on the EU co-financed "KÖZOP Operative Program" is EUR 295,950,247 (HUF 76,651,114,014). From this OLAF concludes that the financial impact on the Cohesion Fund is EUR 227,881,690 (HUF 59,021,357,791).

OLAF has also found that the European Investment Bank (EIB) loans, namely the EIB loan to the State of Hungary (EUR 472,000,000) and the EIB loan to the Municipality of Budapest (EUR 58,500,000), were also found to be affected by irregularities.

Finally, it should also be noted that OLAF has made findings of a judicial nature which are also described in this report.¹⁰

The report from OLAF was communicated to the Hungarian government, which had to instruct the prosecutor's office to investigate the problem identified. However, as a practical matter, given the limits on the prerogatives of the Hungarian prosecution, it is almost impossible to conduct a forensic investigation of a problem if the parties object or refuse to take part. In fact, the Siemens Group's contract for power construction ended without any cases.

There was a clear problem in the bidding (final bid) for excavation and related works announced on December 22, 2004. This work was the centerpiece of the subway construction project, with the Strabag Group-centered consortium (BANCO) overtaking the Obayashi Consortium, which offered the lowest price, and the Zosw Metro 4, which offered the second lowest price. OLAF report addressed this issue and found that the removal of Obayashi for unclear reasons was a discriminatory act that violated bidders' equality.

¹⁰ OLAF, *Final Report*, OF/2012/0118/B, 3.

At that time, I had a friendly relationship with a representative of Obayashi,¹¹ and I asked one of the Socialist Party's parliament members to confirm how much Prime Minister Gyurcsány knew about the matter. The prime minister's response was, "I tried to find out, but the ordering company group was decided from the beginning, and there is no way to intervene in this problem when the contractor has already been designated." Not only could he not intervene after the nomination, but he understood that it would be impossible to make any changes to the decisions because the financial interests of the parties involved in the construction of subway line 4 had already been determined by members of the Budapest Socialist Party.

The drilling contract was signed in January 2006, but BANCO's drilling work was delayed by 126 weeks. Of these, 35 weeks are said to be the responsibility of the construction company. Delays in excavation work led to significant delays in the opening date of the subway, leading to long legal disputes between BANCO and the Budapest Subway Project Management Committee.

Alstom SA signed an advisory contract with a private management company of the former socialist prime minister, Péter Medgyessy, apparently for bribery funds for lobbying activities. Medgyessy served as finance minister in the socialist era, and after the system transformation, he worked as chairman of Paribas Bank Rt., Budapest, which is subsidiary of BNP Paribas in France (from 1996 to chairman). Related to the subway line 4, Alstom signed a contract (2002–2007) with Medgyessy Consulting Kft, revealing that it paid around €600,000 in 2007 and 2008.

Medgyessy served as prime minister from 2002 to 2004, and after his resignation as prime minister he received the title "mobile ambassador" from the Gyurcsány government (until 2008). He was also a member of the Parliament from 2004 to 2006. Knowing that the OLAF report was prepared, fearing that conflicts of interest would be a problem, Medgyessy changed the company name and replaced the company representative, but the owner of the company remained the same.

OLAF has asked the Hungarian and British governments to investigate Alstom's alleged bribery, and when the report was handed over, it was described as a criminal

¹¹ The OLAF report mentions Taisei Corporation as Japanese constructor, but this is a mistake by Obayashi Corporation. Taisei did not participate in the subway construction in Budapest, only Obayashi from Japan participated in the bid. The bids of the five groups that participated in the final bidding were in descending order: Obayashi Group HUF 41.3 billion, Zosw Metro 4 Group HUF 45.9 billion, BAMCO Consortium HUF 51.8 billion, BPV Metro 4 Group HUF 62.9 billion, Hohcstiev-Bouygues Consortium HUF 71.3 billion. The reason for removing the Obayashi group from the tender examination was that "a local subcontracting joint venture is also a joint venture of another consortium that participated in the primary bid violates the bidding rules."

The Budapest Subway Project Management Committee entrusted the Obayashi Consortium with the construction of three subway station buildings in order to control Obayashi's dissatisfaction and prevent things from growing.

case.¹² The request that Medgyessy received from Alstom would be “try to convince the leading members of the Socialist Party to place orders”. It is not a job that requires actual research like a design office, but an intermediating job. It is obviously bribery, not the kind of work a high-ranking official would receive. In a hearing interview with the OLAF and the Hungarian prosecutor, Medgyessy said that he was not in the position of prime minister at that time and was not able to exercise authority.

4.4.3 Misconduct in the EU Subsidy Business (2) – Subsidy Fraud by ELIOS

On January 12, 2018, anti-government media in Hungary simultaneously reported that the Wall Street Journal made public the existence of an OLAF report of irregularities in a company involving Prime Minister Orbán’s son-in-law.¹³ In response to a complaint from LMP, a Hungarian political party, OLAF investigated over 35 biddings in a public road lighting installation project (a project that enjoyed EU subsidies) executed in Hungary from 2011 to 2015 over a two-year period. In October 2017, the OLAF report was sent to the Hungarian government. It sought an investigation and legal action in Hungary.

The OLAF report, which is a recommendation to the government, is not a public document, and disclosure/non-disclosure is based on the judgment of the relevant government.¹⁴ The OLAF report on subway line 4 was released because Fidesz, which took power, sought to expose the “bad acts” committed under the Socialist Party’s government. However, the Fidesz government decided not to disclose the OLAF report regarding the lighting installation business on public roads. This is because it is a project of the company ELIOS owned by István Tiborcz, the son-in-law (the eldest son-in-law) of Prime Minister Orbán.

This project, which was covered by EU subsidies, is a project that converts streetlights in local cities into energy-saving LEDs and has relatively low barriers to entry for bidding. That became the spotlight. To enter the tender of the project did not require specialized knowledge or work experience, and it was the most suitable business as an initial enterprise that helped the bridegroom of Prime Minister Orbán become a businessman and make money.

In Hungary, which has been in the process of transition to a market economy for more than twenty years since the system began change, a subsidized project is the fastest way to succeed in growing businesses. With the support of political power, anyone can “create something from nothing”. If you create a company that will serve as a sub-

¹² Normally, in the case of advisory contracts and consulting contracts, the actual work is small, and even that is often outsourced. Roughly speaking, the money obtained is divided into 20 % for subcontracting, 30 % for company personnel expenses, 10% for intermediary rewards (rebates), and 30-40 % for pure profit.

¹³ “EU Fraud Office Finds Irregularities in Projects Linked to Hungarian Leader’s Son-in-Law”, updated January 12, 2018 11:11 am ET.

¹⁴ Anti-government Internet portal sites obtained the OLAF documents and wrote articles based on them, but the document itself was not disclosed because of confidentiality of the source through which the information was acquired.

sidy recipient and have a mechanism that allows subsidies to flow in, you can start a business without own funds and become a market economy player.

István Tiborcz established a company with his friends when he was a student and aimed to be an entrepreneur. He did not develop any new technology or product, and the company was used as a recipient of public works. A necessary and sufficient condition for obtaining public works is the support of politicians. Becoming the son-in-law of Prime Minister Orbán, Tiborcz had no problem getting full political support.

It was János Lázár, mayor of Hódmezővásárhely, appointed as the chief cabinet secretary of the Third Orbán Administration (in Hungary, a local city mayor can also be a member of parliament or a minister), who helped Tiborcz's company ELIOS obtain the public order. In 2010, before the start of the EU subsidy business, to thank Prime Minister Orbán for having appointed him to the position, Lázár helped Tiborcz's company get a business history. The city of Hódmezővásárhely called the bid for the LED lightning project for the city at the cost of HUF 721,000,000, and in the end, ELIOS succeeded in receiving the bid, as the scenario had already been determined.

However, there was a source of trouble. Tungsram-Schröder Ltd., which has a long history and experience in the lighting field, also participated in the bidding for this project. According to the original scenario, the city of Hódmezővásárhely eliminated the Tungsram-Schröder bid despite the fact that Tungsram-Schröder had ample experience, and chose ELIOS, which had no business background. In response, Tungsram-Schröder protested to the result and presented a complaint to the government's public order decision committee. The decision could not be overturned, but behind-the-scenes discussions progressed. As a result of secret negotiation, the Tungsram-Schröder Ltd. became a sub-contractor of ELIOS, and the issue was dealt with in a manner that was entirely reasonable. This was a typically Hungarian way to settle the problem.

Thus, ELIOS gained a history of streetlight lighting construction and entered the streetlight lighting business of local cities, which started bidding in the following years, one after another, and successfully won the LED conversion business with EU subsidies in 35 municipalities. However, OLAF found that each bid¹⁵ was fraudulent or deceptive. The ELIOS business, which started from scratch in 2010, was undertaken in 46 municipalities nationwide in 2016. This is a typical case of starting a business from subsidies.

Another element helping ELIOS's entry to the business world was implemented in the bid. It was a change in bid conditions. On December 12, 2012, details of the subsidy for the conversion of streetlights in municipalities were announced by the government department in charge, and the start date of the application for subsidies was set on February 11, 2013. However, three days before the reception started, one notice of a change in the tender conditions was suddenly announced by the department in charge of the government to the municipalities. The durability of the LED bulb was changed from 50,000 hours to 100,000 hours. The sudden bid change not only creates a bid barrier that keeps potential bidders out, but also increases the amount of LED bulbs which

¹⁵ OLAF has sent questionnaires to all the local governments that conducted the bidding business that was the subject of the survey, and the local governments were requested to report the details of the bidding.

must be delivered. As the endurance time increases, the amount of power saved will increase, and this will also serve as the object of energy saving (maximizing the return on the investment in LED lighting).

However, in reality, the Tungsram-Schröder Ltd., which delivers LED bulbs as a sub-contractor of ELIOS, states in the brochure that the bulb life is 60,000-80,000 hours, which means that nobody could meet the bid conditions with this modification. Therefore, it was approved that each municipality would finally conclude a 25-year maintenance contract with the supplier to complement this condition. This also increased the contractor's business.

Due to the sudden changes in the conditions and the need for LED streetlight installation experience, the actual number of bidders was limited. However, it was not desirable for there to be only one bidder, ELIOS, so dummy bidders were created. For example, in the bid for the city of Vac, in addition to ELIOS Ltd., SMHV Ltd., KVIKSZ Ltd. and Polar-Studio Ltd. also participated in the tender, but as OLAF pointed out, all the three bidding documents were created by one person with the same PC. The second and third bids were created to be precisely 5 % and 7 % higher than the ELIOS bids, respectively. OLAF also pointed out that all 35 orders received by ELIOS, except for one in the city of Balatonfüred, were put up against the dummy companies bids, which were 5 % and 7 % higher every time. Clearly this was a case of fraud based on fraudulent bidding.

In addition, Sistrade Ltd., an advisory company for the municipality of the LED lighting business, prepared a document of the bid announcement. The owner of this company, Endre Hamar, is an alumni of Tiborcz and also co-owner of ELIOS Ltd. Also, OLAF reported that Ivette Mancz created the EXCEL table used by Sistrade Ltd. to calculate the investment return (return rate) required for the bid announcement. Mancz is responsible for this business at ELIOS Ltd. It is also reported that Ivette Mancz also created the appendix to the Tender Notice for the city of Vác, and the actual creators of the documents of INS Ltd., which performed the final audit of the city of Kalocsa, were also Ivette Mancz and András Puskás of Sistrade Ltd. OLAF asserts that such conflicts of interest were openly held in this project.

In short, from the creation of bid documents to the creation of audit documents of each local government, ELIOS Ltd. actually did everything. This is not simply a case of conflict of interest. It is a case of criminal subsidy fraud. OLAF proposed that the business received by ELIOS would constitute a crime and the EU would require a full refund of EU subsidies.

OLAF asked the Hungarian government to investigate the case as a criminal case, saying that there had been an illegal acquisition of subsidies received by ELIOS Ltd. Actually, in 2015, the Hungarian opposition LMP accused ELIOS Ltd. of the case, and the case was supposed to be investigated, but the investigation was terminated early because it allegedly found no evidence of injustice. This is why LMP filed a complaint with OLAF.

The Hungarian prosecutor's office, which started the investigation again based on the OLAF accusation, concluded that the ELIOS subsidy showed no evidence of improper conduct in early November 2018, and the investigation was terminated. From

the beginning of the investigation, neither the police nor the prosecutor were motivated to investigate the case thoroughly. The minister of internal affairs, the commissioner of the National Police Agency and the commissioner of the Public Prosecutors are all in their positions because they have the personal support of Prime Minister Orbán. So the result was clear from the beginning.

On the basis of this result, OLAF issued the following statement: “We proposed to the EU Commission to return the subsidy and sent the final report to the Hungarian prosecutor’s office, including the evidence of the crime. The EU Commission will discuss this measure in the future. It will happen”.¹⁶ That amount concerned is €43.7 million. This case was left to consultation between the EU Commission and the Hungarian government.

Most Hungarians do not know about the ELIOS scandal, because Hungarian public broadcasters did not report on the issue. Fidesz’s strategy involves keeping both the judiciary and the media under its control, so this kind of scandal will only come from media that does not have government advertising money. After the OLAF report was issued, Fidesz’s parliamentary delegation prepared a set of expected questions and answers for the media. However, some lawmakers disagreed, and it was reported that an agreement was reached that the lawmakers would not speak out on this issue.

The ELIOS Ltd. recorded sales of HUF 14,384,400 in the EU subsidy business between 2010 and 2016, 84 % of which was subsidies obtained from the EU. The owner of ELIOS Ltd., István Tiborcz,¹⁷ sold his ownership of ELIOS in 2015 to escape from the scandal and prepare for another business.

It is unclear what kind of business István Tiborcz has been engaged in following the sale of the ELIOS. Since the matter became public, the movement of the Orbán family has become less visible.¹⁸ The only news that came out was that the couple attended a

¹⁶ <https://hu.euronews.com/2018/11/08/az-olaf-is-reagalt-az-ELIOSt-erinto-nyomozas-beszuntetesere>.

¹⁷ According to the Hungarian list of billionaires (*A 100 leggazdagabb 2019* [Perche Kft., 2019]), István Tiborcz is ranked in 35th of the list. When he made the acquaintance of Orbán’s eldest daughter, Tiborcz’s business sales as a real estate agent amounted to only HUF 9 million in 2009. He quickly became a millionaire with subsidies and public works orders.

¹⁸ The wedding of Sára Orbán, the second daughter of Prime Minister Orbán, was held at a church in Budapest at the end of August 2017. The bride was 23 years old and the groom was 29. After the ceremony, they moved to Alcsútdoboz (the hometown of Orbán and Orbán’s ally Lőrinc Mészáros, who became a billionaire by getting government orders) and organized a banquet at the Puskás Hotel owned by Mészáros. The reception was held with hundreds of close associates. The series of ceremonies and receptions was held with the exclusion of the media, and the honeymoon to Japan thereafter was also prepared in secrecy. Since the ELIOS incident, the Orbáns have become more sensitive to revelations of family movement in anti-government media. The honeymoon in Japan was arranged by the Hungarian embassy in Tokyo, but the information was not leaked even inside the embassy. Still, information is leaking. According to an acquaintance of mine who was requested to reserve a hotel and a Japanese traditional restaurant in Kyoto, the couple stayed at a Four Seasons hotel in Kyoto and held a banquet inviting Geisha at the oldest restaurant in Kyoto. The groom pulled out a wad of cash from his pocket

business school in Switzerland, and the tuition fee was HUF 15 million. Tiborcz's wife, Ráhel Orbán, argued that "the school fees were not paid by the fathers, but by themselves", when Ráhel's old friends at university complained that the source of the money was the same public funds that had been obtained from the EU subsidy.

Money and power (social privileges) change people. It does not matter whether they consider themselves part of the right or the left, whether they are old or young. In Hungarian society there is no sense that money acquired by using power is "dirty". No one feels ashamed to have received public funds for making illegal bids. In Hungarian society, the social norm that illegal bidding, rigging and bribery constitute criminal acts has not yet been established.

In late 2017, a similar incident was reported in the Czech Republic. The case of the son and daughter of Czech Prime Minister Andrej Babiš began to be widely reported. It was alleged that an EU grant of €17.4 million was illegally acquired for the construction of the new Czech resort Storks Nest Farm. Babiš was accused of obtaining subsidies by concealing that his son, daughter and ex-wife were owners of Storks Nest. OLAF sent a report on this matter to the Czech government on December 27, 2017. Based on the investigation by the Czech prosecutor's office, it seems that it has confirmed the illegal acquisition of subsidies.

One year after that, in November 2018, the prime minister's son (Andrej Babiš Junior) said during a TV interview that he was kidnapped and imprisoned by Russia and Ukraine when he tried to give evidence of his father's corruption. Prime Minister Babiš said, "My son suffers from a mental illness", and he contended that his son had lied to the media. There was also a street demonstration against the prime minister.

At least unlike Hungary, where the prosecution and public broadcasting cover the case, in the case of the Czech Republic the fraud and corruption of the prime minister's family was brought to light and met with social criticism. In June 2019, a large-scale demonstration calling for the resignation of Babiš buried Prague.¹⁹ There was no such protest in Budapest under the Fidesz government. The social reaction to crimes by people in power is very different in Hungary and the Czech Republic.

and generously distributed chips to the Geisha. My acquaintance asked: "I wonder if there are so many rich people in Hungary?" I replied that "Most of the rich people in Hungary make money from public subsidies. One cannot waste money if he earned it by his own sweat." A wad of Japanese Yen was probably a present (celebration) from Mészáros. It is no wonder because Mészáros became one of the shareholders of MKB Bank Rt., the only commercial bank that handles Japanese Yen accounts in Hungary.

The groom, Tamás Szokira, is only an official in Hungary of a public organization and comes from the rural town of Nyíregyháza near the Ukrainian border, and his father is a minister in the Eastern Catholic Church. Unlike the older couple, it was said that the second couple lived a modest life because Tamás was from a solid family, but this was not true. Money and power seem to overcome all other influences.

¹⁹ Over 100,000 demonstrators filled the center of Prague, and large-scale demonstrations took place since the system transformation began. On June 27, 2019, the Czech Parliament rejected Babiš's non-confidence proposal. The political party ANO, led by Prime Minister Babiš, has the support of 30 % of the voters, and Babiš has consistently refused to resign.

However, it is surprising that in the advanced countries undergoing system transformation, for instance the Czech Republic and Hungary, even after thirty years of the system change, there have been open acts of misconduct using this kind of power. The situation of the countries to the southeast of the Czech Republic and Hungary cannot be better than that of the Czech Republic and Hungary. Corruption in Bulgaria and Romania are more serious.

OLAF's annual report contains a list of unauthorized uses of EU subsidies (Table 4.12.). The large number of recommendations by OLAF concerning Hungary and Slovakia may be due to the oversight of their domestic politics. In countries where the ruling and opposition parties are in conflict, the ability to monitor the illegal receipt of subsidies is likely to increase, because the complaints reported from the country concerned are the starting point of OLAF's investigations and recommendations.

As a result of the ELIOS's misconduct, the Hungarian government has reportedly decided not to apply for EU subsidies for this subsidy project. This is because it is not advantageous for the ruling party to prolong the problem. No matter what it is, in the end, Hungarian tax revenue is used to fund the prime minister's son-in-law's successful startup.

As noted above, Hungarian voters are silent on these injustices because public broadcasting does not report on them. See Chapter 6 (6.5 Fidesz Media Reconstruction and Public Opinion Manipulation) for more on this point.

4.4.4 The Fraudulent Sale of State Assets Abroad

In 2008, almost twenty years after the transformation, incredible news was reported. An opaque transaction was made in the sale of a trade representative building owned by Hungarian government in Moscow.

The real estate of the Hungarian Trade Representative (building area: 1,700 m²), located in Moscow's government area, was sold to an offshore company in Luxembourg for \$233.3 million, and a month later, the company further sold the building at 4.6 times as much as \$108.7 million to the Russian government. It was said that this selling price was commensurate with the real estate valuation in Moscow at that time.

The news was first broadcast from Moscow on Interfax, and it was reported by the Hungarian media. The topic in Moscow was because the company in Luxembourg, Diamond Air, was owned by Viktor Vekselberg, a Russian oligarch. Why did the Hungarian government sell the real estate at a price far below the valuation? Why was it necessary to use an offshore company? And who was involved in this sale? It was reported that the Russian prosecutor's office began to investigate the transaction.

The sale of diplomatic real estate in the center of Moscow is impossible without the permission of the Russian government. In fact, as the Hungarian ambassador to Russia, Árpád Székely, who was the negotiator, repeatedly said that the sale was brought in by the Russian side. What's more, it was in 2005, not 2008, that a contract was already created, when the Hungarian ambassador Székely signed the contract, and a deposit of \$2 million was paid and transferred to the Hungarian Treasury account. Of course, it is not a matter that an ambassador can decide on his own. However, it is very strange

Table 4.12. Member State/ OLAF detection of irregularities and their financial impact in the areas of European Structural and Investment Funds and agriculture for the period 2013–2017

	Member States		OLAF	
	Detected fraudulent and non-fraudulent irregularities(N)	Financial impact as % of payments	Investigations closed with recommendations(N)	Financial recommendations as % of payments
Austria	371	0.30 %	2	0.02 %
Belgium	387	0.48 %	1	0.02 %
Bulgaria	904	1.67 %	43	0.54 %
Croatia	86	0.56 %	1	0.00 %
Cyprus	104	0.89 %	0	0.00 %
Czech Rep.	3,48	3.40 %	7	0.08 %
Denmark	205	0.30 %	0	0.00 %
Estonia	414	1.54 %	0	0.00 %
Finland	139	0.08 %	0	0.00 %
France	1,24	0.28 %	8	0.01 %
Germany	1,771	0.33 %	7	0.40 %
Greece	2,251	2.76 %	14	0.30 %
Hungary	2,808	1.20 %	49	3.92 %
Ireland	1,432	2.41 %	0	0.00 %
Italy	4,101	1.27 %	20	0.31 %
Latvia	611	2.89 %	1	0.00 %
Lithuania	1,109	2.21 %	3	0.06 %
Luxemburg	2	0.09 %	0	0.00 %
Malta	117	2.42 %	1	0.43 %
Netherland	813	1.74 %	4	0.04 %
Poland	5,461	1.74 %	21	0.09 %
Portugal	2,422	1.49 %	9	0.36 %
Romania	5,759	3.21 %	107	0.52 %
Slovakia	1,672	11.39 %	16	2.09 %
Slovenia	297	1.92 %	1	0.12 %
Spain	11,161	3.13 %	5	0.40 %
Sweden	224	0.21 %	0	0.00 %
United Kingdom	3,062	0.75 %	5	0.04 %
Total	42,403	1.83 %	325	0.43 %

Source: OLAF, *OLAF Report 2017*, European Union 2018, 41.

that, except Ambassador Székely, no executives of the Hungarian Ministry of Foreign Affairs knew about the transaction. Obviously, it should be considered that there were direct instructions from then Prime Minister Ferenc Gyurcsány and Minister of Finance János Veres.

Therefore, there was nobody other than the people involved who knew about this case, and the Hungarian government (treasury department) denied the fact of remittance of \$2 million. Therefore, the media reported the affair as a \$2 million fraud case.

However, in addition to being a case of financial fraud, the sale itself was an illegal sale of state assets led by Russian and Hungarian politicians.

In 2005, the year before the Hungarian general election, the real estate sales contract was put on hold without the approval of the Hungarian cabinet because it would be a hassle if this kind of scandal were to come to light. Even after the general election, street protests took place in various scandals around the Socialist Party, and there was no environment to handle this case. At the end of the uproar, the Russian side urged Hungary to fulfill the contract. Therefore, the sales contract was signed again with the Russian side (Diamond Air) as of March 15, 2008. The Hungarian signatory was again Ambassador Székely. The contract was the same as it had been in 2005, with the price set at \$23.3 million, less the \$2 million down payment.

However, at the time, secretary of state of the Ministry for Foreign Affairs Márta Fekszí insisted that the contract was invalid, because Ambassador Székely did not have received the delegation of the government representative to sign the contract, but he also had not gone through the procedure for selling public assets. Thus, there was confusion inside the government. Therefore, the approval procedure of the Ministerial Meeting was to be carried out later. It is said that the government paid special attention to Márta Fekszí, because she was said to be a secret intelligence member in the former regime era. In fact, on the old secret police list – <http://www.szigoruantitkos.hu> – exposed online, Fekszí is registered as a top-secret intelligence member of the Ministry of Interior with the codename D-249/, which meant she was part of the International Espionage Agency. She is said to be the woman in K-583.

It was necessary to set up formal requirements to clear up this case. To that end, a ministerial resolution was prepared. This is the resolution of the extraordinary ministerial meeting of mobile ministers (June 11–12, 2008) held in the town of Dobogókő. However, many ministers did not remember this resolution at this extraordinary meeting, where many agenda items were proposed. The resolution proposed at this meeting was: “Moving Moscow Real Estate from the state assets list is a prescribed policy, and the Minister for Foreign Affairs, in cooperation with the Minister of Finance, prepares necessary documents stipulated in the 2007 law on the state assets”, and it was not an important matter for the ministers who did not know the core of the problem.

On the basis of the resolution of the ministerial council, Miklós Tátrai, the CEO of the National Asset Management Corporation, flew to Moscow and announced a bid on July 30, 2008. This was a formal procedure which involved only three companies, including two dummy companies applying for the same bid and the same buyer, Diamond Air, making a successful bid. In this way, the third contract was supposed to be exchanged on November 5, 2008, but in a later investigation by the prosecutor’s office, a contract dated December 2008 was also discovered in the house of Ambassador Székely. So, the actual contract date is uncertain, but the signing date is not an essential issue, because it is the third contract made as part of the alibi.

Márta Fekszí became Hungarian ambassador to the UN before this matter had been settled. It was a reward for accepting the soft measures of government leaders. However, she was ordered to return to Hungary due to a change of government in 2010, and

was arrested on suspicion of breach of trust, along with former Ambassador Székely and Tátrai, former CEO of the National Asset Management Corporation.

As a sequel to the event, the clerk of the National Asset Management Corporation, who was in charge of processing this case, thought that the transfer of ownership would not be registered until the payment of the sale was completed. However, in January 2009, shortly after the contract was signed in November 2008, the real estate was re-registered as a property owned by the Russian Regional Development Agency. Diamond Air had already resold the real estate to the Russian government. Some Hungarian government leaders already understood the deal, but it was a complete surprise for the office staffs.

Was the sale price not paid? No, it was remitted long ago. The deposit of \$2 million had been transferred more than three years earlier under the first contract in 2005, and the balance of \$21.3 million was transferred under the second contract of March 2008. People involved on the Russian side and the Hungarian side were aware of this. However, since there is no supporting document in the treasury account, these two remittances were only reserved as unprocessed money.

What a rough deal! In Russia, if a politician agreed, a contract can be created later, but in a normal democratic country, this is not possible.

In November 2009, the prosecution and investigation of this case began, and in parallel it was discussed at the Foreign Relations Committee in the parliament, but at that time it was discussed as a fraud case with a deposit of \$2,000,000. What's more, the government had responded to questions concerning the whereabouts of the the money with the line "do not know, does not exist". However, the issue involves more than a \$2,000,000 down payment. It is a scheme in which Russian and Hungarian politicians got huge amounts of money by selling off national assets. However, such an international case of fraud is unlikely to be filed, particularly if Russian politicians are involved.

In May 2013, seven people were again arrested as a result of the investigation that began in 2009; Székely, former ambassador to Russia, Márta Feksz, former vice-minister, Ministry for Foreign Affairs, Miklós Tátrai, former CEO of the National Asset Management Corporation, and three officials from the relevant departments of the National Asset Management Company. No politicians were included. The allegations were forgery of official documents, delinquency that caused damage to national assets and acts that compliment it.

The first trial started in 2014 and concluded in 2015. The seven defendants were acquitted. The second trial of the prosecution's appeal ended in March 2017, supporting the first judgment, and all defendants were acquitted.

Again, the people accused of having committed international economic crimes during the period of system transformation were acquitted without punishment. In cases in which an international investigation is required, the prosecution cannot gather enough evidence to file a case. If the stage were Russia, it would have been impossible for the prosecution to win from the outset. It might be possible to gather enough evidence to prosecute domestic politicians. However, the prosecutor did not have enough

competence to investigate the case. Most of the economic crimes in the process of system transformation have been overlooked.

The following belongs to the sequel concerning the case. After resigning from his post as ambassador, Székely got the manager post of the Russian office of the TriGránit, the largest real estate company in Hungary. The TriGránit is a Hungarian conglomerate led by Sándor Demján. It is a politically commercial company that develops business while maintaining good relations with the leaders of the Socialist Party and Fidesz. Székely was guaranteed to have a life of wealth even if he were arrested and prosecuted.

4.4.5 Delinquency Using the State Bureaucracy: the Golden Visa

In January 2013, the Hungarian government began selling the state bond with settlement (immigration rights to foreigners). This was invented by Antal Rogán, chairman of the Hungarian Parliament of the Economic and Information Committee (Gazdasági és Informatikai Bizottság) at the time. Rogán is a person reported in the media to be involved in various bribery allegations and cases of subsidy fraud, despite having been given important posts by the Orbán government and the Fidesz parliamentary group.²⁰

The state bond with the right to settle is a scheme that was approved by the parliament without much discussion because it was said to be a cheap way to raise funds. After an influx of large numbers of refugees and migrants to Europe in the summer of 2015, however, the Hungarian government took a strict attitude toward refugees and migrants, but that attitude and the recommendation to accept some immigrants as part of the state bond program became contradictory.

In the autumn of 2016, the Hungarian government held a referendum (October 2, 2016) calling for “the pros and cons of the EU’s mandatory allocation of immigrants” in order to show Hungary’s attitude to the outside world. It was a government intention that after the referendum the government proposed to implement amendment of the basic law (a constitutional amendment). Although the referendum itself lost all political relevance and substance because of low voter turnout, with a turnout rate of less than 50 %, the government proclaimed that 98 % of the votes (3.36 million votes) chose “No” and praised the referendum as a success.

Following the referendum, the government called for a parliamentary resolution (with requires a two-thirds vote for approval) to amend the basic law (the Consti-

²⁰ On June 3, 2019, the Hungarian Supreme Court rejected Rogán’s accusation to appeal that “during a general election campaign in 2014 the Budapest City member Péter Juhász belonging to the political party Együtt denounced the mayor of Budapest’s District V, Antal Rogán as criminal person who has a connection with the mafia. It is a violation of human rights of Rogán to blame him as a criminal”. Rogán strongly denied that he was in a business relationship with Tamás Portik, who is involved in various crimes. The trials of the first and second trial rejected Rogán’s action because “the personal rights of politicians may be limited in order to uphold the social norm of free opinion”. The Supreme Court upheld the lower court’s ruling.

tution), which states that “the EU has no compulsory power in problem areas that infringe on Hungary’s sovereignty.” In response, the opposition party Jobbik (Movement for a Better Hungary) stated that “whether rich or poor, we should not accept immigrants. Therefore, Jobbik only agrees with the government’s resolution in the case of abolition of the state bond with the right to settle.” Thus, the existence of the state bond with the right to settle came into the limelight. To the demand of the Jobbik Prime Minister Orbán did not give a clear answer, but in March 2017, the sale of the state bond with the right to settle was suspended. The Orbán government has received various criticisms concerning the sale of the bond, and therefore it was a good time to close this scheme by taking advantage of criticism from Jobbik.

The reason why this scheme has received a lot of criticism from inside and outside is that it is an infinitely opaque business. Foreigners who are willing to purchase the state bond cannot purchase it directly from the Hungarian government, but only through an intermediary company designated by the government. The intermediary companies were supposed to be licensed and monitored by the Economic and Information Committee, but the eight intermediary companies proposed to the committee are all established in tax havens, and their owners are in fact unknown. Although it is clear that politicians and officials of the ruling party are involved in this intermediary business, the owner information of the intermediary company and the details of the business are classified as state secrets, and the government has refused to provide any information.

G7.hu, an anti-government website, sued the ÁKK (Államadósság Kezelő Központ Zrt., Government Debt Management Agency) in April 2016 with the support of Transparency International to disclose information regarding the sale of the state bond with the right to settle. In the first and second trials, ÁKK lost the suit, and even the Supreme Court decided that information should be disclosed as a matter of the public interest, and finally certain information was disclosed. Subsequently, G7.hu published an anti-

Table 4.13. Intermediary companies of the state bond with immigration right

	Name of intermediary companies	Registered place	Sale target area
1	Arton Capital Hungary	Hungary	Middle East, North Africa, UK, Switzerland, USA, etc.
2	Hungary State Special Debt Fund	Cayman Islands	China
3	Innozone	Cyprus	Cyprus, India
4	Migrat Immigration Asia Ltd.	Cyprus	Malaysia, Mongolia, Korea
5	VolDan Investment Ltd.	Liechtenstein	Russia, CIS, South-East Europe, South Africa
6	S&Z Porogram Ltd.	Liechtenstein	Middle East, North Africa, UK, Switzerland
7	Discus holdings Ltd.	Malta	South Africa, Kenya, Nigeria
8	EURO-ASIA Investment Pte Ltd.	Singapore	Singapore

Source: <https://www.parlament.hu/web/gazdasagi-bizottsag/informacio-a-letelepedesi-magyar-allamkotvenyrol>, *A letelepedési államkötvények szerepe a magyar állam finanszírozásában* (https://transparency.hu/wp-content/uploads/2018/10/lmak_tanulmany_final_HUN).

Note: Arton Capital Hungary is formally registered in Hungary. The actual transactions were done through off-shore companies.

cle signed by Tamás Wiedemann dated December 21, 2018, disclosing important data which I give in the following which contains my suppositions, too.

First, the total number of foreigners who actually purchased bonds was 6,543, and a little less than 20,000 people, including their families (13,312), received the Hungarian settlement permit (the so-called Golden Visa).

Second, when the scheme was introduced in 2013, the amount of the bond purchase required was €250,000, and an annual interest rate of 2.5 % was attached with five year redemption period. The required purchase amount was raised to €300,000 in January 2015. Buyers could purchase the bond only through an intermediary company. The companies freely set the settlement fees from buyers, which varied from company to company and were said to have ranged from \$30,000 to \$50,000. In other words, the brokerage fee was much higher than the government bond interest rate. Therefore, the bond buyers did not rely on interest at all, and many were unconcerned about whether or not they got interest.

Third, there are 332 gaps between the number of the bonds sold by the National Debt Management Center of 6,543 and the number of requests for settlement to the Immigration and Refugee Administration Bureau of 6,211. Although the government has not explained this discrepancy, it is highly probable that the intermediary bought the bond with its own money, which was obtained as an intermediary fee, in order to manage the funds. The yield on government bonds was 2.5 %, which was considerably higher than ordinary bank rates and equivalent Euro bonds. It is my guess that the surplus funds obtained from the brokerage fees were used to buy bonds. The bond interest was paid to the intermediary company, and it is unclear whether it was really paid to the bond buyers.

Fourth, except for one of the eight authorized intermediaries, all of them were registered in tax haven countries, and the actual situation of the company is unknown. The company registered in Hungary also conducted transactions through a company in the tax haven, and the situation reported in Hungary might differ from the actual operation. Although the name of the representative of the intermediary company was included in the documents submitted to the Economic and Information Committee, the information of the actual company owner has not been disclosed even after the court judgment.

Fifth, of the eight companies, the company named Hungary State Special Debt Fund for China was a company registered in the Cayman Islands, and the representatives were Lian Wang and Attila Boros, but they might be dummy companies. This company founded a subsidiary in Hong Kong to monopolize the sale of the bonds to China, received a commission of HUF 74.5 billion, accounting for 73.25 % of the total commission obtained by all eight companies. The total interest received by the company was HUF 47.6 billion, accounting for 78.42 % of the total interest paid to all eight companies.

Sixth, the Hungary State Special Debt Fund established for China was registered in the Cayman Islands on January 15, 2013, one month before the Ministry of Finance announced detailed information on the establishment of an intermediary company. A subsidiary of the company in Hong Kong was registered on December 4, 2012. This

is three weeks before the government program went into effect, and one week before the Parliament approved the program's legal restrictions. Apparently, it is speculated that a person closely related to the government or politician performed the company registration and brokerage work.

Seventh, the yield of the Eurobond with a maturity of five years in 2013 when this scheme was first introduced exceeded 4 %, and the interest rate of 2.5 % on the state bond with the right to settle was indeed a case of favorable financing for the Hungarian government. That was the only advantage in support of the introduction of this opaque scheme. However, one year later, in early 2014, the interest rate on 5-year maturity of Eurobonds fell below 2.5 %, from which it continued to fall to below 0.5 % in 2016. Along with that, the interest rate on the secondary interest rate of the bonds with the right to settle fell to around 2 %. As a result, the state bond with the right to settle became much more expensive for Hungary than to raise in the ordinary market, and the tax revenues of Hungarian citizens were wasted accordingly.

These facts were revealed at the end of 2018. The state budget wasted through this scheme leaked abroad in the interest of the shadow owners of the intermediary companies. The program was invented and promoted by the current chief cabinet secretary, Antal Rogán. It is said that Rogán's companion and a private adviser to the prime minister, Árpád Habony, were behind the intermediary company for Russia and China.²¹

²¹ The weekly magazine *168 ÓRA* Internet website October 10, 2018 (8:53: <https://168ora.hu/itthon/kiszivargott-dokumentumok-isbizonyitjak-hogy-habony-arpad-kore-nyakig-benne-volt-a-kotveny-bizniszben-157277>) reported that a document was found according to which Árpád Habony, a personal adviser to Prime Minister Orbán and a companion to Chief Cabinet Secretary Rogán, was involved in the bond business. The Voldan Investment, which sold the bonds to Russia, was undertaken by a Georgian-Israeli named Michaeli Shabtai and by Michael Gagel, who has a bread sales chain on the premises of the Budapest metro and speaks both Russian and Hungarian. They are friends with Habony, Mrs. Rogán, Ms. Fanny Kaminski (Habony's ex-wife and current spokeswoman for the Prime Minister's Office) and Boglárka Nagy (Habony's current mistress), Tímea Vajna (Mrs. András Vajna). Photos of Habony and Vajna can be seen on Gagel's Instagram account.

It is known that 384 people bought the bonds using this scheme in Russia, and a total of 1256 people, including their families, settled in Hungary. In addition, the Kosik Kristóf law firm, which is responsible for the immigration procedures of those who purchased the bond in Russia, has a close relationship with the government. Of course, this office is not commissioned by chance. It turned out that the law firm was also the legal representative of the district's public corporation during Rogán's mayorship of District V of Budapest. The law firm also has dealings with the Fidesz parliamentary group of the National Assembly and the defense cases of Rogán's office and Habony's office. Furthermore, the law firm is also the legal representative of Arton Capital, the bond sales brokerage company.

Habony frequently visited China as the prime minister's advisor, revealing that it is Jonathan Chan, an independent banker, who actually works for a Hong Kong company selling the bonds to Chinese. It was Jonathan Chan who signed the bond sales contracts, along with the legal representative of the intermediary company, Dr. Lian Wang. In June 2016, Habony took a helicopter flight over Hong Kong under the name of his mistress, Boglárka Nagy, and Jonathan Chan made the reservation. This scenic flight took 45 minutes and cost HK\$26,500 (<https://444.hu/2016/06/29/hongkongi-helikopter-tura-koti-ossze-habony-arpadot-a-magyar-letelepedesi-kotvenyek-egyik-offshore-forgalmazojaval>). Most likely, the government bond sales agency in Hong Kong covered it as entertainment expenses.

Politicians and bureaucrats who were practically involved in this scheme accumulated private wealth through the bond scheme. It is a clear example of malfeasance and breach of trust to use state organs to cause an outflow of state funds. However, Hungary at the moment does not have the necessary social norms or prosecutorial power to judge and convict these kinds of criminals.

In addition to Rogán and Habony, politicians and officials from the ruling party were deeply involved in the offshore companies doing this business. Otherwise, such a strange scheme could not have been implemented as a government policy. If so, this scheme is a breach of trust in the use of state money, as it involves the embezzlement of state funds and it damages the state. In addition, brokerage fees are extremely high compared to the interest paid, and it is expected that interest might not even have been paid to buyers. If the intermediary company obtained both the brokerage fee and the bond interest, this is a kind of economic fraud, too.

Indeed, the sale of the state bond with the right to settle was very easy business for an intermediary company to make profits. The Fidesz politician who proposed this scheme could not outsource such a delicious business to a stranger company. If an intermediary company was registered in Hungary, the tax authorities could easily investigate the activity. That's why they created a mechanism to circulate and return money by using offshore companies out of reach of Hungarian state power.

When the government suspended the program, the finance minister explained that "it was no longer as lucrative as it had originally been expected." It is true that it was much easier and cheaper to raise funds from the international financial markets, but the government wanted to stop the scheme before the whole image of the scheme became public knowledge. It is a good example of the permissibility of crime in Hungarian society thirty years after the system transformation.

In this way, Fidesz, who criticized the corruption of the Socialist Party and took over the government, also worked on various corruption schemes involving the embezzlement of state assets while maintaining a long-term dictatorship. To that extent, power and money are demons that take politicians' souls beyond ideology and political faith.

4.4.6 Addendum

OLAF is angry that the Hungarian prosecutor's office has overlooked overt financial fraud and is slowing down the investigation. It seems that the Hungarian government has abandoned EU subsidies to end the pursuit of the investigation of fraudulent acts around ELIOS, but the European Commission assumes that there was market cartel behavior in the business related to the ELIOS dating back to the past decade. Five companies, including ELIOS, will be the subject of the investigation. In investigating this market cartel action, an inspector commissioned by the European Commission will

The bond sales to China and Russia account for 85% of total world sales. In other words, Rogán and Habony might be the protagonists of the bond selling scheme, and their shares might be stored in some tax havens or in bank accounts outside Hungary. It constitutes fraudulent use of national assets.

directly conduct an investigation in the country, but in order to do so, permission must be obtained from the court of the country. It is unclear how this investigation will proceed.

Pushed by the movement of the European Commission, the Hungarian prosecutor's office has resumed the investigation of Medgyessy's company related to bribery in the case of subway line 4 instead of investigating the ELIOS project. The ELIOS case involves the prime minister's family, and the prosecutor's office is still unwilling to undertake this investigation. Instead, it looks like they are trying to escape criticism of the European Commission by prosecuting a case involving a former prime minister.

As mentioned above, it is a French vehicle manufacturer, Alstom, that is being investigated, not only in Hungary but also in Britain for bribery charges. The Hungarian prosecutor's office announced on April 10, 2019 that it would sue four people involved in Alstom's vehicle procurement decision (the public prosecutor did not disclose any names).

Medgyessy's representative consultant, his arm Károly Tóth and BKV president at that time, Botond Aba frequently exchanged information with Alstom's officials, eventually dropping competitor Bombardier, making Alstom the contractor. Not only did it help the company make a successful bid, but it also changed the payment terms to meet Alstom's request.

In Alstom's case, the email exchanged between the Alstom executives and the Hungarian intermediaries has already been passed from the British prosecutor's office to the Hungarian's counter partner, and the situation has been clarified. Alstom paid €8,463,643 to Hungarian intermediaries via Danish and Austrian companies through three fictive consulting agreements between 2007 and 2009. Among them are László Puch, who was the financial officer of the Socialist Party at the time, and László Máté (former financial officer, the Hungarian Socialist Workers' Party), who has already faced charges involving economic crimes from the time of the Horn cabinet. They were invited to a meeting with Alstom executives in Singapore. In addition, the minister of economy and transport at the time, János Kóka, and deputy secretary, Ábel Garamhegyi, were also mentioned.

Of the €8.46 million, €2.3 million went to the BKV and other intermediaries, and the company of Medgyessy obtained a total of approximately €600,000 in 2007 and 2008. As a portion of this money, HUF 9 million was transferred to the personal account of Mrs. Péter Medgyessy (Katalin Csaplár) in January 2010, HUF 60 million was transferred on October 29 and another HUF 46 million in 2011. Almost ten years have passed since the start of investigation, but most economic criminal trials in Hungary take decades. The Alstom case will begin to be elucidated from now on.

4.5 Capital Accumulation under the Treasurized Economy

It should be said that the sale of state bonds with the right to settle by the Fidesz government is a criminal act involving the breach of trust and the use of the state bureaucracy. Also, the public orders and subsidies given to ELIOS involved unfair practices and subsidy fraud, which constitute crimes in which the central government and local

governments were actively involved. Nevertheless, Hungary does not currently have independent legal organs and social norms to investigate and prosecute these crimes.

As another story involving the Fidesz administration, it is necessary to write about the legend of a sort of Cinderella story involving Lőrinc Mészáros, who is a friend of Prime Minister Orbán and who went from being a petty gas fitter to the top billionaire in five years. The support of Prime Minister Orbán and the whole Fidesz government have made Mészáros increase his personal assets to more than HUF 300 billion in the years of the third Orbán cabinet (2014–2018). The families of Orbán and Mészáros share a common destiny; they dominate the political and economic worlds of Hungary.

4.5.1 From Gas Fitter to Billionaire

A 100 leggazdagabb (Perche Kft., 2019. május) estimates that Hungary's largest fortune holder is the OTP Bank President Sándor Csányi, who owns HUF 360 billion of assets. Second-ranked was Orbán's ally, Lőrinc Mészáros, with personal assets estimated at HUF 280 billion.²²

Lőrinc Mészáros is from a village not far from the Lake Balaton in the same county as Prime Minister Orbán. Originally a gas fitter, he succeeded in a gas pipe laying project in the village of Alcsút in the 1990s, but it is said that he had almost no business income due to the slump in business around 2007. It was his reunion with Prime Minister Orbán that led him to appear at the top of the list of Hungarian billionaires ten years later. By joining the management of a football club in Felcsút, the town next to Alcsút, he decided to deepen his alliance with Prime Minister Orbán and to prioritize public orders and subsidies. While serving as the mayor of Felcsút from 2011 to 2018, Mészáros expanded his business and received huge public orders and subsidies during the third Fidesz cabinet era, which began in 2014. The success of Mészáros is the Cinderella story of the Orbán administration. He could amass huge private wealth by receiving public orders and subsidies from the central and local government in these years. The Orbán and Mészáros families often use the various properties built by Mészáros.²³ The Mészáros empire and the Orbán family share a community of fate. In 2013, when Mészáros was first ranked in the "100 billionaires" in Hungary, his total assets came to only HUF 7 billion. His assets increased to HUF 8 billion in

²² The Hungarian version of *Forbes* (January, 2019) reports that Mészáros is ranked first in 2018 with the total assets of HUF 381.3 billion. In 2017, *Forbes* ranks Mészáros at HUF 105.7 billion in eighth place, while it ranks only 28th at HUF 35.4 billion in 2016. As we will see later, Mészáros's wealth surged incredibly in 2017–2018.

²³ Mészáros owns two villas on the Adriatic coast. This was revealed when it was publicly reported that the midfielder Ivan Rakitić's family at the Spanish football club Barcelona was hit by a stoning attack from a Croatian football hooligan while staying in the Mészáros's villa (*HirHatár*, July 1, 2016). More accurately, the villa is owned by the Croatian football club NK Osijek, which is owned by Mészáros, and he is involved in the management of the Croatian football club, and it is speculated that they have a deep (inexplicable) relationship with the Croatian football world.

2014, HUF 23 billion in 2015, HUF 120 billion in 2016, HUF 280 billion in 2017, HUF 296 billion in 2018, showing an incredible surge in recent years. Although the amount of assets differs from *Forbes'* estimate, both data show the same trend regarding the rapid increase in assets from 2016 to 2018. Regarding this extraordinary asset growth, Hungarian private TV, the RTL reported in 2016 that various companies related to Mészáros received a public order of HUF 225 billion.²⁴

According to RTL, Mészáros és Mészáros Ltd., a large-scale construction and designing company of Mészáros, obtained public orders in the amount of HUF 140 billion in various consortium forms, while R-Kord, a railway construction company of Mészáros, and the consortium obtained public orders of HUF 76 billion. The construction company Fejér B.Á.L. Ltd., which is run by Mészáros's son with a consortium, received HUF 8.5 billion, and Vivienvíz Kft., a drinking water company, the president of which is Mészáros's second daughter, Ágnes, obtained an order in the amount of HUF 486 million. The drinking water company exclusively supplies the water PET bottles to the Hungarian National Railway (MÁV), which distributes bottles free of charge at stations and trains in the summer. The total amount of drinking water delivered to MÁV was HUF 1 billion in 2018.

4.5.2 The Formation of the Mészáros Empire

The company owned by Mészáros has accumulated capital through public works and subsidy projects and has begun to acquire companies in various fields. The corporate group Konzum Plc. firstly extended to the field of tourism. In October 2016, Konzum, working through its investment company, acquired ownership of the Hunguest Hotels, which mainly operates rural hotels. Following the acquisition of ownership, Hunguest Hotels invited Gellért Jászai (Mészáros' right arm), Péter Schmidl as business manager, and Zoltán Somlyai, manager of a real estate company owned by Orbán's son-in-law Tiborcz. The hotels owned by Hunguest Hotels are mainly 3-star hotels and are scattered all over the country. It is the largest group in Hungary in terms of the number of hotels under its umbrella.²⁵

On March 3, 2017, the Budapest Stock Exchange suspended stock trading of Konzum Plc., a holding company of Mészáros, and of the Opimus Group Plc., because the ownership of the latter group was acquired by Mészáros. On August 3, 2017, the

On August 20, 2018, the news Ráhel Orbán, Prime Minister Orbán's eldest daughter, had thrown used diapers on roadside at a highway rest stop in Croatia was delivered with pictures. News by Croatian-Hungarian paparazzi was distributed not only in Croatia but also in Hungary (<https://24.hu/kulfold/2018/08/21/Orban-rahel-pelenka-horvatorszag/>). It might be they were on their way to Mészáros's villa.

²⁴ Watch the RTL news video of December 13, 2016, which shows this, at <https://444.hu/2016/12/13/225-milliard-ennyit-nyertek-kozbeszerzeseken-Meszaros-lorinc-cegei> be able to.

²⁵ https://index.hu/gazdasag/2016/07/27/ezek_az_eladasra_itelt_hunguest_hotelek/.

company name of Opimus Group Plc. was changed to Opus Global Plc.,²⁶ and on October 3, it was raised to the premium category of the Budapest Stock Exchange. This group integrates companies in the energy and construction fields of Mészáros.

In April 2017, Konzum Plc. acquired the former state-owned company Balatontourist, which owns a vast camping site on the shores of Lake Balaton, and thus expanded its tourism portfolio. Balatontourist was the largest tourism company in the region, with 106 hectares on the shores of Lake Balaton, a camping ground that can accommodate 5,200 vehicles, 500 bungalows and 200 mobile sheds.²⁷

The Konzum Group has decided to expand into the agricultural field, and it established Visonta Projekt Ltd. As a first project, the Visonta Projekt Ltd. established a company, Viresol Keményítő- és alapanyaggyártó és forgalmazó Ltd., which manufactures starch from wheat as a joint project with Duna Aszfalt Ltd. in Heves prefecture county. At the groundbreaking ceremony on April 24, 2017, Minister of Economy Mihály Varga cut the tape, and the company started production in 2018. A factory with a site of 33,000 m² was built with a total construction cost of HUF 30 billion and employing 250 people. Of the HUF 30 billion construction cost, the government spent HUF 6.2 billion as a subsidy, and the rest was financed by the Export-Import Bank and MKB Bank.²⁸ The site where the factory was built is adjacent to the Mátrai Erőmű (Mátra Power Plant), which was later acquired by Mészáros, and it was decided that electricity and gas to the factory would be supplied from there.

As of early June 2017, it was announced that Konzum Befektetési Alapkezelő co. Ltd. which is owned by Mészáros (53 %) and the Konzum Group (47 %), acquired 49 % of the MKB Bank Plc., the fifth largest commercial bank in Hungary. At the same time, a 10 % stake in the bank was also acquired by Tamás Szemerey, who is a relative of György Matolcsy, the National Bank governor. The MKB Bank was the foreign trade bank in the socialist era which could carry out exchange transactions. It was bought by the Bavarian State Bank soon after the beginning of the transformation. However, in 2014, its ownership was sold to the Hungarian government, and it became a state-owned bank again, and finally Mészáros put it under his umbrella.

In addition, in early 2019, MKB Bank announced a change in its shareholder composition, with Duna Aszfalt Ltd.'s president László Szíjj having acquired 32.9 %. Szíjj is a business partner of Mészáros. Accordingly, the two individuals own 80 % of MKB Bank.²⁹ The Duna Aszfalt Ltd. is also a company that has “expanded” due to public orders and subsidies. With the change in the structure of owners, the MKB management team was also changed, and Adam Balog took the post of MKB president, who was the Deputy Governor of the National Bank and previously worked under Matolcsy when he was the minister of economy. The supervision of commercial banks and the ap-

²⁶ [https://24.hu/fn/gazdasag/2017/07/04/megvaltoztatjak-az-opimus-nevet-Mészáros-lo-rincek/](https://24.hu/fn/gazdasag/2017/07/04/megvaltoztatjak-az-opimus-nevet-Meszáros-lo-rincek/).

²⁷ <https://www.balatontourist.hu/en/> for details.

²⁸ <https://magyarepitok.hu/mi-epul/2017/04/elkezdodott-a-30-milliardos-visontai-elelmi-szeripari-beruhazas>.

²⁹ [https://forbes.hu/uzlet/Mészáros-sziji-mkb/](https://forbes.hu/uzlet/Meszáros-sziji-mkb/) (January 15, 2019).

proval of privatization are the task of the Financial Supervisory Authority established within the National Bank. Indeed, MKB re-privatization was done by persons involved in financial supervision and government politicians. In any case, a commercial bank was added to the portfolio of Mészáros's corporate empire.

In October 2017, a bid for the Komárom Duna Bridge (600 m), which connects Hungary and Slovakia across the Danube, was held, and the consortium of the Mészáros construction company Mészáros és Mészáros Ltd. and Hídépítő co. Ltd. succeeded with an estimated cost of HUF 27.3 billion.³⁰ An Italian-Slovakian consortium also participated in the public tender. However, the Italian-Slovakian consortium was eliminated, despite it having offered a lower price than the Hungarian consortium. The reason was that the Italian consortium did not reply to the complement question raised by the bid executor. Since the successful bidder was decided from the outset, any reason could be found to exclude the competitor. It was a very unfair bidding practice.

In December 2017, Mátrai Erőmű (Mátra Power Plant), Hungary's second-largest electric power plant, became part of the Mészáros empire. Mátrai Erőmű was once privatized after the transformation. 51 % was owned by the RWE group based in Essen, Germany, and 21.7 % by EnBW based in Karlsruhe. MVM (Hungarian Electrical Works) also owned 21.7 %. Since early 2017, the sale of shares held by two German companies had been a hot topic. Mátrai Erőmű uses coal and gas to generate electricity and will reach its 50-years deadline in 2025. German investors were aiming for a selling timing, as poor-quality coal and aging equipment required a large investment to extend the operational deadline.

On the other hand, although there were domestic and foreign investment groups aiming to acquire ownership of Mátrai Erőmű, Mészáros was keen to add an energy company to his corporate empire. Prime Minister Orbán also thought that Hungary's energy market is dominated by large companies such as MOL and MVM, so he wanted to have Mészáros enter the energy market and thus create a domestic energy company with domestic capital. The RWE Group has invested in wind power companies in addition to Mátrai Erőmű, and it knew it was not a good idea to defy Hungarian politicians. On the premise of acquisition of Mátrai Erőmű, Mészáros had already established a company to manufacture wheat starch in the same region with the full support of the government. There was an implicit understanding that he would and should do so. The success of the deal was announced on December 13, 2017.³¹ In the end, Mészáros ob-

³⁰ <https://forbes.hu/uzlet/igy-epul-Meszaro-sek-komaromi-duna-hidja/> (February 25, 2019).

³¹ This deal is rather complicated, and in reality, Status Power Invest Ltd., which was jointly funded by the investment company (Status Capital Kockázati Tőkealapkezelő) of the Mészáros group, and the Czech energy company EPH (Energetický Průmyslový Holding) purchased 72% of Mátra Power Plant (21.7% ownership of MVM remains unchanged). The EPH is a strategic investment company which has long been active in the acquisition of Mátra Power Plant and has been operating in Hungary for many years. As Mészáros has no experience in the energy field, it is supposed that the joint venture has implications for risk diversification. It took nearly a year to realize this deal because of the prolonged discussion between the Mészáros side and the EPH. The management committee of the company has a total of five members, including Beatrix Mészáros, Mészáros's oldest daughter, and two others from the Mészáros side,

tained Mátrai Erőmű, which is the second-largest electric power company in Hungary with the second highest power generation capacity, after the Paks nuclear power plant.

The expansion of the Mészáros empire has not stopped. Let's take a look at the key acquisitions and mergers in 2018.

In June 2018, the Mészáros Group announced that it has acquired 4iG Rt., which is a computer software development and equipment sales company listed on the Budapest Stock Exchange. Following that, it was announced that Gellért Jászai, who as noted earlier is the right arm of Mészáros, would leave the position of the corporate group of Mészáros and become the president of 4iG Nyrt. (May 2019). In 2017, 4iG was in the red, and in 2018 it did not improve, and it was looking for a buyer.

However, business performance improved as soon as the company entered the Mészáros empire. In February 2019, a bid for the MÁV (Hungarian National Railways) project (MAV INKA2) was awarded for HUF 800 million. In April, 4iG acquired Hungary's Telecom subsidiary, the T-System Magyarország co. Ltd. Then, the company signed a contract of HUF 1,297 million with the Nemzeti Infokommunikációs Szolgáltató co. Ltd. (NISZ) to deliver an Oracle product (license) to a national institution via NISZ, and it received an order to back it up. In May 2019, 4iG submitted a successful bid for an interactive tablet distributed by the Ministry of Human Resources, Klebelsberg Center to schools under its jurisdiction and signed a contract of HUF 4.4 billion. Furthermore, according to the MTI news, on June 26, 2019, 4iG won the order of MVM (Hungarian Electrical Works) subsidiary MVMI Informatikai Ltd. for HUF 2,679 million. It seems that the 4iG has monopolized the public orders for IT development.

Incorporated into the Mészáros corporate empire, 4iG received a series of publicly ordered jobs and rapidly recovered its performance, resulting in promotion to shares in the premium category of the Budapest Stock Exchange from 19 June, 2019.

The Mészáros corporate group was based on tourism, agriculture and construction. It became a big conglomerate through acquisitions in 2018. Mészáros founded Talentis Agro co. Ltd., a group company for agricultural and food processing, in 2018. It is a holding company that manages 14 agricultural-related companies, but if it includes related companies, it will become a group of 40 companies. The planted area of vegetables and fruits (wine grapes) reaches 38,000 hectares, and it is a major agricultural holding company that covers livestock and egg production, hunting business, and food processing.

In June 2019, the merger and integration of two holding companies of the Mészáros empire, Konzum Plc. and Opus Global Plc, was approved, and the fifth largest company was created on the Budapest Stock Exchange on June 30 2019.

and two people from the EPH side. On the other hand, the audit committee consists of one representative from Mészáros's side and two representatives from the EPH. (https://hvg.hu/gazdasag/20171213_Matra_Energy_Meszarosek_a_visontai_hoeromu_kapujaban).

4.5.3 The Future of the Mészáros Empire

The Mészáros empire continues to expand with the full support of the Fidesz government. In the previous section, we looked at the investment activities of the Mészáros group, but that alone does not reveal the actual state of asset formation of Mészáros as individual. The dividends earned from companies owned by Mészáros and its families are enormous. The following is an example of dividends in 2018.³²

1. Dividend paid by the Talentis Group to Mr. and Mrs. Mészáros, HUF 10.6 billion
2. Dividend of HUF 8.3 billion acquired by Mészáros from the Mátra Power Plant
3. Dividend of HUF 5.6 billion from the construction company Fejér-B.Á.L. Ltd. run by his sons
4. Dividend of HUF 5 billion from the railroad construction company R-Kord Ltd.
5. Dividend of HUF 5.4 billion from the Mészáros és Mészáros Ltd. that undertook the large-scale construction
6. MKB Bank dividend of HUF 2.3 billion
7. Hunguest Hotels dividend HUF 550 million
8. Dividend of HUF 7 billion from the V-Hid co. Ltd., which undertook construction work for the Hungarian National Railway (MÁV)

Other dividends could be added to this list. In this system, the dividends increase with each investment acquisition. If investment dividends increase in this way, asset growth will skyrocket.

According to news on June 14, 2019, the Mészáros empire will fully join the railway modernization project between Budapest and Belgrade. 85 % of the total investment of HUF 590 billion will be financed by Chinese loans, and the CRE Konzorcium was established for the construction project. The consortium consists of RM International co. Ltd., which was founded by Mészáros for this project, as well as two Chinese companies, the China Tiejuju Engineering Construction Ltd. and the China Railway Electrification Engineering Group Ltd.³³

The consortium is subcontracted by the R-Kord Ltd. and the V-Hid co. Ltd., owned by Mészáros, Fejér B.Á.L. Ltd., owned by his three children, and the VAST VILL Ltd., owned by his son-in-law. Thus, the Mészáros Group of companies will receive the total order of HUF 295 billion. The Mészáros empire is quite simply the political commerce of the Fidesz government.

The Hungarian government absorbs half of its GDP as tax income and redistributes it. A significant portion of corporate subsidies and expenditures for public works are used for capital accumulation and asset formation of specific companies owned by entrepreneurs who have good relationships with the ruling party. This not only contributes to assets of the Mészáros family, but also to the asset formation of politicians, bureaucrats and businessman who are contributing to the expansion of the

³² <https://444.hu/2019/06/08/Mészáros-lorinc-es-csaladja-tobbet-vitt-haza-a-cegeikbol-mint-az-allam-barmelyik-mamutjabol>.

³³ <https://444.hu/2019/06/14/Mészáros-lorinc-a-csalad-cegeit-huzta-be-alvallalkozonak-a-budapest-belgrad-vasutvonal-epiteséhez>.

Mészáros empire. There is an absolute limit to what the family of Mészáros and the surrounding managers can do. Therefore, it is necessary to pull in excellent human resources and experienced businesspeople to each business in the empire. People close to the ruling party and government are jointly participating in the formation and growth of this empire. Subsequently, the economic empire of Fidesz is also formed. The development of economic activities using public money involves precisely the accumulation of capital under the treasurized economy, which produces tremendous profit for certain entrepreneurs and politicians. The refer to this as state capitalism, a term which could be used for Russia and China, is a little bit of an exaggeration in Hungary's case. It is rather a type of the crony capitalism which has been brought about as a result of the treasurization of the national economy. Or as we can refer to it, the "Treasurized Economy".

The task of the Mészáros empire is to secure talented people who support the corporate empire. If managers are chosen based only on political colors, the empire will eventually decline. Maintaining corporate compliance is not easy in crony capitalism. If specific families and specific politicians are united too closely, behavior which does not harmonize with the discipline necessary in the business world may become widespread, and the contamination of compliance may bring about fatal risks to the empire. In the 1990s, when the Socialist Party was in power, bank loans were disbursed to politicians and businesspeople connected to the party without consideration of profitability. If MKB Bank provides favorable loans to politicians and relatives, it will eventually have large non-performing loans, and this will cause the corporate empire to collapse.

Since the Fidesz government and Prime Minister Orbán will not be in power forever, the possibility of a change of government presents an extremely serious risk to the political commerce. The family-oriented business development of the Mészáros family and the Orbán family will surely reach a dead end somewhere.

As long as Hungary spends half of its GDP as tax income redistributed by the government, the market of independent economic players remains narrow, and specific companies (groups) receive disproportionate amounts of subsidies and public orders, one can hardly expect much development of the domestic market. The treasurized economy is neither a market economy nor a capitalist economy. It only creates a deviant distorted national economy that destroys the foundations for dynamically developing economy.

Addendum: Difficulties in Changing Social Norms

The system transformation should not only bring about a change in the political economy system, but also a change in the social norms of the people who build and constitute society. However, as we have seen in this chapter, even 30 years after the system transformation, the social norms of the old era still dominate the thinking of politicians and entrepreneurs. People's thoughts and behavior are not automatically changed by the transformation. In order for everyday behavior to be controlled by new social norms, it is essential to develop a market economy based on the premise of equality of economic agents, which gradually brings about establishment of the civil

ethics and norms under the “give and take” principle. Unless the transactions based on equal relationships are repeatedly incorporated into daily society life and the political ethics reflecting them are formed, no fundamental change of social norms can be accomplished.

Politicians were enthusiastic about increasing the redistribution rate and increasing the portion of GDP that political parties could dispose of freely, but they had not real grasp of the direction of national economic development. As a result, they do not rely on the development of the market economy, and they do not aim for a mature market economy. They are therefore not keen on lowering the redistribution rate. In particular, the borrowed economy gave politicians and economists a kind of illusion. It is assumed that an increase in exports by multinational corporations is a sign of the development of a market economy. This superficial grasp has led to the national economy becoming treasurized. The mechanism of the treasurized economy basically operates on the same principle as the economic system of the old era. However, not only politicians but many economists fail to understand this.

The socialist system was based on the arrogance of the notion that the government (Communist Party) could control the national economy by suppressing the development of the market economy, which resulted in arbitrary economic management by the Communist Party and a distribution control based on the principle of “give but obey”. However, after the system transformation, economists failed to examine and understand the essential problem of the old system from its foundations. They were busy tackling newly emerging problems and were involved in the immediate formation of economic proposals, and thus forewent deep analysis of the old system based on its social philosophy. Therefore, the question of the socioeconomic system for which a society should aim was not a theme of discussion among economists and still less among politicians, who had only short-term interests in mind.

History repeats itself. The essential problem of the socialist system was not simply that it was a political dictatorship by a single political party. It also involved the distribution control system which penetrated the economic system. It was the allocation from above to below and the national economic control based on the “give but obey” principle. Fidesz criticizes the political dominance and violence of the socialist system, but it is indifferent to the essential question: “what was the problem in the old economic system?” Among the economists behind the Fidesz government, Zsigmond Járαι proposed reducing the government’s redistribution rate to below 40 % of the GDP, but Fidesz politicians not only completely ignored this proposal, but also cut off intellectuals who complain about party policies. As a result, the national economy is driven by the same economic principles as the economy under the old socialist system.

The Fidesz government tends to rely on the principle of “give but obey”, which is not different from the principle of the old system. Those who show loyalty to the Fidesz political group enjoy preferential economic treatment. Correspondingly, entrepreneurs focus on maximizing their connections with politicians rather than on succeeding in the market. Rather than acquiring customers in the market, it is much more efficient to carry out a public order and deliver goods in bulk to the assigned customers. Busi-

ness is determined not by the market, but by connections to politicians. This kind of national economy cannot be called a market economy. It is neither a market economy nor a capitalist economy. It is just the treasurized economy.

Where the treasurized economic relationships dominate, people's social norms deteriorate continuously. In the "shortage" economy under the old system, establishing a connection to bureaucrats and the Communist Party was the only way to survive. The following common features can be observed between the two systems (socialist economy and treasurized economy):

1. An illusion dominates according to which it is the role of the government to concentrate the majority of GDP in government hands and allocate it at the discretion of the government. The two systems are essentially the same in the sense that the control of the national economy can be accomplished by the treasury.

2. Abuse of power is carried out by excluding people who do not show loyalty to the government or by punishing them with penal measures.

3. The political group that holds power and companies (entrepreneurs) that are in tune with it will acquire public orders preferentially, and the residuals were given to other companies and the people outside the realm of interest.

4. Since the government acquires the majority of the GDP, the market size of the national economy cannot grow spontaneously. In addition, by narrowing market competition, the ruling party limits competition in public ordering and maintains an arbitrary bidding system that allows specific companies (groups) to make successful bids. Politicians and businesses thus provide mutual benefits to each other and share inside information to maximize profits.

5. Equality among bidders in public orders is not guaranteed. Bribery, conflicts of interest, unfair transactions, insiders, fraud and other norms that are in conflict with equal opportunity and social equality are widespread. Criticisms and ethical norms concerning such unfair transactions are not encouraged.

6. In a society in which new norms are not promoted, the tyranny of power fosters a feeling of helplessness and resignation among the citizenry, and becoming obedient to power becomes an unconscious reflex.

No new social norms are born spontaneously from in a society based on the "give but obey" principle. Unless the civil social ethics and norms supported by the development of the market economy are formed, the norms of the old system continue to prevail, and the transformation of social norms and ethics will never be realized.

The formation of new social ethics and norms in Hungary is still a matter for the future, perhaps the distant future.

Chapter 5: The Sociology of System Transformation

Shortage in the Treasurized Economy

5.1 Changes in the Consumer Lifestyle and the New Shortage Phenomenon

5.1.1 The Shortage Phenomenon Hidden in the Consumption Boom

Kornai characterized the socialist economy of the twentieth century as the “economy of shortage”. He suggested that the reason for the chronic shortages of commodities and the reproduction of shortages was that a system had been established in which the planner (the person in charge of allocation) set the waiting time (queuing time) as a control norm for the distribution of commodities (materials), rather than the producers taking into account the supply and demand of commodities based on prices, as would be done in a market economy. Under such a system, the supplier (seller) takes control of the sale of goods, and a product (material) supply system can be established with a minimum amount of inventory (the optimum is zero inventory). The simple control principle of increasing the supply of goods when the waiting time is long and decreasing the supply of goods when the waiting time is short, had been routine controls. Originally, in a rationing economy, there were extremely few product types and few alternative choices for the same type of product, so consumers had no choice but to be patient and stand in line for to purchase products or wait patiently for a long time.

There was only one type of toilet paper, a hard, slippery paper, and only a few types of bread, so there were no options for choice based on taste. The supply of goods was always inadequate, and long lines were formed when bananas, which were rarely seen, were sold. This is because it was impossible to know when imported consumer goods would be available again, so if you saw a sale, there was no other way to get the imported products. Someone eager to purchase a passenger car from Russia typically paid 50 % upfront and waited several years for delivery, and in the case of the East German Trabant, the wait time was seven to ten years.

From the stories told by people who had traveled to Western Europe and the images of Western society on the television screen, people knew that the markets in Western Europe were full of goods. So, as soon as the countries to the east of the Iron Curtain opened to the world, people began embarking in droves on shopping trips to Germany and Austria.

Even before the regime change in 1989, travel abroad was liberalized in Hungary, and access to foreign currency was also gradually liberalized. As a result, many Hungarians went on shopping trips to Austria in search of goods that were not available on the Hungarian market. Nearly a billion dollars in foreign currency was purchased in the year in which travel was liberalized, and many Hungarians went to Austria to

buy goods ranging from toilet paper to color televisions and refrigerators and freezers. A passenger car with Hungarian plates was parked on Vienna's Mariahilfer Straße, and the owner was stuffing the car with goods and strapping a freezer and other large items to the roof before returning to Hungary.

Eventually, several electronics stores opened in the Austro-Hungarian border town of Nickelsdorf, not to mention a large supermarket, so it was no longer necessary for Hungarians to travel to the city of Vienna to do their shopping. Workplaces in Hungary began sending out buses for shopping excursions. This buying frenzy lasted for several years until Hungary's complete import liberalization was implemented and there was a massive influx of foreign goods. The thirst for commodities in a shortage economy erupted all at once. This was the case of Hungary, which had a relatively wide variety of goods and decent quantities of goods in comparison with the other former socialist countries. Therefore, with a certain time-lag, even more explosive shopping tours were organized for citizens of Poland and Czech-Slovakia, where goods were far less easily available than they were in Hungary at the time.

After the hasty rush of purchases of consumer goods had settled down, the private imports of automobiles (mainly used cars) became a boom, putting even greater burdens on Hungary, which had a large amount of accumulated foreign debt. This led to the fiscal tightening measures of 1994.

The people, who were thirsty for consumer goods in a shortage economy, welcomed the massive influx of consumer goods which came in the wake of the liberalization of imports. Roughly a decade after the process of transition had begun in 1990, large Western-capitalized supermarkets opened one after another, and people no longer had any difficulty obtaining general consumer goods. Of course, this phenomenon was observed not only in Hungary, but also in the surrounding transition countries.

The opening up of the economy has made it possible for people to enjoy a life of consumption that was unimaginable before the systemic change. Today, as long as you have money, you do not have to struggle for everyday commodities. However, compared to everyday consumer goods, mainly high-value goods, various skilled and technical services and medical services face daily shortages. Despite the fact that it has been 30 years since the beginning of the system transformation, a shortage of these goods and services can be observed in general. Moreover, this shortage phenomenon is not confined to Hungary, but is common in all the countries undergoing transformation.

The background to this problem is the fact that the level of development of the market economy is still low, and many specialists and technicians who do not earn sufficient incomes in the domestic market are moving to Western countries. FDI of export-oriented MNCs (multi-national corporations) creates jobs in the country, but most of it remains in low-wage labor and does not lead to the development of the domestic market through the activation of subcontracting companies.¹ The structure of a virtuous circle, in which the development of a market economy boosts income

¹ As we see in the Chapter 4, most subcontracting companies of MNCs are also foreign owned companies which went abroad together with parent companies.

levels and increases the state budget that can be spent on social security, is not built. Originally, as a historical factor, private businesses were repressed under the socialist system, and only a few individual proprietors survived. The shortage of technicians and specialists in various private business has already been an acute problem for many years, and when technicians and specialists began to leave in large numbers for Western European countries as soon as they had gotten the freedom of movement to join the EU, the shortage of domestic specialists and technicians became increasingly dire.

There has been a significant outflow of the workforce from Central and Eastern European countries to Germany and the UK, and within the former Soviet Union there has been a significant outflow of economic immigrants from the former republics of the Soviet Union to the Russian Federation. Disparities in income levels have led to a mass migration of labor from the East to the West. In many countries undergoing system transformation, there are still ties to the old regime which inhibit the development of market economies, hinder economic development and prevent income levels from rising. On the other hand, politicians are always trying to strengthen state control and state-led economic development rather than implementing measures to promote the development of the market economy, but this misguided state-led economy is further slowing the development of the market economy.

This vicious cycle has led to an exodus of specialized technical and skilled workers from the countries undergoing transformation, and it has brought about a new type shortages in these countries.

5.1.2 New Types of Shortages of Food and Building Materials

In March 2017, the Hungarian government launched a national investigation into food products sold in multinational supermarket chains, such as Auchan and Tesco, on the suspicion that these chains were deliberately selling products of lower quality than the same products sold in the West. Agriculture Minister Fazekas told parliament at the beginning of September that, in addition to the survey conducted in March, a survey of summer products had been underway since May and had found that about a third of the products were of lower quality than those sold in Western countries.

Also in 2017, the Slovak Ministry of Agriculture compared the components of 22 identical products sold in Austria and Slovakia. According to the report, the products sold in Slovakia contained more preservatives and used more artificial sweeteners than those sold in Austria. In the case of processed meat products, the amount of meat was also lower than in the same products on the shelves in Austria.

The issue was also discussed at the V4 summit and, at Hungarian initiative, was raised to the European Commission. The point of the problem is that in Central and Eastern European countries, where income levels are low, in order to keep prices low, foreign companies sell products of lower quality than those sold in Western countries.

European Commission President Jean-Claude Juncker raised this issue and acknowledged the existence of double standards for goods in the EU at the EU's opening plenary session on September 17, 2017, stressing that this has an unfavorable impact on EU unity. In line with President Juncker's statement, the EU decided to use a com-

mon analytical approach to analyze commodities, and the countries of Central and Eastern Europe also proceeded with their own institutions using a common methodology to address the issue of double standards for commodities, with research to be conducted throughout 2018.

In accordance with the study, the European Commission's Joint Research Center (JRC) released its interim results in February 2019, reporting that after 64 products had been examined, 20 products showed deviations in components that were not recognizable from the product's packaging. A final report would be issued when 76 of the 140 targeted products had been inspected for quality.

At the end of the investigation, the European Parliament made a proposal to strengthen consumer protection rules on April 17, 2019, which passed by 474 in favor, 163 against and 14 pending.² Under the new rules, if the same goods under the same name are sold in Europe under different quality configurations, the reasons for this must be made clear. Companies that violate this rule will be fined 4 % of their annual turnover (with a fine of €2 million if sales information is not available).

On June 24, 2019, the final report³ of this study was submitted, and it was concluded that no systematic differentiation of products by geographic region of the EU countries was observed, but further research will continue.

The issues raised here provide clues to explain the phenomenon of commodity shortages common to the transition countries. In the transition countries, where income levels are lower than in Western Europe, various supermarkets sell relatively low-priced goods (and I am thinking not only of everyday items, but also mass merchandisers of construction and building materials). Low-priced products are, of course, of inferior quality. For example, outdoor tiles that are inexpensive but of poor quality can easily crack. So, if you want durability, a quality product with a certain amount of strength is desirable. However, mass-market stores do not carry quality products, so you have no choice but to buy them at specialty stores. The problem is that even if there is such a specialty store, the product must be ordered because the store does not have it in its inventory. Tiles are mostly imported from Italy. It takes at least one month for the ordered products to arrive. In some cases, it may take two or three months. As a matter of fact, no one knows the exact date of acquisition. There is no choice but to wait for information on the arrival of goods from the store. Sometimes the wrong items are delivered, or when you order multiple items, not all items arrive at the same time. When this happens, the missing item will arrive on the next delivery, but the store staff does not know if that will be a month or two months away. Shipping from outside the country is only possible after a certain quantity of orders has accumulated, so the arrival date cannot be determined. Even if the product is placed on a regular delivery schedule, you have to wait at least a month for it to arrive. Furthermore, the

² Press release, April 17, 2019, 13:09, reference No. 201904101PR37533, European Parliament.

³ European Commission, *Results of an EU Wide Comparison of Quality Related Characteristics of Food Product*, June 2019, Publications Office of the European Union.

delivery date is frequently changed to make the process more convenient for the shipping company.

Some companies manufacture high-end products domestically using technology licenses for some products, but again, these products are made to order. This is because even domestic companies do not keep costly inventory. For example, in the case of an indoor door set (around \$600-1,000 for the door and framework), a usual delivery estimate of one month is shown. However, for example, if you place an order in early July, due to the summer vacation in August, delivery will be in September. Unless one asks for a delivery date, there is no communication from shops about the progress of the manufacturing process. Even if the delivery is more than a month behind schedule, the dealership will simply instruct the customer to come to the store to pick up an item which has arrived without any communication beforehand. The process is amateurish from order to sale.

You cannot arrange for a craftsman until the arrival date of the goods ordered has been confirmed. It is difficult to get good craftsmen, but if the goods do not arrive by the scheduled work date, they would not start work. This kind of inconvenience is a daily occurrence in every aspect of life.

In Hungary, even simple renovations (partial renovations) are not easy to schedule. The same is true for refurbishing bathrooms, re-flooring, replacing doors, various building materials, etc. The renovation of a bathroom, for example, can take six months or more from demolition to completion of tiling and installation of equipment. Not only does one need to procure materials, one also needs to arrange for a demolition company, tiling, plumbing, electrical work, installation of equipment, and other craftsmen. The same is true for private house construction. In fact, many of the house construction projects in the vicinity have not been completed though more than two years has passed since they were begun. The completion of a house, for example, takes five to ten times longer than in Japan. Due to a combination of lack of building materials, lack of specialized craftsmen, and a mismatch between the arrival of materials and the availability of craftsmen, even partial renovations are not easy to finish. So it is no surprise that it takes several years to build a house. If a house is completed in a short period of time, it is something of a miracle.

Once the transition to a market economy was completed, the commodity shortage was supposed to be resolved. However, present-day Central and Eastern European societies still suffer from a chronic shortage of quality products and professionals and technicians. This is ironic!

5.1.3 Lack of Specialists and Craftsmen

The harsh cold of winter can cause outdoor tiles to crack and float. From early spring to summer, it is necessary to replace tiles, but it is difficult to find a tile craftsman. Often, a craftsman will promise to start work several months after a request is made. Even if the appointment is made in the early spring, it is sometimes put off to the following year if the summer vacation comes and the craftsmen are not available in the early fall,

because by November, the cold weather no longer allows them to tile. The tile craftsman is one of the kinds of jobs that are lacking on a daily basis.

Off-site water lines are the responsibility of the city's water department, but the work on the property is the responsibility of the respective property owners to resolve. However, for both water and sewer, finding a good contractor is a challenge. Even if you do find one, it is hard to get a competent contractor to come to your property. Often, after all the hard work of setting a date and time, they do not show up at the appointed time. Even if they are late or cannot come, it is rare that they will inform you. Most of them promise multiple orders in a day, and if a big job comes in, they go to a remote town for a day-long job instead of honoring prior commitments. When they have extra time, they try to go back to Budapest to do some small work, but if the local work drags on, of course they cannot do the work in Budapest. The world of these private craftsman is a world of producer sovereignty, in which the producer (vendor) is in control, so there is often a lack of consideration for the consumer, and vendors do not even bother to make a simple phone call.

Furthermore, talented craftsmen may take on work outside the country through an acquaintance or friend who has emigrated abroad. They may go to Austria, Germany, or even England for a short period of time to work. Naturally, priority is given to jobs that pay well, so if those jobs come in, jobs in Hungary will be put on the back burner. Because the economic ethics of a market economy are not prevalent, a craftsman will leave a job in Hungary half-done and go abroad without even giving notice. After contacting him by email, the client discovers that he is not in the country and he would not be back until the Christmas holidays. The work requested before the summer in the end is not completed until the end of the year, which is obviously a major inconvenience.

The situation is pretty much the same across all of these kinds of occupations: roofers, carpenters, electricians, tiling contractors, painters, sewers, etc. Therefore, even if you commission a small renovation job, you have to be prepared for it to take a year to complete. Many specialist craftsmen have no employees or are working with one or two assistants. It is difficult to obtain assistants and apprentice craftsmen in these industries. The fact that young people tend to shy away from this type of work is another reason for the shortage of specialist tradesmen. Artisan matching websites show that there is a shortage of artisans across the country. If you have assistants or apprentices, you can double the amount of work you take on, but there is a limit to the amount of work you can do on your own.

This also shows that the countries undergoing transformation are still unable to overcome the negative legacy of the old socialist system, in which artisans and technicians were not allowed to be self-reliant as private businesses and private businesses were almost completely wiped out. In the old system, it took a week to get a broken flush toilet fixed. Nowadays, it only takes one or two days to get a toilet repaired. However, when it comes combining slightly higher-grade materials and craftsmen, this is not an easy task in Hungary today, and the situation in the neighboring countries which have undergone some form of regime change is the same.

5.1.4 Shortages in the Medical Sector

There are many problems that inconvenience people in Hungary after thirty years of regime change, but the shortage of medical services is a matter of life and death. Even before the regime change, the medical systems of the former socialist countries had a fundamental flaw. The main cause of this flaw is the doctor-first medical system, which I call “doctor sovereignty”. Of course, the doctor plays a central role in health care, but everything works as a system that takes into account the doctor’s convenience to the greatest extent possible, and the patient has no choice but to comply passively. It was truly a system of “give but obey”.

Prior to the system transformation, there was no system in place to receive patients in public hospitals and community public clinics. Since no system existed to manage the order of care, patients had to wait their turn at the front of the doctor’s room where they sought treatment. Patients would communicate with one another to determine who had come first or would not and would simply jostle one another to try to be as close as possible to the door, and they would give their insurance cards to the nurse when she opened the door to see them. In the worst-case scenario, nearly a dozen patients tried to be the first to hand over their insurance cards. Patients who lost the race were not seen for some time. The nurses never went out of the room to guide the patient through the order of care. Rather, they remained in the room with the doctor. If you tried to knock, a nurse would shout at you and tell you not to.

In Japanese hospitals, once a patient is registered, a personal card is issued, and subsequent treatment is carried out through the receptionist of the department in question based on the information recorded on the card. When the clerical staff and nurses at the reception desk are ready to treat a patient, they call out the patient’s name and explain the next step in the treatment process to the patient in the hallway. Thus, in Japan, administrative staff and nurses are prepared to take care of patients, and hospitals are careful to find patients and make sure that there are no omissions. However, in hospitals in former socialist countries such as Hungary, patients need to find the administrative staff and nurses and have their health insurance cards accepted before they can receive medical treatment. It is precisely in the relationship between the patient and the hospital that one observes most vividly the contrast in behavior between Japan and Hungary.

This system of “doctor sovereignty” remains essentially unchanged, even after the system change. Some hospitals have introduced number tags, but only a few, and many are still functioning under the old system. Public clinics in the region have not introduced number tags, but rather continue to function using the exact same routines as were used under the old system.

Therefore, expatriates and rich people avoid public hospitals and public clinics and seek medical treatment at their own expense in private clinics. Private clinics accept treatment appointments, so there is no waiting time. In return, no public health insurance is available. Some clinics offer a “10 % discount” if you present your health insurance. I refer to this as “discount couponing of public health insurance”. This is because the health insurance you pay for each month only serves as a discount coupon.

As an even greater distortion of the public health system, some private clinics have been established inside public hospitals, where concessionary medical services are provided. Of course, they are paying rent to open it, but the double standard in the health care system is visible. Although there are some dedicated doctors in private clinics, most of them work in other public hospitals and perform consultation services in private clinics several times a week.

Public hospitals also have a different response to patients who come to the hospital at their own expense. For example, some hospitals provide a comfortable separate room for patients who come to the hospital at their own expense, even for simple cases of blood collection. There is no such overt differentiation in the case of inpatients, but even hospitals and public specialty clinics have several private rooms where the director can accommodate a patient. Private rooms may be used for self-funded care, for patients with overseas insurance, or for patients with special connections.

It is fair to say that the health care system remains in the turmoil of regime change. In recent years, the lack of easy access to surgery has become a serious problem. Due to a shortage of doctors, most surgeries require long waiting times. The waiting time for even a simple cataract surgery can be anywhere from one to three months, depending on the area, and in some areas it can be as long as 10 months. Of course, if you are in a private clinic, there is no waiting time, but as previously mentioned, the state health insurance offers no coverage for this kind of treatment.

For example, if you have a knee prosthesis and undergo metal bonding surgery, only limited metals are covered by public insurance, and most public hospitals will inform you a year ahead of time that you will undergo surgery. Patients who cannot wait that long or can afford the medical bills can make an appointment at a private clinic and have the surgery in a week to ten days. In such a case, the cost of the treatment would be around \$5,000, including three days of hospitalization. The cost of surgery in public hospitals is covered by health insurance, but it is customary to give the doctor an honorarium (\$500 to \$1,000). This is a practice that has continued since the days of the old regime.

The shortage in the medical service sector is brought about not only by abuses of the old regime's "doctor sovereignty" system, but also by the flight of talented doctors and nurses from the country in search of higher incomes. As of 2019, Hungary is experiencing a severe outflow of not only doctors but also of nurses, and the shortage of both doctors and nurses is becoming more acute. According to the latest data in 2019 from the National Health Service Center (ÁEEK, Állami Egészségügyi Ellátó Központ), it is estimated that approximately 250,000 people (249,585) hold nursing qualifications in Hungary, but only 108,000 (107,784) of them are actually employed in nursing jobs. In particular, more than half of the newly qualified young people will choose another profession. Furthermore, the turnover rate among nurses over the age of 30 is increasing, with a reported shortage of nurses in their 30s of 24 % and a shortage of nurses in their 40s of 23 %. In the eight years between 2010 and 2018, 4,780 people requested nursing credentials for employment outside the country, with these nurses in their 30s and 40s making up the largest percentage of this group.

In terms of national averages (2018), there is a reported shortage of 10 % of general nurses, 25 % of maternity-related nurses, and 13% of emergency nurses, but the shortage in the capital city of Budapest is severe, with a shortage of 30 % of nurses and a need for 1,108 additional nurses. According to ÁEEK, nationally, the shortage of nurses serving inpatients reached 3,300 in 2017 and 3,800 in 2018, and if this situation does not improve, there will be a national shortage of 5,800 nurses in two years' time, including the need to replace nurses who go into retirement.

Daily newspapers (*Magyar Nemzet*, *Népszava*) and the website Index.hu have published articles on the problem of the shortage of nurses based on ÁEEK data. According to the news, in Budapest, where there is a severe shortage of nurses and doctors, emergency care is being provided by temporary nurse replenishment from a temporary employment agency. For example, Péterfy Hospital (Péterfy Kórház), one of Budapest's emergency medical centers, accepts eight anesthesia assistants and eight surgical nurses on a day-to-day basis from a temporary employment agency to perform twelve operations a day. Nevertheless, the shortage of nurses is still not being solved.

ÁEEK assumes that policies such as raising nursing school scholarships (according to the terms of which a student signs a contract to work at the hospital while in school), raising nurses' salaries, introducing a compensation system, and recalling nurses who have entered the pension system will alleviate the shortage of nurses somewhat, but the reality is grim.

This shortage and exodus of doctors and nurses is a serious problem common to all countries undergoing system change, and in some countries it is causing a serious crisis in their health systems.

Table 5.1. Average waiting time for surgery

operation	patients waiting for surgery (May 22, 2018)		patients undergone surgery in 2017	
	number	average planned waiting time	number	average waiting time
cataract	11,237	92	76,225	45
tonsils	1,048	43	18,127	21
sinusitis	108	35	2,225	17
spinal correction	725	302	2,972	38
spinal hernia	60	27	2,298	8
enlargement of the prostate	130	29	2,426	15
gynecological benign tumors	462	25	12,639	9
knee prosthesis	5,442	322	8,134	137
gluteal prosthesis	4,652	262	11,757	104
coronary artery	2,47	50	39,288	17
cardiac testing and ablation	731	190	5,023	31
severe spine surgery	54	349	111	84
total	27,443		186,163	

Source: The website of the National Health Insurance Fund of Hungary.

5.1.5 A Lack of Crematoriums

In Europe, the number of crematoriums was originally limited because many people chose to be buried rather than cremated. However, in recent years, the limited development of cemeteries has led to an increase in the number of people wanting to be cremated, and more and more people are placing their ashes in small estate type graves. As a result, crematoriums became scarce, and it became common for families to have to wait for a crematorium to become available following the death of a loved one. When people are alive, they have to wait for medical treatment, and even after they die, they had to wait their turn to be cremated. What a pity. The body is kept in the hospital's freezer morgue until it is cremated, but if a public burning site is chosen or a public cemetery is commissioned to incinerate the body, no further information is provided on when and where the body will be burned. One applies to the office that accepts cremation and then waits for the ashes to be returned on the promised date, which takes at least two weeks. So the funeral must be planned afterwards. As was customary in the days when there was only a public burning ground, the bereaved would not be present at the crematorium.

If you ask an intermediary company to do everything from freezing the body to burning it, there is no way to be sure that the ashes really belong to the person in question. All one can do is to trust the work of the people who are responsible for the process. However, considering the conditions and work ethic of Hungarian society, it is not possible to dispel fears that no mistakes are made or that the people in charge of the incinerator are not disposing of the ashes arbitrarily. I do not know whether there are rules and systems in place to check this, or if there are rules, whether they actually work. But at least the Hungarian people are not concerned about whether the ashes they receive are actually the ashes of their loved one. It is normal to want to say a final goodbye to the person who has died, but few people in Hungary go to the morgue to see the body and say a final goodbye to the dead at the crematorium, as if the body were little more than an object. Therefore, the question of whether or not the ashes are actually the remains of the lost family member or friend remains unasked and unanswered. Compared to the Japanese custom, this is a very unusual response.

The public incinerator in Budapest is maintained and operated by Budapesti Temetkezési Intézet Zrt. The company is a privately held joint stock company owned by the City of Budapest, which owns and manages 14 cemeteries in Budapest and owns an incinerator and cemetery named Csömöri Hamvasztó-üzem és Sírkert in the village of Csömör. If you look at the company's website, you will see that they offer a service to videotape the incineration and tell the time of the incineration. This service is claimed to be a service that allows relatives who are not able to come to the site to receive the video or to pray at home in time for the incineration.⁴

Since 2000, several private incineration plants have been built in various parts of the country. As far as internet sources reveal, as of 2019, there are 17 incineration plants across Hungary, eight of which are privately owned. Among them, seven incineration

⁴ <http://www.btirt.hu/temetok/csomori-sirkert/>.

facilities are owned by Adytume Kft. Adytume Kft. built its first privately owned incinerator in 1992 in a rural area, and over the course of the past twenty years, the company has built a series of incinerators with the latest equipment. These private incinerators offer a series of services, from incineration to burial. Of course, you have to pay a reasonable fee for each service. Those who cannot pay that fee would have to ask the public burners to incinerate the body of a loved one at a lower rate and pick up the ashes at the reception office or the funeral home.

Much as the medical field is divided into public and private treatment, the incineration sites are now divided into public and private. The choice of incineration is divided according to the family's access to money, and there are now two ways in which people bid farewell to the dead has also been.

5.1.6 A Shortage of Public Servants

Among the various government office, the immigration office has perhaps the longest waiting times. While the system has never worked well, the fact that the necessary number of people has not been not assigned to the necessary departments has caused extreme shortages (and queues).

Normally, the director of the immigration office should be making frequent visits to the site to examine the situation on the ground and consider ways to improve it, but since the socialist era, the heads of these offices have been confined to their offices instead of being compelled to confront and address the situation on the ground. So, even if there is a long line of people waiting, no one considers possible ways of addressing this. It is not the public servants who suffer the inconvenience, but the applicant, and the public servants can get the job done if they turn a blind eye to the inconveniences they create for the applicant. This is a typical bureaucratic structure.

As my residency permit expired in early 2019, I prepared documents through the outsourcing agent for the new application. I was told it would take about 30 days from the time of the request until a new permit would be issued. However, even after 60 days had passed I had not been contacted. I urged the agency to address the matter, but the agent could not get any definite answer because the government office responded only vaguely. Even had the agent tried to contact the person in charge, he would have been unable to get in touch because of that person's absence, despite the fact that the law requires that the application be processed within 60 days. Moreover, once the residency permit expires, the health insurance card is automatically invalidated as well. Even if you continue to pay social security from your salary, you cannot renew your health insurance card without a valid residency permit. Thirty years after the regime change, nothing has changed at the central government level. They have no interest in taking the convenience of the processes for applicants into consideration.

According to the agency, there is a shortage of officials at the immigration office, and the paperwork is lagging behind. It could be completed if the appropriate number of officials was assigned to the necessary departments, but that is the government office. The idea of being flexible and quick to respond and getting the paper-

work done within the timeframe required by law never really occurs to anyone in the government offices.⁵

Obtaining a building permit, which falls under the jurisdiction of the local government, is also a very time-consuming process. Departments that deal with permit documents, such as those involved in building permits, do not make immediate decisions because the deadline for decisions is 60 days after a request has been submitted. They leave the documents on the shelf, and just before the legal deadline arrives, they pull them out and give permission. This is not because of a manpower shortage. It is, rather, a symptom of the bureaucratic mentality, but in any case, old habits remain part of the bureaucracy.

To refer to a personal example, I considered enclosing an outdoor terrace with glass to protect it from the winter wind and snow. That way, even in winter, as long as the sun is shining, one can spend time on the terrace. However, in Hungary, there are severe restrictions concerning work one can undertake to change the shape (appearance) of a house, and even a plan to enclose a terrace with glass has to be approved by the district building department. Particularly in the case of so-called “twin houses,” where a symmetrical building is constructed in which two domiciles share a wall to make the best use of the site, changes to the exterior of the building are not initially permitted. If the neighbors refuse, it becomes almost impossible to make any changes.

⁵ The legal deadline of two months for the issue of my residency permit renewal passed with the renewal being issued, so the agency contacted the immigration office. The agent could not get in touch with the person in charge easily, and he only confirmed that the settlement had already been made. However, the office’s card-producing equipment was malfunctioning, and allegedly this was why the issue of the card had been delayed. According to the immigration officer, as soon as the card was ready, it would be sent by registered letter. However, after a month (three months from the submission of application), I still had not received the card, so the agency asked the immigration office to check again. The immigration office answered that “It’s ready, so if he is in a hurry, he can come to the office to pick it up personally”. So, the next day, I went to the immigration office with the agent in charge. The agent in charge had already lined up at the number-tagging machine for the service in question early that morning, and when he took the number tag, it was marked as the 16th number for the desk in question. Based on his previous experiences, the waiting time would be about two hours. However, 2 hours and 45 minutes after the person in charge took the number tag and 2 hours and 15 minutes after I joined the person in charge, we were finally called to the desk in charge. If the only thing the office needs to do in the case of a given applicant is hand over a newly issued card, then it would make things significantly easier if they were to set up a special desk for this. However, since the handover is handled at the general service desk, it does not go as quickly as it could. Moreover, not all the desks are open in the morning hours, and a small group of officials is in charge of a mix of services. So everyone has to wait for nearly three hours just to get a processed certificate. All this wasted time could have been saved if the immigration office had sent the card by registered letter as promised. The agency that handled my paperwork is an established multinational company, but if it takes this long even for the agency to get the certificate for the customer, then how much time and energy would it take to go through the process without an intermediary agency. This is the response of the immigration office 30 years after the beginning of the process of system transformation.

I submitted construction plans and applied for a permit, but I was notified that the official at the building department would refer the matter to the city planning committee, which consisted of several experts, without checking the site. At the committee meetings, the expert members deliberate on the cases put before the committee one by one without seeing the site, but the committee members give their personal opinions in a conversational manner, one after another, and most of the requests are denied. In the case of the request I submitted, we were speaking not of a building in the center of the city, but of the terrace to a house on the edge of the city. It seems hardly necessary to refer every such small matter to a committee; the person in charge of the building department should visit the site and make a decision. However, the person in charge never visits the site.

The resubmission of a building application once it has been rejected is very cumbersome. If one is dissatisfied with the decision, one has to request a re-evaluation by a higher authority in the Pest Province within ten days of the notice of the rejection. In the case of my request for permission to enclose my terrace, which was denied, I prepared a lengthy appeal:

“Although the two homes are twins, the shape of the site, the shape and color of the hedges, and the color of the walls of the houses are different, and they are separated from their neighbors by a three-meter-high bush, so it is impossible even to recognize that they are the same type of house. However, if one stands in front of the two houses and checks their shape, one will recognize that they are twins, but the houses do not exist for the sake of passers-by. In the case of the house, which is on a corner lot, the wind is strong and cold in the winter, which is not the case for the neighboring house. Therefore, enclosing the terrace with glass would give the residents a great benefit in their lives. If the property were located in the heart of the city of Budapest, the rejection of the request would be understandable. However, it is unreasonable for a request for permission to make a small change to the profile of a house located in an alleyway on the city’s border to be rejected for the sole reason of maintaining the appearance of the house. Houses are for the people who live in them, not for the street or a passerby’s appreciation of the exterior.”

Two months after the appeal was submitted, I received a response and was notified that my arguments were persuasive and that the case would be sent back to the district office for reconsideration. It was like a court case. The deadline for municipal settlements would have been another two months. In these types of cases, i.e. the cases which have been sent back for reconsideration by the higher authority, the appeals must eventually be approved, so it is customary for the officer in charge to shelve the documents until the legal deadline approaches and then pull them off the shelves as the deadline nears and issue a building permit. The officer in charge does not once actually check the site.

However, after two months had passed, I still had not been given any information, in spite of the fact that the office was required to inform me of its decision by law. I asked a lawyer to call the Building Department of the Budapest District II Office. In response to a question about “how this case has been processed since the legal deadline has already passed”, an officer replied that “the person in charge is on summer

vacation and the documents for this case cannot be found”. The lawyer told him that he would file a lawsuit if this was their response, and then a week later I received two express registered letters. One was a notice indicating that the review period had been extended by one month and the other was a notice indicating that the building permit had been issued. Since the legal deadline had passed, the department decided to extend the review time and, at the same time, to issue the permit. This in and of itself offers an indication of the confusion that reigned in the office.

By then, more than eight months had passed since the initial application had been submitted. The process had involved a great deal of written correspondence from the moment of the initial application and more than 50 pages of documents received from the municipal office. Most of them are printed out in standard text. During this time, the building department of the municipal office only printed the documents and never checked the site. More paperwork was exchanged after the building permit was obtained. A report on the disposal of waste materials associated with construction and a report on the completion of construction had to be submitted and a building use permit had to be obtained. There were about 20 more pages in that exchange of documents alone.

Thus, almost a year after the application had first been submitted, all the back and forth communication was over, and this was a comparatively simple project involving little more than enclosing an outdoor terrace with glass.

I once filed a request to cut down a huge tree on a public road that was spreading cotton dust. In season, the cotton dust piles up in the yard like an inch of snow, and it causes allergic reactions for some people. But when one applies for permission to remove a tree like this one, the request is usually not granted. My request, for instance, was denied. The cotton dust was so terrible that, in the end, I paid a passing logger to cut the tree down, which took about 10 minutes. If one applies for a permit, it will be denied, so it is quicker to handle the task oneself than to ask an irresponsible official representing the municipality to do it. One needs a permit from the authorities to cut down a large tree on one's own property. According to a recently received municipal announcement of the Budapest District II, the municipal Council adopted an ordinance on March 28, 2019 with stricter penalties for cutting down trees on one's own site. According to the ordinance, the felling of a tree primarily on private property (fruit trees are not included) requires notification and a permit. Felling is permitted in cases of transplanting for construction, fallen trees due to storms, hazard removal, and in response to professional advice, but a felling permit must be obtained, and if one fells a tree without having first obtained permit, one may be subject to a fine.

What the above two cases have in common is the norm of a “limitation of private rights”, a norm which evolved in the socialist era. Of course, restrictions on certain private rights are necessary to maintain the appearance of the city. However, severe restrictions that prohibit any form of change to private property is a violation of private rights through the abuse of public power.

Under socialism, the distinction between private and public property was blurred, which meant that perceived public need always took precedence. Therefore, a norm was formed according to which residents were not allowed to change or dispose of

property in private ownership at their own discretion. In a socialist society in which public interest has absolute priority and power, the departments in charge of local governments did not accept requests based on the interests of the residents unless otherwise instructed. As this was the norm in the society in question, it was needless for the municipal officers to visit the site before considering whether or not to grant a permit. “No means no” from the outset. Even 20 and 30 years after the regime conversion, the behavior of municipal offices has not changed, and local council members cannot respect people’s private rights.

5.2 A Shortage of Skilled Workers Brought About by Migrants

5.2.1 Population Outflow from the Countries Undergoing System Transformation

According to the IMF study, in more than 20 years between 1990 and 2012, the number of people from Central and Eastern Europe and the CIS countries who migrated to EU countries was nearly 20 million. In fact, this is the combined population of Hungary and the Czech Republic. Clearly, these migrations are flows aimed at higher incomes, which is a sign that the process of transition to a market economy in Central and Eastern European countries is not going well.

Almost 60 percent of the nearly 20 million migrants are from EU countries in Central and Eastern Europe and Southeast Europe. In recent years, there has been an increase in migration from non-EU southeast European countries. As a percentage of the 1990 population of the region (countries), we observe for more than twenty years an outflow migrants of just under 9 % in Central Europe, 8 % in the Baltic States, over 14 % in the South East European countries that are members of the EU, and just under

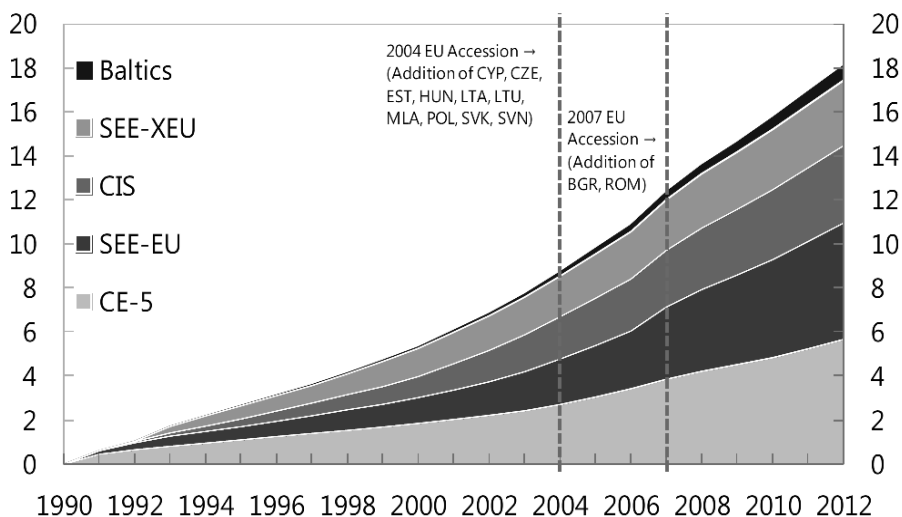


Figure 5.1. Cumulative emigration flows by region (millions of people)

Source: IMF Staff Discussion Note, Emigration and its Economic Impact on Eastern Europe, 2016, 9.

17 % in the South East European countries that are not members of the EU. Since the migrants from the Southeastern European countries are mainly an active labor force, the impact on the economic activity of the respective countries is significant. The labor force in these countries has declined by more than 20 %, which is a fatal blow to the national economic development of the countries concerned.

While most of the migrants from Southeastern Europe are unskilled workers, most of the migrants from Central and Eastern Europe are highly educated and professionally skilled people, which brings significant benefits to the countries to which they move and significant social losses to the countries they have left. In particular, the mass exodus of doctors and nurses has become a serious threat to the lives of the people in the countries which migrants are leaving. Thus, after the system transformation, each country is facing a situation of a mass exodus of its labor force and is facing a crisis of shortage of an active labor force. Although the impact on social life differs depending on the state of development of each country, the exodus of a large number of professional and skilled workers has had a serious impact on the life of the society concerned.

5.2.2 Hungarian Expatriates and Prospective Migrants

According to the 2016 Hungarian Central Statistical Office's (KSH) micro-census (an interim survey between the censuses), as of 2016, there were an estimated 463,000 Hungarian nationals who had been living outside the country for at least more than one year. 71 % of them live in Germany, Austria and the UK. The rate of return to Hungary from these three countries is estimated at 57 %. Outside of these three countries, 22 % of Hungarians reside in European countries, and their return rate is estimated at 28 %. 3.6 % of them live in the United States, with an estimated return rate of 6.8 %.⁶

These estimates show that the rate of return to Hungary is relatively high for those who went to Germany, Austria, and Britain, but the rate of return for those who went to other countries, especially the United States, is very low. This is consistent with everyday experience. Technicians who go to the United States and get a good paying job rarely return to Hungary. In contrast, many of them go to Germany and Austria to work for relatively short periods of time. Short-term migrants tend to be simple laborers or artisans, while doctors and other professionals often leave for long-term stays. In contrast, work in the UK is relatively long term, with many highly educated and highly skilled people, such as doctors.

In addition, the outflow of Hungarian labor has continued to increase since 2011, with the number of workers leaving the country doubling in almost seven years. Some have explained this as a result of the change of government in Hungary, but it is likely to be due to the lifting of temporary restrictions on labor from new member states in many EU countries. As already mentioned, three quarters of the labor force that flows out of Hungary is concentrated in Germany, Austria and the United Kingdom. Of these, most of the workers in Austria are migrant or seasonal workers. Particularly

⁶ KSH, *Mikrocenzus* 2016, 10. *Nemzetközi vándorlás* 2018, 10–14.

in the Burgenland region of Austria, which borders Hungary, a large number of Hungarians have lived for historical reasons, and in many cases they work with a pattern of internal migration.

In the case of Hungarians, the number of people who have resided abroad and would stay even after retirement as permanent residents is less than the corresponding number for the countries of Southeastern Europe. A higher proportion of people return to Hungary after accumulating a certain amount of assets and reaching retirement age. The probability is higher if the spouse is Hungarian, because it is considered more valuable to use the assets they have accumulated in Hungary where they grew up.

The 2016 micro-census also surveyed those planning to emigrate (expatriate labor). According to the survey, around 510,000 people, or 8.4 % of the workforce of working age (16–64 years), plan to move out of the country within two years. However, the survey asks about the individual's plans, and those planning to leave will only depart if they can get job that meet their needs. In fact, half of the 510,000 people surveyed are only considering the possibility of emigrating out of the country, but they have no specific plans. It is considered a kind of statement of hope. In contrast, 36 % of the population is quite serious about emigrating, and 14% of those who have already decided to emigrate are already thinking of emigrating. Thus, a total of 254,000 people are serious about emigrating in the near future. This represents 4.2 % of Hungary's working population.

Figure 5.2 shows another study on the outflow of the labor force from Hungary. The numbers does not coincide entirely with the data from the micro-census. Several studies use different databases, so there are differences among the studies. However, the sizes of the outflow indicate tendencies which are similar, more or less.

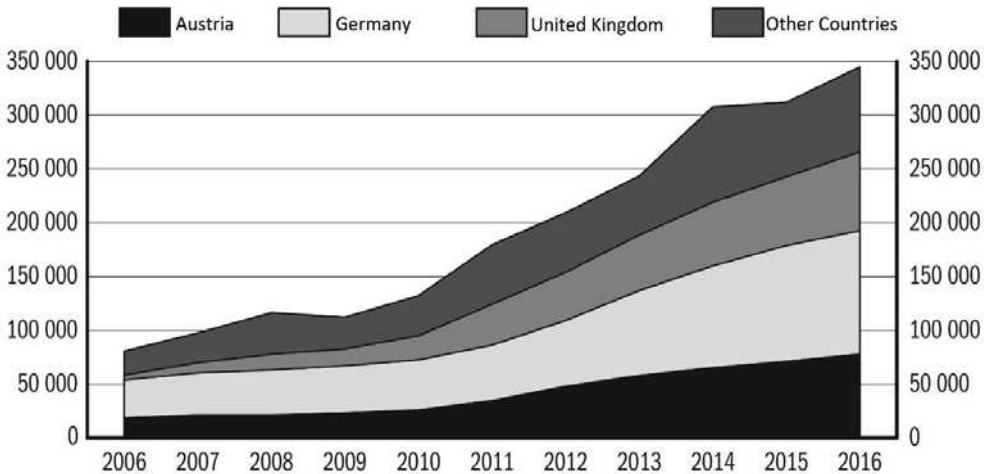


Figure 5.2 Outflow of the labor force from Hungary (accumulated number)

Source: Hárs and Simon 2017a, 96.

Note: The number shown in this study does not coincide with the data from the micro-census, because different studies use different databases, so there are differences among the studies.

In Hungary, where the population is shrinking, and where 4.2 % of the active labor force is leaving the country, the situation is critical for the development of the Hungarian economy. The exodus of the working population from the countries of Southeast Europe is considerably more serious than the exodus of workers from the countries of Central Europe. In particular, the exodus of doctors and other professionals is threatening the health care system of the countries.

5.2.3 The Mass Exodus of Doctors

The exodus of labor is a common problem facing all the countries undergoing system transformation in Central and Eastern Europe. Compared to Hungary and the Czech Republic, the labor force outflow from Poland is greater. Moreover, it is much worse in Romania, Bulgaria and Croatia than in Central and Eastern Europe. In particular, the situation in the countries of the former Yugoslavia is critical. The outflow of labor does not necessarily involve long-term employment, but even in cases of short-term employment, seasonal labor and regular migrant work are common, and the country's labor shortage is chronic.

Even after thirty years of system transformation, the development of the market economy has not been smooth, and the income gap between East and West has not shrunk. The East-West disparity in income and the freedom of movement of the labor force have attracted a large labor force movement from the East and South to the West. In particular, the exodus of highly educated physicians has led to a crisis situation that threatens the sustainability of the countries' healthcare systems.

In general, salaries for graduate doctors in the countries undergoing transformation do not exceed €1,000. News distributed by Politico.eu (September 30, 2017)⁷ deals with the issue of the exodus of doctors and nurses from the countries undergoing system transformation. A young doctor graduating from Estonia's medical school earns about €600 a month, but if he or she moves to Finland, a mere 200 km away, even young doctors can earn €2,000 to €3,000 a month. That's why over the course of the past few years 30-40 % of the medical students who have finished their studies have already left the country.

Estonia joined the European Union in 2004, and since then, out of 4,312 doctors, 1,800 have wanted to work outside the country. Nurses are similarly interested in working outside the country, with more than half of the 17,749 health care workers in Estonia considering working outside the country. Slovakia had 15,000 doctors when it joined the EU in 2004, but 3,800 have already left the country since it joined, according to the report.

The August 22, 2017 issue of the Hungarian-language periodical *Magyar Szó*, published in Novi Sad, Serbia, presents data from the Serbian Employment Office, which states that "254 nurses left Serbia in the half-year of 2017". In two years, 2015 and 2016, 1,200 health care workers, including doctors, left the country. These outflows are often mediated by a job broker agency, and the price of the agency's fee seems to

⁷ *The EU exodus: When doctors and nurses follow the money*, by Ginger Hervey.

be around €2,000. A nurse who moved to Germany from Novi Sad has a regular job and earns €2,000 a month after learning minimal German (which is a requirement) in 18 months. The salary in Serbia is 36,000 dinars (about € 300), so one will get about six times as much. In addition to health care workers, there has been a notable exodus from Serbia in recent years of childcare workers and drivers, with the former earning at least €1,200 a month in Germany. Many of the drivers are headed to Canada, where they can earn at least €2,500 a month. This has led to a continued exodus of drivers from Novi Sad, and there is a shortage of 100 drivers in the Novi Sad transportation public company.

The case of Romania is tragic. Between 2009 and 2015, the number of doctors in Romania decreased by half. In addition to doctors, there has been a severe exodus of ordinary workers, with an estimated 3 million people (15 % of the population) leaving the country in the ten years since Romania joined the EU in 2008. The Hungarian weekly magazine *Figyelő*⁸ published an interview with Viorel Husanu, the president of Romania's national health care trade union, according to which, as of 2017, Romania has 14,000 doctors out of 231,000 health care workers, but an equal number of doctors left the country between 2009 and 2015.

In Hungary, the total number of doctors is estimated to be 30,000, according to a statistical survey study in 2015.⁹ As of 2012, there were an estimated 3,250 Hungarian doctors residing outside the country, but the outflow has been increasing since then, with an annual outflow of around 1,000 doctors and nurses combined between 2016 and 2017 (the same phenomenon was observed in the Czech Republic in the same period). The outflow of Hungarian doctors is primarily to Germany, the UK and Sweden, with approximately 60 % of the outgoing doctors residing in these three countries.

This same survey, which posted (on page 99) the results of a survey of why doctors choose to work outside the country, found that the biggest factor was income, followed by medical facilities, and the third most common reason was the work environment. These reasons were followed by the “ability to improve professional skills” or the “ability to utilize professional skills” as the next most common reason. In the case of Hungary, private clinics are widespread, and dental and orthopedic surgeries are well managed in the domestic market. Physician remuneration for private clinics is comparable to that in the West. It is possible to open private clinics in Hungary with the funds accumulated in Western countries. If such possibilities in the medical service market expand, there could be a possible reversal of the flow of doctors.

In addition, Hungary's Higher Education Act was amended in 2011 to make it mandatory for state scholarship recipients to enter into an employment relationship in Hungary for a number of months equivalent to the duration of the scholarship. The law was challenged by student organizations to the Parliamentary Ombudsman, and the Ombudsman asked the Constitutional Court to make a decision. The objection is that “unilaterally forcing people to remain in the country when the government does not guarantee employment violates their fundamental right to free choice of occupa-

⁸ www.medicalonline.hu/2017_marcius_08.

⁹ Hárs and Simon 2017b, 96–103.

tion and infringes on the EU's fundamental principle of freedom of movement". Finally, in 2014, the Constitutional Court ruled constitutionally and made it mandatory for scholarship students to work in the country for a certain period of time. However, this applies to all scholarship students, not just medical students. The European Commission did not investigate a breach of the principle in this decision. It seems to have been recognized as being within the sovereignty of the country concerned.

As a reminder, the exodus of doctors in recent years has not been limited to a unilateral exodus from the former socialist countries, but has become a major trend that involves a complex interplay between the EU countries as a whole. While the fact remains that Romania is the largest outflow state and the UK is the largest inflow state, there is also a significant outflow of doctors from countries with economic problems, such as Greece and Italy. Surprisingly, a large number of doctors is also leaving Germany, presumably to establish clinics in other EU countries or countries undergoing system transformation in which private practice is allowed in order to take advantage of new business opportunities. This is a very interesting phenomenon.

5.3 The Social Psychology of Queuing

The lack of dynamic development of the market economy and the slow narrowing of the income gap between the East and West have led to a drift of people to Western Europe. Due to the severe labor shortage, these already dysfunctional market economies are now reverting back to the shortage economies of the period before system transformation. Of course, this is not the same as the previous shortage of basic consumer goods, but we are experiencing a chronic shortage of service supply, which is an important aspect of social life. Once a society or economy is stuck in the world of shortage phenomena, it is hard to get out of it. With the chronic nature of shortages, people's social attitudes also show a tendency towards social regression, which means people are reluctant to adapt to a state of shortage.

People accustomed to "waiting and being waited on" under the socialist system have adopted a mode of behavior to self-regulate their desires and demands for goods and services. Expressing one's rights and desires does not help solve the problem, so the social behavior of patience and perseverance became dominant. There is a peculiar psychology at work there, a force that inhibits people's positive behavior. Moreover, this mode of behavior does not change easily, even when the political system changes. This is because not only the general public, but also the politicians themselves are governed by the inertia of the old system's social behavior. Moreover, this is because even after the systemic change has taken place, rather than actively building a system that allows people to exert their initiative, government retains a system of distribution based on subsidies and benefits, where the higher-ups give things to the lower-ups, just like under the old system.

As a matter of fact, politicians find it easier to gain public support for such policies. Collectively, the people appreciates the free assistance provided by central and local governments, and this attitude has not changed, not even in the twenty-first century, and not only in the countries undergoing system transformation, but in almost every

country in the world. So, by consciously adopting policies which allow the governments to provide assistance for the people due, seemingly, to the mercy and generosity of politicians, governments can solidify their support. These populist policy fads have become dominant not only in the countries undergoing system transformation, but also in the EU countries of Western Europe.

As already analyzed in Chapter 2, the ethical norm of “give and take” is established in an exchange-based economy and society, while the ethical norm of “give but obey” is taken for granted in an allocation-based economy and society. In the former society, the equivalence of subjects is established, and in the latter, the dominance-subordination relationship between superiors and subordinates prevails. This ethical code defines people’s social psychology at a deep level.

5.3.1 The Queuing (Shortage) Phenomenon in the Public Service Sector

In a market economy, making the buyer wait for the supply of goods and services has a direct impact on business opportunities and sales. Therefore, sellers do their best to sell products and services without making the customers wait. In the former socialist countries, however, the old system of the public service sector does not evolve easily even after system transformation. The various administrative services provided by government offices and the medical services provided by hospitals are typical examples of such services. There is a clear relationship between the medical services provided by doctors and nurses and those received by patients.

When the position of giving and receiving is clear, the position of giving acts authoritatively, thus maintaining a hierarchical relationship. As long as the hierarchical relationship is maintained, the “official (doctor) sovereignty” (government official first, hospital physician first) relationship is not broken. As long as this relationship is maintained, the service provider (supplier) can subordinate the service recipient (demander) and give priority to the convenience of the service provider. This relationship confers authority (dominance) on the giver and demands a subordinate relationship from the recipient. One cannot complain in this relationship. If one complains, one will be harassed and retaliated against rather than see any improvement.

Even today, it is common for patients in public hospitals to gather in front of their doctor’s room. Sometimes they call the doctor in advance to make an appointment, and sometimes they do not. However, the odds of being seen at the time of the appointment are infinitesimally low, since most phone appointments are not definite, and it is common for doctors to summon multiple patients at the same time. When many patients are waiting at the same time, one has no idea who has the priority to be seen. This is because most hospitals do not have a system in place to receive patients. Everything is determined by the doctor’s preferences, i.e. the doctor enjoyed “sovereignty”.

In these hospitals, as the doctor’s medical examination begins and the nurse opens the door, numerous patients fight to hand over their medical insurance cards. Five or ten people try to hand it to the nurse at once, but the nurse takes only a few cards. This scene is repeated throughout the period during which the doctor is, in principle, available. Patients who are unable to get the nurse to take their cards will not be seen for an

indefinite amount of time. Even if one waits in line in the morning, eventually it will be lunchtime and the patient reception for the day will be over. It is nearly impossible for foreigners to get medical care in these systems. Therefore, it is common for many multinational companies to enter into a “special medical service provision agreement” with hospitals for expatriates or to use the private medical insurance of the sending country to transfer them to private clinics to avoid the inconvenience of waiting for medical treatment. Of course, in this case, the public social insurance (health insurance) premiums paid out of the monthly salary are money lost. The public insurance would be a “non-refundable” insurance required only to obtain the residency permit in the country concerned.

Neither the doctor nor the nurse gives a second glance to the patients who could not be seen. “That’s it for today. We’ll see you tomorrow.” The doctors and nurses are fine with that, but the patients are not. But there is nothing one can do about it. Occasionally people get angry and complain, but it is extremely rare, and most give up and go home. There is no better system for doctors and nurses than this “doctor sovereignty”.

The website index.hu on July 25, 2019 presented a video report of patients waiting their turn in the corridors of the National Cancer Institute to undergo chemical (anti-cancer) therapy. According to the report, many patients had been waiting in line near the stairs in the building since about 5 am, despite the 7:30 am start time for receiving patients.¹⁰ This is because it is necessary to get to the number tag from the machine as soon as possible in order to get an earlier number for treatment. The waiting room opens at 7:00 am. According to the reporter, the order of entry into the waiting room (the order of taking the number tags) is decided by the patients as they share number tags which they have made themselves. The number ticketing machine was originally introduced to avoid unnecessary congestion, but patients decide the order in which to line up for the ticketing machine. This is why dozens of patients queue up every morning. This is a frequent spectacle in the procedural offices of the central government and in the notary offices of the District offices. Thirty years after the system change, there are still some organizations and institutions that have never made any attempt or introduced any new devices to eliminate the queues. That is how deeply the queuing phenomenon under the old regime has affected society.

¹⁰ https://index.hu/belfold/2019/07/25/orszagos_onkologiai_intezet_sorszamhuzas_betegiranyitas_bejelentkezes/. Tumor treatment in private clinics is banned in Hungary. Therefore, rural patients who receive standard treatment, especially anti-cancer drugs, come on the first train in the morning to receive treatment at the General Hospital or the Cancer Institute. Chemotherapy treatment ends at 3:00 pm, so patients line up early in the morning to get an early number tag to make sure they will get treatment that day. If one gets a late number tag, one will likely not get treatment that day. If that happens, one has to come back the next day. This situation is common not only at the National Cancer Institute, but also at other public hospitals.

Since this report came out, the National Cancer Institute has stopped letting patients inside the building early in the morning, making them wait outside the gates to get rid of the lines in the building. There is lack of innovation in the provision of medical services from the patient’s perspective which might help lessen or eliminate waiting times.

As mentioned above, a similar scene is found at the immigration office. You have to go to the immigration office to get a residency visa or to renew your visa. Immediately after the system transformation, it was almost chaotic around the office. The huge influx of Chinese immigrants made the office very crowded, and to avoid this, a line began to form at the entrance to the immigration office at 5:00 in the morning. We had to stand in line by ourselves or, if that was too much for us, we hired an agent to queue instead of us. When the entrance opened at 8:00 am, people queued up in the hall. If you had hired an agent, you switched places with him or her there. Anyway, the queue behind you was a mess, as over 100 people were crammed into the hall.

After Hungary's accession to the EU, immigration offices were moved and numbered tags were introduced to replace the chaotic queues. Indeed, with the introduction of number tags, the anarchic queues have been eliminated. However, the introduction of number tags will not significantly reduce queue times. Nowadays, one has to queue to get a number tag. There is a long line at each of the two machines which issue the number tags, because there is an attendant by the ticketing machine who listens to each procedure and tells the people which number button to choose, and thus it takes a few minutes for each individual to get a number tag. If there are thirty people in line, you will be waiting in line in front of a number ticketing machine for over an hour. And even if you have gotten a number tag, you would not be able to get to the counter right away. You will wait for another hour or two. At lunchtime, the window closes, so depending on the number tag you have, you may get an afternoon receptionist. You cannot complain to anyone. You just have to follow the rules of the immigration office.

As noted above, if you pay a reasonable amount of money to a company that handles immigration procedures on your behalf, you would not have to stand in line. However, in this case, the company representative will stand in line for you and meet you at the office around the time you get your number tag. Applicants with an annual income of more than HUF 10 million (\$30,000 at the current exchange rate) are also eligible for VIP treatment and receive priority treatment. However, if a foreign student with no connections tries to get a visa, he or she will have to spend an entire day in the immigration office.

Various types of personal certificates are issued at local notary offices, but the notary office located in Budapest District II municipal office limits the number of tickets that can be issued in the morning and in the afternoon, for example, 30 in the morning, 30 in the afternoon, and so on. So if you want to get the process done quickly, you will have to queue up before the notary office opens to get your number tag quickly. Late arrivals can no longer receive a number tag. Numbered tags are issued once in the morning and once at noon, so those who do not get a numbered tag at those times must come back the next day.

In short, before the system change, people were queuing anarchically, but after the regime change, they just queue to get their number tags. To Hungary's credit, it is not that there has not been any progress at all. You do not have to go to a notary office in your area of residence; you can go to a notary office in another district, too. There is also a system in place that allows you to book appointments through the internet, which makes it possible to make appointments in advance. However, there are only a

limited number of days and times when you can make an appointment in advance, so if you are in a hurry, you have no choice but to go to the office in person, which is disastrous.

Recently, the number of notary offices that can process applications has increased, and since it is possible to process the application at any notary office, regardless of where you live, you can choose a notary office that is relatively free. Fewer and fewer notary offices, such as the one attached to the Budapest District II (where many foreigners live) municipal Office, restrict the issuing of numbered tickets, so nowadays the process of getting various documents is more flexible. However, there are still some places, such as the notary office in Budapest District II office, which still operates with a mindset of old regime. In particular, the central notary offices are still working under the mindset of the old regime. Unlike central notary offices, local notary offices have a dedicated desk to receive certificates, so you do not have to wait as long as at the immigration office to receive your completed certificate.

However, not all certificates and rewrites can be completed at the local notary office. For example, the replacement of license plates for business vehicles and for vehicles that have received tax exemption treatment can only be done at the central notary offices. This central notary offices have the same limitation on the issuance of numbered tags as the Budapest District II office (a few times a day), and those who fail to get their numbered tags have to wait and queue until the next time the tags are issued. Again, it is possible to get an appointment using the internet, but if you are in a hurry, the only way to get an appointment is to stand in line (first in the queue for the ticketing machine and then at the counter).

What these reception systems have in common is that the service giver has absolute authority, and the service recipient has no choice but to passively comply. No one complains about queues or waiting times. In offices in which these queues form, opaque and corrupt connections can arise between government officers and private contractors.

Thus, “official (doctor) sovereignty” is not merely a residue of the socialist system era, but an inherent dominance-subordination relationship universally observed where there is a distributional relationship enforced by the “give but obey” principle.

5.3.2 Hospital Patient Services

The health care system in Hungary has remained largely unchanged since the socialist era. The situation for health care in other former socialist countries is likely to be similar in other former socialist countries. Basically, the first place to see a doctor is the district clinics, which is funded by social security. Of course, there are now many private clinics and you can go to them in person, but all private clinics are self-funded and are not covered by public health insurance.

Also, you cannot go to a general hospital or university hospital unless you have a referral issued by the district clinic. If you go directly to a general hospital without a referral, you will automatically pay for your own treatment. This is an unavoidable measure because it is confusing when patients are rushed to the general hospital from

the start. What is difficult to understand, however, is that if direct care is limited to the general hospital, patients must obtain an appointment from their own physician at the general hospital where they want to be treated before they can be issued a referral at the district clinics. It is understandable if the doctor at the district clinic contacts the general hospital to make an appointment and then issues the patient's referral, but the patient has to make the appointment with the transfer doctor himself. However, if you are brought to a general hospital by ambulance, you can get a referral after the fact. Therefore, if you feel that you need urgent medical treatment, you should not take a taxi to the hospital by yourself, but rather call an ambulance to get to the hospital. This is an important piece of wisdom. The reason for this is that if you do not use an ambulance, you usually have to wait in line for emergency care, while patients transported by ambulance are given priority.

I was in a general hospital in Hungary for about five days in 2002 and 2019. Despite the difference of about seventeen years, I noticed that the treatment of patients (inpatient services) in general hospitals has hardly changed. These were very valuable experiences. The medical services themselves are standardized in every general hospital, so that's not where the problem lies. Of course, doctors are struggling with low remuneration and limited installation of sophisticated treatment and diagnostic equipment. However, doctors in Central European countries are highly skilled. The training and education of doctors is rigorous, and there is active interaction with Western hospitals and doctors.

The problem is how to serve patients. In a very difficult management situation in the hospitals, where even basic medical services are a struggle because of a lack of equipment, most hospitals do not have the concept of improving the environment for receiving patients (patient services). This situation in the medical institutions is part of the legacy of the socialist era.

First of all, general hospitals that have existed for a long time cannot afford to spend money on maintaining sanitary conditions in the toilets and shower rooms, and hospital staff, who are used to it, do not have a voice for improvement. There is no toilet paper in the toilets and inpatients bring their own toilet paper, partly for financial reasons, but also because of the problem of installing toilet paper, which can be stolen very quickly. The floors and walls are not repainted or reupholstered in order to keep the toilets clean. Cleaning is often done once in the morning and once in the afternoon. The toilets and walls are broken but left in disrepair; when I was admitted in 2002, I was told that the bed in which I was lying was fifty years old. Seventeen years later, I was admitted to another general hospital, and the basic problems are the same. The paint on the window frames was peeling and left in place even though there was a problem with the seal, and cold air was getting into the room. The toilet, shower stall, bed, window sills, etc. all have problems, but there is no solution other than to renovate them completely, so partial repairs are not an option.

Then there's the food, and since patient care at the General Hospital is basically maintained by health insurance, the unit cost of meals is kept low. In the morning, it is just two slices of bread with a piece of margarine and a couple of pieces of poor quality ham. Tea is poured from a large pot. Nothing has changed in seventeen years from this

perspective either. The evening meal is basically the same, with the only difference being that instead of margarine, it comes with liver paste. The quality of the ham was so bad that we could never find similar low quality meat in ordinary supermarkets. The budget for breakfast and dinner is not more than \$1. Only hot meals are served for lunch. Lunch comes with hot soup and a main course, but the unit price is still about \$2 or less. So many patients' families bring meals from home.

In Japan, meals would be different depending on the type of illness, but in Hungary the same meals are served in the morning and at night, and no distinction is made according to the condition of the patient. For lunch, there are apparently two or three different meals available depending on the type of illness, but there is a limit to this on a budget of about \$2 per lunchtime meal.

It would be a tragedy to be squeezed into a large room in a hospital in Hungary. Patients with all sorts of illnesses are crowded together, and it is hard to keep them clean. There is no room change, even if some patients are coughing constantly or defecating in bed in the middle of the night. Simple cleaning routines are maintained, and in some cases antibiotics are given to prevent infection, but this can lead to other illnesses.

The notion of providing services that allow patients to remain clean and stress-free is completely absent since the old regime. From the outset, minimal expectations concerning basic comfort and sanitation in a hospital, such as providing rooms where patients can stay free of nosocomial infections, providing meals according to the patient's condition, and ensuring the cleanliness of toilets and shower rooms, have been entirely neglected. In the first place, the concept of hospital management itself is lacking. There is no one responsible for running a hospital or for improving the medical and patient services provided by the hospital. This is part of the lack of patient care that has persisted since the socialist era. The notion that hospitals do not provide services to patients, but only provide treatment for diseases has been maintained since the socialist era. The notion of patient care services itself does not exist.

Many large general hospitals have only one CT scan machine, and even here, there is a waiting list. Moreover, it is an old model. When I visited the new building of the School of Veterinary Medicine at Osaka Prefecture University, I was surprised to see the latest model of CT and MRI machines equipped for human use. The medical and diagnostic equipment in old Hungarian general hospitals is far inferior to the equipment in Japanese veterinary schools or veterinary hospitals.

Obviously, the maintenance of medical institutions has been lagging, and in the meantime, the institutions have fallen into a situation in which even partial maintenance cannot keep up with the decline, so the hospitals have no choice but to use temporary repairs.

The payment of a tip (gratuities) to doctors and nurses is also a bad practice that has continued since the socialist era. It is a phenomenon found in all former socialist countries. In fact, doctors and nurses are paid so little that it is difficult to live on their salaries alone. Doctors can work on the side in private clinics, but nurses have limited freedom to work on the side. Everyone knows this, so they give gratuities to the doctors who operate and the nurses who take care of them. One hands the money over quickly when no one is looking, but it is hard to get the timing right in practice. Unless you are

a frequent visitor to the hospital, it is difficult to decide how to give this gratuity to doctors and nurses when you are only going to be in the hospital once every ten or fifteen years, for example. This is also a psychological burden for patients.

In short, the medical system in the former socialist countries has a notion of how to treat disease, but not of how to receive patients in a comfortable and hygienic environment. The reason why the idea has not spread beyond the basic notion that a hospital is a place where doctors provide medical treatment is because the basic notion of the relationship between the two actors is fixed: the doctors provide medical treatment and the patients follow them. This is the medical version of “give but obey”. In a health care system in which doctors are sovereigns and patients are subjects, the very idea of creating an environment for patient acceptance is not existing. If the situation is like this even in Hungary, the situation in other countries east of Hungary may well be worse. Many hospitals are likely to run out of the drugs themselves, and therefore drugs might even be sold illegally. Even under such circumstances, politicians and high-ranking bureaucrats usually have special hospitals designated for them. This is another bad practice from the socialist era.

5.3.3 The Social Psychology of “Official’ Sovereignty”

The only way to reduce the queues (shortages) seen in public services is to increase staffing or change the way people work. Whether we are speaking of a hospital, notary office or immigration office, the only way to reduce waiting times is to allocate staff appropriately according to the level of congestion among service recipients and to be flexible in the provision of services.

However, the idea of staffing appropriately according to the level of congestion does not prevail in the governmental agencies. Unlike in the private sector, long lines will not reduce the number of customers. The inconvenience of not being able to receive medical attention, be issued a certificate, or obtain a residency permit unless one waits in line is a disadvantage suffered unilaterally by the service recipient alone. There is no detriment to the organization providing the service. The heads of each organization often do not even know how long the lines are each day, or how long customers have to wait. It is rare for a chief to take the initiative and take steps to reduce lines and wait times. Most of them are not even aware that this is their job. This is an example of the typical insensitivity of someone who has worked in a hierarchical organization for a long time. Unless instructed to do so by their superiors or by the competent ministry, officials in the field do not think of shortening queues and waiting times.

On the contrary, the presence of a queue makes people aware of the importance of their organization and work, and it is arguably even a source of pride. Each official feels some sort of advantage in dealing with the service-seekers who are asking humbly for assistance. The more an official performs a simple task, the more he or she feels this kind of superiority. This sense of superiority shapes the psychology of the official, as he finds the meaning of his work in this sense of superiority.

Under the old regime, customs officials meaninglessly inspected baggage in what seemed to be a dispiriting gloom. Even more authoritative behavior, such as the con-

duct of the officials who demanded bribes and harassed people, was common among lower-level officials. This mode of behavior does not disappear overnight with regime change. Rather than disappearing, it morphs into various forms of conduct within organizations and survives for a long time.¹¹

5.3.4 The Social Psychology of People in Queues

Before the regime change, those who complained about the officials at the airport's immigration control were forced to queue at the end of the line. "If you want to argue with me, please go to stand at the end of the line," he used to say. Whether the person you were dealing with was an immigration official, a doctor, or a receptionist at a notary office, there was nothing to be gained by defying the authorities.

As mentioned in the previous section, there has been no essential change in the bureaucracy after the system change. Complaining about the hospital system does not help change the system. Complaining about long wait times at the immigration office does not speed up your wait. If you complain in an organization with authority, you will be forced to be silent with the usual phrase: "We'll hear about your complaint later, so line up again at the end of the line." So people have no choice but to be patient, stand in line, and wait their turn, even if they are complaining and disgruntled.

There are two ways to avoid these waits.

One method is to find an acquaintance of an official of the organization in question and have him handle it through his connections. This is a common method in both hospitals and governmental organizations. In this case, bribes often flow. The amount of money varies depending on the difficulties of the procedure.

The other option is to hire an agency. However, if you do not have any connections with a hospital, the only option is to go to a private clinic. There are always agents in the case of governmental procedures and individuals who can act on your behalf. Those who want to spend money to avoid inconveniences choose to do this, but those who do not want to waste their money have no choice but to use their own time to wait their turn patiently.

Neither of these methods will fundamentally solve the problem, only the immediate personal solution. However, this often involves complex and cumbersome official procedures, so people choose to use their connections or money to get the problem done. That is a piece of wisdom from the old system.

¹¹ It is not correct to see this as simply a legacy of the socialist era's top-down organization. It is a social behavior/phenomenon commonly found in power organizations that are forced to be unilaterally passive. News of the occasional seizure of a musician's high-priced instrument (Stradivarius) because he or she did not have the proper papers or the confiscation of a footballer's luxury watch at Frankfurt Airport in Germany has been reported. When the federal minister of finance brought the attention of the customs organization to these cases, the organization reportedly did not budge an inch, claiming it had exercised its authority legitimately. Officials in public organizations that have been given certain powers believe to be making a show of themselves by regularly taking draconian measures.

When people get used to this kind of social behavior, they lose their critical spirit. Constructive action, such as proposing measures to eliminate lines and waiting times, does not occur spontaneously. People try to overcome their immediate difficulties by adapting to the system. Where the “give but obey” system dominates, people choose to suppress criticism and adapt and use their social connections as best they can. The society before the regime change was exactly this kind of society dominated by a castrated mentality. The system transformation was supposed to correct this social mentality and build a society which would once again foster a healthy critical spirit in its citizens. But the reality is far from this ideal.

The deeply-imprinted restraining mentality of the people and the diminutive behavioral patterns of trying to live by using connections continue to thrive in various social dimensions. The idea of improving one’s own organization and making it more open has not nurtured, even after thirty years of systemic change. This is a pity, but it teaches us that this kind of shift in social spirit and social behavior still takes a long time to happen!

Chapter 6: The Politics of System Transformation

The Legacy of the Old System

The regime change was first and foremost a change in the political system. With the shift to a multi-party system, many people who had not been involved in the old regime or who were critical of the dictatorship were supposed to enter politics to replace the politicians of the socialist era. Certainly, the first general elections after the regime change were attended by a large number of intellectuals, scholars and researchers who had had no experience of governing and were distant from the Communist Party. But for those who lacked experience in political organization and in government, everything was a series of trials and errors.

In Hungary's first general election (1990) held after the regime change, the Hungarian Socialist Party (MSZP, Magyar Szocialista Párt), the successor to the Hungarian Socialist Workers' Party (MSZMP, Magyar Szocialista Munkáspárt), went out of power with less than 10 % of the vote.¹ MDF (Magyar Demokrata Fórum, Hungarian Democratic Forum), which was founded by intellectuals and civilians who had distanced themselves from the former Communist Party, came to power. However, the new government was suddenly faced with the extremely difficult task of dealing with the economic crisis that accompanied the system transformation. The transition from one-party dictatorship to parliamentary democracy proceeded without confusion, but the task of coping with the crisis of the transformational economic depression was too much for anyone to handle. Continued social turmoil, including the collapse of the national economy and roadblocks by taxi drivers, rapidly cooled the hopes and dreams of the MDF government; the death of Prime Minister József Antal in 1993 also accelerated the stalling of the MDF government.

Although MDF won power in the first free election, it was criticized by the public for its lack of tangible results and its inability to clean up the social disruption of regime change. The simple public sentiment that "we cannot leave politics to amateurs after all" led to a one-man victory for the Hungarian Socialist Party in the 1994 general election.² Thus, with the exception of a brief period of seizure of power by Fidesz

¹ MDF received 42.75 % of the vote and won 164 out of 386 seats. SZDSZ (Szabad Demokraták Szövetsége, Alliance of Free Democrats) won 92 seats (23.83 %). FKgP (Független Kiszgazdapárt, the Independent Smallholders' Party) won 44 seats (11.14 %). MSZP won 33 seats (8.55%). Fidesz (Fiatal Demokraták Szövetsége, Alliance of Young Democrats won) 21 seats (5.44 %).

² MSZP (Hungarian Socialist Party) won the election by 209 seats, while MDF lost by a whopping 126 seats. The Socialists won 1.78 million votes in the regional areas, thus tripling their share of the vote. SZDSZ won 69 seats, MDF won 38 seats, FKgP 26 won seats and Fidesz won 20 seats.

(1998–2002), the Socialist Party, which had a large number of personnel from the old regime, remained in power in Hungary until 2010.

As discussed in Chapter 2, changes in society are, first and foremost, changes in people's social relationships, and changes in the social roles and functions of the people who make up society create a new society. In the course of these kinds of changes, people who have been excluded from the leadership of the previous society, will join the leadership and determine the direction of social change. Social change is a break with the old society, but because the same people who have lived in the same society are all responsible for the change, the social norms and ethics perpetuated under the old social relations will live on for quite a long time. Even if superficial changes are seen, the old norms and ethics will continue to live on in the new social relations. Even if people in new social roles declare a break with the practices and ethics of the old society, even if temporary bans and other measures are introduced, it will take generations for the ethics and norms of society as a whole to change.

This process of social change is complicated when the leadership of the old regime enters the leadership of the new regime. In general, in social change, even if the role of the old society's leadership is temporarily denied, after a certain amount of time the old society's leaders may reassume leadership positions in the new social constellations. The same person assuming a leadership position in both the old and new regime is a phenomenon commonly observed in social change. In particular, the person who demonstrates competence in organizing the society takes on such a role. The issue of discontinuity and continuity arises in all social changes because such temporally overlapping social relationships are maintained for a considerable length of time. It is precisely this overlapping social relationship that will be analyzed in this chapter.

The regime change in Hungary was led by the reformists within the former Socialist Workers' Party, and it proceeded peacefully, so the leaders of the old regime assumed leadership positions in the new social system as well. There is an interesting study of the roles of the elites of the old regime in the political system of the new regime. Table 6.1 shows how much weight the elites of the old regime carried in the political arena (governmental composition) during the two decades of the system transformational change from the first freely elected Antal cabinet (1990–1993) to the Gyurcsány cabinet (2004–2009).

Particularly noteworthy in this table is the composition of the Horn cabinet. The total number of top leaders in Horn cabinet (chancellor, ministers, parliamentary vice-ministers and undersecretaries etc.) was 66, 70 % of which were people who had held elite positions in the old regime or in government institutions. Even in the case of the Medgyessy cabinet, 57 % of the top leaders had been members of the old regime's elite. Though the phrase "regime change" has become a standard term to refer to the shift which took place with the fall of socialism, from the perspective of real politics, the new government included many elites of the old regime.

In major political and economic changes in society, not only in Hungary but also in other countries, a significant percentage of the social leaders of the old regime will secure leadership positions in the new society as well. The mass elimination of the leadership of the old society, as in the case of the Pol Pot regime in Cambodia, is an

Table 6.1. Weight of elites of the old regime in the governments after the system transformation

	Antal Cabinet N=86 (1990–1993)		Horn Cabinet N=66 (1994–1998)		First Orbán Cabinet N=97 (1998–2002)		Medgyessy Cabinet N=80 (2002–2004)		First Gyurcsány Cabinet N=73 (2004–2006)		Second Gyurcsány Cabinet N=41 (2006–2009)	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
A. Top Leaders in the old Regime	6	6.9	25	37.9	5	5.1	23	28.8	18	24.7	13	31.7
MSZMP			3				8		8		4	
KISZ			1				4		4		4	
Népfront (Patriatic Front)					2							
Deputy Prime Minister			1									
Minister			2									
Deputy Minister	4		7		2		1		1		1	
Vice Minister	2		4				2		2			
Council Leaders			5		1		4		1		4	
Member of Parliament			1									
Labor Union Leaders			1				2		2			
B. Administrators of Public Institutions in the Old Regime	29	33.7	23	34.8	13	13.4	22	27.5	15	20.5	3	7.3
Senior Officials	13		16		8		16		9		2	
Corporate Executives	10		5		3		4		5		1	
Academic, cultural and media leaders	6		2		1		2		1			
Health Care Executives					1							
total (A+B)	35	40.6	48	72.7	18	18.55	45	56.25	33	45.2	16	39

Source: Éva Ványi “Elitcsere és kései életreprodukció. Kormányzereplők, 1990–2010”, *Politikatudományi Szemle* XXII, no. 1 (2013): 7–26.

Note: There are calculation mistakes in the original tabel, therefore mistakes are corrected and further simplified by omitting two very short cabinets data from the original one. “N” means the total number of the elite post each cabinet held. MSZMP is the Hungarian communist party and KISZ is the Youth organization of the communist party.

extremely unique case, and in most cases of social change, many people adapt to a fluctuating society by changing their social relationships (roles) and functions.

However, Table 6.1. is only a quantitative comparative table, and that alone does not allow us to understand the political changes. Therefore, this chapter first examines the change from the old Socialist Workers' Party to the Socialist Party and looks at the behavioral patterns of the old elite. It then explores the causes of the collapse of SZDSZ and analyzes the character of the Fidesz regime.

6.1 The Character and Changes of the Socialist Government

6.1.1 The End of the Socialist Workers' Party

With the suppression of the movement for political freedom in Czechoslovakia in 1968 and with conservatives once again gaining momentum within the Soviet Communist Party, the Hungarian economic reforms of 1968 had to be half-heartedly completed. Ten years after the reforms began, in 1978, I had the opportunity to study in Hungary, but both university life and the atmosphere in the city were stagnating. There were absolute limits to reform within the framework of Soviet-style socialism. A sense of melancholy was prevalent, not only in Hungary, but throughout the entire Eastern European socialist bloc, which was stuck in a stagnant society. In response to the social stagnation, the Communist Party organization itself had lost its vitality and was unable to envision its prospects for social development.

In the 1980s, illegal publications (*samizdat*, *самиздát*) began to be active in Hungary, but they did not become a powerful force to change society. The change and reform movements came from within the party. Around 1987, a movement for economic reforms began to emerge from within the Hungarian Socialist Workers' Party, and as if in response to this, the intellectuals' movement was activated and the party's bonds began to loosen. The movement did not originate from the leadership of the party, but began as a revolt of party members who had distance from the leadership of the party. Inspired by this, young intellectuals outside the Party became more active in illegal publication activities, and opposition forces gradually came to the fore. At this time, the Party leaders were already losing their power to control these movements.

One movement toward reform was led by Imre Pozsgay, who had worked through the party's cultural field and held key positions in the minister of culture and in the editorial department of the monthly magazine *Társadalmi Szemle* (Social Review) published by the Party. Although he was a party central committee member, he was not high in the party hierarchy and belonged rather on the margins of the leaders. Because of his frequent association with intellectuals and cultural figures and his flexible thinking, the party leadership posted him to the position of First Secretary of the Patriotic Front. This constituted a demotion, as the job was relatively trifling. However, he came to the fore again during the turmoil that followed Kádár's resignation and led party reforms (the party breakup) between 1988 and 1990. After his promotion to Politburo member in the fall of 1988, he actively led the reinterpretation of the 1956 Hungarian uprising, and as the leading reformist in the party, he went into an all-out

confrontation with General Secretary Károly Grósz, who succeeded Kádár. Pozsgay's momentum and his popularity outside the party forced Grósz to retreat from the political stage. Pushed by a torrent of reform, Grósz left the general secretary's post after less than two years. This became an ultimatum to the old guard of the Socialist Workers' Party after Kádár's resignation. With the defeat of the conservative old guard, the Central Committee members, who had remained silent, accepted the reform line, and the Hungarian Socialist Workers' Party was forced to go on with its last party reforms in order to survive.

Another movement of reform was that of a group of economists led by Rezső Nyers, who led the 1968 economic reforms and had the power to unite economists. While Pozsgay's role was to unite the literati, Nyers's role was to unite the reformist economists.³

I arrived at the Japanese Embassy in Hungary at the end of August 1988 as an economic adviser to the Ministry of Foreign Affairs. With the resignation of General Secretary János Kádár (May 22, 1988), the clash between the reformists and the conservatives within the socialist workers' party was beginning. By late summer 1988, the final chapter in the political struggle had begun. The party's Central Committee meeting in September was the scene of a fierce debate between the reformers and the conservatives. The central committee had begun to change from the formal discussion scene, in which decisions are made by unanimous consent, to an arena in which intense debate over the direction of reform was being fought.

After arriving in Budapest, I visited T. Iván Berend, a historian who held the position of president of the Academy of Sciences. At the time, Berend was also a member of the Central Committee of the Socialist Workers' Party. After each General Meeting of the Central Committee, I visited Berend in the office of the President of the Academy of Sciences to hear the status of the discussions. For almost six months, from September 1988 to March 1989, the Central Committee of the Socialist Workers' Party continued to struggle between the conservatives and reformers.⁴ Watching the heated exchanges between the two factions and observing what was going on outside the Workers' Party, the middle faction hesitated and could not decide which factions to join. The flow of

³ I am acquainted with Rezső Nyers, and when Nyers visited Japan at the invitation of the Ministry of Foreign Affairs, I organized a seminar at Hosei University and showed him around Tokyo. Nyers was elected as the last leader of the Socialist Workers' Party in June 1989. When I visited Nyers at the party's headquarters on the morning of July 6, 1989, I was informed of Kádár's death that morning. After the virtual failure of economic reforms in 1968, Nyers was demoted from the party leadership and given the position as director of the Academy's Institute of Economic Research. However, the personal relationship between Nyers and Kádár was not bad; the two men were tennis buddies.

⁴ When Professor Berend visited Japan in 1987, the Society for the Study of Eastern European History held a seminar at Hosei University. As the deputy dean of the faculty of Social Studies, Hosei University at that time, I helped organizing a seminar of Professor Berend. As a result of this relationship, I had a very close relationship with him in Hungary, both in private and public life.

the majority of the middle faction to the reformists determined the direction of the Socialist Workers' Party. It also meant the end of the party.

From early 1989, Grósz and Pozsgay were at odds with each other violently over the evaluation of the 1956 incident. A Historical Review Committee was organized by fifteen historians at Pozsgay's initiative to examine the history of the forty years which had passed since 1956, with Berend serving as the chief investigator. The report of the Historical Review Commission,⁵ which defined the 1956 incident as the "peoples' uprising" was prepared, and Pozsgay published it without the consent of the Politburo and the Central Committee, and the final struggle between the conservatives led by Grósz, and the reformers led by Pozsgay took place. Ex post facto, the Central Committee consented to this report and the conservatives were defeated.

6.1.2 Miklós Németh and Gyula Horn

On September 11, 1989, the Hungarian government opened the Austrian border and allowed the "refugees" from East Germany who were staying in the country to "flee" to the West. This decision eventually resulted in the fall of the Berlin Wall in November.

At the time, Prime Minister Miklós Németh and Foreign Minister Gyula Horn were involved in this decision in the Hungarian government. The Hungarian government's opening of the borders was praised in West Germany. Chancellor Németh and Foreign Minister Horn gained an overblown reputation in the historical narratives of the events as the people who had liberated East Germans eager to flee dictatorship for freedom. Their reputations in Hungary are not as high as their reputations internationally. This is because they did not actually play an active role in the reform process within the Socialist Workers' Party and only had the historical good fortune of making government decisions in a situation in which they have no other choice.

Neither Németh nor Horn led the movement in the reform process of the Socialist Workers' Party. They were merely party bureaucrats, and they did not speak out actively beyond their roles as bureaucrats, nor did they collaborate with intellectuals outside the party to get involved in party reform. This is the essential difference between them and Pozsgay in the process of the reform of the Socialist Worker's Party. However, in the fall of 1988, amidst a struggle for leadership, the party's conservatives retreated and young competent members were given a chance thanks to the efforts of Pozsgay and Nyers. In November 1988, the shaken Socialist Workers' Party leadership tried to prevent the dismantling of the party by making Nyers, the reformist, prime minister. However, Nyers did not accept this proposal, and he recommended a young party member, Németh, as prime minister. At the time, the Socialist Workers' Party still maintained a one-party dictatorship, and there was no choice but to select someone outside the party as prime minister. Like an "unexpected good luck" nomination, Németh was suddenly appointed prime minister. This was just before he turned forty-

⁵ Report published in full: *Társadalmi Szemle*, special issue, 1989. <http://www.rev.hu/rev/images/content/rendezvenyek/tarsadalmi-szemle.pdf>.

one years old. Realizing that the aging party needed a young face to weather a period of tumultuous change, Nyers handed over the premiership to a younger party member.

After graduating from the Karl Marx University of Economics, Németh became an assistant researcher in the Department of National Economic Planning.⁶ He then moved to the Institute attached to the Planning Agency, and from there he worked his way up to the economic bureaucracy at the Party headquarters. As can be seen from this background, becoming a party's economic bureaucracy for Németh meant that he would eventually climb to the top of the government as minister of economic affairs. Németh embodied the typical elitist orientation of the competent party bureaucrats of the time. Thus, even when criticism of the one-party dictatorship grew from outside the party, he did not join the process or lead the process himself. The tactic used by elite bureaucrats was to surrender to the flow of politics and wait for the time to act. Waiting for the chance is the typical and best way for competent bureaucrats.

In the process of the unexpected collapse of the Eastern European socialist systems, Németh proceeded down the path of peaceful dissolution. He ran and won the free elections in May 1990 as an independent candidate rather than as a candidate of the reconstructed Socialist Party. However, when he was invited to become vice president of the European Bank for Reconstruction and Development (EBRD), which was established in 1991, Németh left Hungary and moved to the UK. Németh had no intention of sweating as a soldier in the reformed Socialist Party. Although he became a member of parliament as an independent, that did not satisfy his ambition. Therefore, the invitation from the EBRD was a godsend to him. It was a far more meaningful life choice for him to leave Hungary and take an honorary position in the EBRD than to get involved in daily political disputes as a mere member of parliament.⁷

The Socialist Party, which regained power in 1994, was seeking a presidential candidate. Within the party, Németh's name was mentioned. Németh himself thought that he might run "if all parties would support him". However, Horn did not push for Németh. There was no choice for Horn to endorse Németh, who was living the good life abroad

⁶ The Department of National Economic Planning at the Karl Marx University of Economics (now Corvinus University) was an elite department. The elite course for economic bureaucrats was to graduate from this department and enter the Planning Agency or the Institute attached to the Planning Agency. I had a chance to study in this department for a year and a half from 1979, where I got to know several researchers of my generation. The graduates of this department served as successive directors of the Planning Agency and its affiliated institutes. When I began to study at the Department, Németh had already moved to the Planning Agency, and I had no personal relationship with him. Németh had been politically active since his school days, and being the head of the Communist Party branch at the University of Economics, he was on his way to becoming an elite cadre of the party. This was not because he believed in the ideology of the party, but rather because this path under a one-party dictatorship was the only way to success and processional advancement in life at the time.

⁷ The elite economic diplomat position of EBRD vice president not only satisfied Németh's self-esteem, but also ensured his stable economic life. For Németh, who had worked his way up from economic bureaucrat to prime minister, there was nothing more he could have wished for in this position.

without having to sweat and tend to the difficult task of rebuilding the Socialist Party. Therefore, there was no reason for Horn to celebrate and appoint Németh as president of Hungary.

Németh resigned from the EBRD in 2000 and returned to Hungary, but he has no intention of returning to politics and lives a quiet life on the shores of Lake Balaton. Hungary gives him a large pension, which is available to those who served in office as prime minister, and the EBRD also gives him a pension, and at the young age of 52, he retired from active duty and became a pensioner.

What about Horn, who was a typical mid-level party bureaucrat? Horn was born in Budapest, but he grew up in a poor family and left school in the fifth grade to get a job. He was a hard worker to the core. He graduated from a night technical school in 1948 and later joined the Communist Youth League. Then, he pursued higher education at the Rostov College of Economics and Finance in the Soviet Union and returned to Hungary in 1954. He studied in the Soviet Union with the support of the Party. This was another career path for the children of a working-class family, which represented a different way of making a career from that of Németh. For Horn, Russian was the first foreign language, and even after he became prime minister, it was common for him to speak in Russian at international conferences.

Horn was a loyal party bureaucrat in the Socialist Workers' Party and did not defy the party center. He was one of the central committee members who remained reluctant to reform to the end during the reforming process in the party. In particular, for Horn, the reevaluation of the 1956 Hungarian uprising was unacceptable, and he never changed his assessment of the Hungarian uprising as having been a "counter-revolution". Horn was sent by the Party to study in the Soviet Union, and he lost his brother during the turmoil of the 1956 upheaval. Horn believed that his brother was killed by those who rose up, but his brother was also said to have been shot by a Soviet tank, so the truth is not known. After Horn returned to Hungary after he had completed his studies in the Soviet Union, the uprising happened and Horn joined the party's squad to suppress the "revolution" according to the party's assessment of the uprising as a "counter-revolution".

Later, Horn worked in international relations at the party headquarters. Because he could speak Russian, most of his work was probably in Soviet affairs. There was a strong feeling in Horn that the Party was the organization that had nurtured him, and that he should never betray it. However, in the process of dismantling the Socialist Workers' Party in 1988-1989, he was forced to change his position. He had to ask the following question: "will you be a loser and side with the conservatives, or will you compromise with the reformers and hold on to your political career?" For Horn, who was about to turn 60, he was faced with a final decision of his life. By compromising with the reformers, Horn chose to stick to flow of political change.

However, Németh did not appoint Horn as foreign minister in his first cabinet. When Németh's cabinet was formed, he retained Péter Várkonyi, who had served as foreign minister for a long time. His sudden appointment as head of the cabinet left him unprepared to preside over his ministerial appointments. He appointed Nyers and Pozsgay as ministers of state and he also appointed Péter Medgyessy as deputy prime

minister in charge of economic affairs. Medgyessy had served as finance minister in the Kádár government, and the two of them had known each other at the University of Economics.

On May 10, 1989, six months into his term as prime minister, Németh attempted to rejuvenate his cabinet by reshaping it. He appointed László Békesi minister of finance and Ernő Kemenes director general of the Planning Agency, consolidating his entourage with graduates of the University of Economics, while at the same time appointing Horn as minister of foreign affairs. Horn was almost the same age as his predecessor, Várkonyi, but Várkonyi, who was at the core of the conservatives, was the one who needed to be removed. However, even in 1989, all ministerial appointments were Socialist Workers' Party appointments. There was no room for outside personnel to be selected. It was necessary to select people in the foreign affairs bureaucracy at the party's headquarter who were sympathetic to the reformers. It is supposed that Németh chose Horn for two reasons.

The first was the flexibility in the way in which he carried himself. He felt indebted to the leaders of the conservatives who had looked out for him during his time as a party bureaucrat, but he sensed the changing times and realized that the only way to survive was to side with the reformers. Horn set aside the ideological issues involved in the reassessment of 1956 and prioritized dealing with real life in line with the times. He chose his role as a foreign affairs bureaucrat over the ideology of his party.

The second reason was the relationship with the Soviet Union. Németh knew that he would eventually have to talk to the Soviet Communist Party. That's why it was necessary to appoint someone who was familiar with the Soviet situation and who was fluent in Russian.

The appointment of a foreign minister did not make Horn a reformer in body and soul. The unfolding of history has made Horn seem a "reformist leader". Shortly after Horn became foreign minister, the number of "refugees" staying in Budapest from East Germany surged, forcing Hungary to decide whether to open its borders. As long as there was no way to send them back to East Germany, it was inevitable that Hungary would open the border with Austria at some point. And then, on September 11, 1989, when the Hungarian government opened its borders to Austria, Prime Minister Németh and Foreign Minister Horn became historical heroes. This was ten months after Németh had become prime minister and only four months after Horn had become foreign minister. For both Németh and Horn, this coincidence of history changed their lives. The "Hungarian hero who decided to open the borders" was hailed, especially in Germany. Horn has been talked about as a reformist politician in Hungary, and Németh got an appointment to serve as EBRD's vice-president because he was seen as a leading reformer in Eastern Europe.

What about Pozsgay? Pozsgay, who until the summer of 1989 had led the charge for reform within the Socialist Workers' Party and had pushed for the cutting of the barbed wire fence on the border, was supposed to be a step up in the road as a presidential candidate for the new Socialist Party. However, Pozsgay lost his chance to become the first president when a roundtable meeting with opposition forces decided to hold a referendum on the method of presidential election, and it was decided that

president would be elected by the new parliament, which the opposition forces had insisted on.⁸(8) This was because Pozsgay, a politician who was popular nationwide, would have gotten a majority of the votes if the election had merely been determined by popular votes, but he could not win a majority in parliament after a free election. With the referendum on how to run for the presidential election on November 26, 1989, Pozsgay lost his political place and gradually faded from the political scene. It was an ironic end to his career as a politician.

Pozsgay, the real reformer who had led the de facto dissolution of the Socialist Workers' Party for years and had prepared the country to open its borders, failed to gain the recognition he deserved in the history books, while party bureaucrats Németh and Horn, who had played no prominent role in the process of dismantling the Socialist Workers' Party, gained historical recognition as "politicians who achieved a historic feat" within a few months of their appointments as prime minister and foreign minister, respectively. History is so unfair and cruel in its assessments of the people involved.

There is an interesting episode about the relationship between Németh and Horn. The celebration of Horn's 75th birthday was held in the National Gallery of the Buda Royal Palace on July 9, 2007, with 300 guests. Gorbachev was invited to this party, at which Németh was not present. Later, in response to a newspaper reporter's inquiry, Németh said, "I left Lake Balaton for Budapest by car to attend the party, but on the way, I got stuck in traffic and turned back, thinking I would not be able to arrive on time". From the outset, he had not been keen on attending the celebration. They were two very different men, both in terms of their backgrounds before they started working at the party headquarters and from the perspective of where they stood after the regime change. With the exception of one period of opening borders, the relationship between the two men never deepened.

This reminds me of the time when Mátyás Rákosi imitated the celebration of Stalin's 70th birthday when he celebrated his 60th birthday at the Opera House on March 9, 1952 and was sworn in as president of the Supreme Council in Parliament on August 14, 1952. Mihály Farkas, one of the troika in the leadership of Communist Party at the time, stayed at the party's villa in Balatonaliga and did not attend the inauguration of this parliamentary session. Beginning with this incident, the relationship between Rákosi and Farkas gradually deteriorated, and then Farkas's push for the formation of the Nagy cabinet led to a complete breakdown in their relationship. Ultimately, Rákosi left for the Soviet Union without being held criminally responsible for the crimes committed under his dictatorship, while the Soviet Communist Party tried to set things

⁸ SZDSZ, which was made up of opposition activists in the old regime, strongly opposed the election of a leader of the Socialist Workers' Party as president, even if he or she was a reformist. They also argued that electing a president before free elections was undesirable. Therefore, a referendum was held on the method of electing the president. In the referendum on whether the president should be elected directly or by the parliament, votes in favor of allowing the new parliament to elect the president slightly outnumbered votes in favor of electing the president directly (50.1% to 49.9%).

right by blaming all the criminal acts of the Rákosi era on Farkas. This was in July 1956. Three months later, the 1956 uprising broke out.

6.1.3 The Nature of the Horn Cabinet – Heavy Use of Former Regime Leaders

After suffering a heavy defeat in the 1990 general elections, the Hungarian Socialist Party chose Gyula Horn as its leader and sought a way to rebuild itself. After four years awaiting the chance, the Hungarian Socialist Party won an overwhelming victory in the 1994 general election, and Horn was appointed to the position of prime minister. Horn, who had been little more than a mid-level foreign affairs bureaucrat in the Party until 1988, was named foreign minister in 1989, and witnessed the moment of the opening of the borders, and after the system transformation, he was elected prime minister in the second general election in 1994.

During these four years, Németh was elected as an independent member of parliament in the 1990 general election, but was invited by the EBRD to move to the UK. Medgyessy did not join the rebuilt Socialist Party but rather joined SZDSZ in an attempt to secure his political career, while Pozsgay was also elected as a member of the Socialist Party, but he left the party in the fall of 1990. While leading politicians were abandoning the Socialist Party one by one, Horn staked his political life on rebuilding it.

The political forces on which Horn relied in the rebirth of the Socialist Party were the party bureaucrats in the headquarters of the former Socialist Workers' Party and the comrades who had worked with him. This is evident from Table 6-1. He had no other choice. Among the appointments that truly illustrate the character of the Socialist Party led by Horn are the appointment of László Máté as deputy leader of the Socialist Party and the appointment of Piroska Apró as cabinet secretary in the Prime Minister's Office. László Máté was the treasurer of the former Socialist Workers' Party, and Piroska Apró was the eldest daughter of Antal Apró, a long-time politburo member of the Party as a comrade of Kádár.

As noted in chapter 3, Máté began his business⁹ immediately after the system transformation by acquiring a state-owned trading company, and he is known to have been involved in various economic fraud cases since then. As already described in detail, he teamed up with András Szász, said to be the Hungarian representative of the KGB, to set up Nádor 95 Rt. and became known as a shady fixer, working in the dark to defraud Postabank of funds and to obtain government ordering of wiretapping devices. Horn did not have the power to control Máté's economic crimes, and he valued Máté as an excellent businessman and gave him the reputation of being a true businessman who supported the market economy.

⁹ As noted in Chapter 3, "3.5 Corruption Phenomena Associated with System Transformation", the state-owned trading company acquired by Máté was named Kossuth Kereskedőház (trading house), with Piroska Apró as president. Clearly, the takeover involved senior bureaucrats and politicians of the former Socialist Workers' Party. I was invited to visit the office when it had just opened, and I remember being surprised by the marble refurbished offices.

Apró's election as secretary of the cabinet was clearly a tribute to the indebtedness to the era of the former Socialist Worker's Party. He rewarded Antal Apró's daughter with a corresponding post in order to return the favor for Antal Apró, Horn's boss when he had been a party bureaucrat. Piroška Apró was known for her pride and temperament. After a series of complaints from Socialist MPs that her approach to mediation was arrogant, Horn had to move Apró from Cabinet Secretary to Chairman of the Management Committee of the Budapest Airport Management Company. But even here, with her arrogant behavior backed by Horn's support, she clashed with the man who had been sent by SZDSZ as president of the company. So Horn once again moved Apró, appointing her to serve as chairman of the Management Committee of Magyar Hitelbank. Why did Horn have to go so far as to give Apró one important post after another?

Horn was able to become leader of the Socialist Party because of his sincerity and righteousness. He was not an aggressive character and he never rejected his admirers. He also dealt faithfully with all kinds of petitions. Thus, his approach of sincerely taking care of matters propelled Horn to the top of the organization. However, Horn's defenses became vulnerable, as he always showed a kind face to everyone. Máté gradually became involved in economic crimes using his position as deputy head of the Socialist Party, while Apró, who had obtained a post at Magyar Hitelbank, made the most of her post by working with her son-in-law Gyurcsány on various privatization deals by arranging loans from the bank. Horn was completely indifferent to economic crimes of all kinds. He had no understanding of insiders, looting of state and party assets, social justice or social ethics. In this sense, he was a man who grew up under the old regime and who was steeped in the old regime's code of conduct, from which he was unable to break free.

In March 2007, Prime Minister Gyurcsány decided to give Horn a national decoration to coincide with the celebration of Horn's 75th birthday in order to gain the backing of the Socialist Party's leading figures. However, then-President László Sólyom refused to sign it and asked the Constitutional Court to decide whether "the president must automatically accept the decision of the government or whether he has the power to reject that decision". The then president of the Constitutional Court was Mihály Bihari, a well-known reformist politician at the time of the system transformation, who was elected as a member of the Socialist Party in the first general election. He was a popular professor of political science at the ELTE School of Law, where many Fidesz politicians studied. After having been elected to serve as a member of parliament, he was later appointed president of the Constitutional Court with the support of both the Socialist Party and Fidesz. The Constitutional Court ruled that "the President is not a mechanical entity that automatically signs decisions of government, but has his own room for discretion", and as a result of that decision, President Sólyom did not sign the application for conferring a decoration on Horn. Thus, the plan to give Horn a national decoration was thwarted. This was the second proposal for giving Horn recognition of some kind,¹⁰ and Horn lost face on two occasions.

¹⁰ In 2002, then Prime Minister Medgyessy proposed that Horn be decorated, but when Ferenc Mádl, who was president at the time, did not immediately settle the application, Horn

In response to this decision, the Executive Committee of the Socialist Party criticized the president and Horn himself implicitly criticized Mihály Bihari,¹¹ saying, “Someone has forgotten the gratitude of the Socialist Party”. He wanted to say, “Who made you the President of the Constitutional Court?”. However, Bihari judged according to his own conscience and legal reasoning. The notion of the independence of government and the judiciary had not caught on among politicians even twenty years after system transformation began.

The rejection of the decoration was a hot topic in Germany, with articles and interview articles questioning why heroic reformist politicians were not honored. When asked with László Máté in mind, “Isn’t it a problem that you are missing economic crimes committed by your aide,” Horn replied, “He is an excellent businessman and a leading Hungarian businessman. The Hungarian capitalist is a multinational corporation”.¹² His answer was beside point. The German media was unaware of Horn’s background as a party bureaucrat and overestimated the importance of a single moment in history. At Horn’s 75th birthday celebration, Gorbachev stated that “the Soviet army’s intervention in the ‘56 uprising was an inevitable event,” but immediately the Executive Committee of the Socialist Party issued a statement that the Party had clear difference of opinion with Gorbachev’s views. However, Horn himself held the same views as Gorbachev, which is why two presidents of the state opposed the idea of bestowing a decoration on him. The Socialist Party, with Horn as its leader of party rebuilding, faced an unresolvable contradiction.

As mentioned above, Horn sided with the suppression of the 1956 uprising, and he consistently held the view that the uprising was counter-revolutionary; he did not agree with the Socialist Workers’ Party’s 1989 resolution to change its assessment of the event and redefine it as having been a “peoples’ uprising”. He never changed his view according to which “the 1956 uprising was counter-revolutionary”. This was the reason for the president’s refusal to sign the decoration.

An important part of the policy under the Horn government was the disposal of accumulated state debt and the sale of state assets to foreign capital. We can appreciate the solutions adopted by the Horn government in these policy decisions. Horn was determined to solve the problem of accumulated debt, even if it meant that the Party would lose the next general election. This is the debt accumulated during the days of the old Socialist Workers’ Party. Horn’s determination that the Socialist Party should deal with this debt responsibly was correct. The introduction of fiscal austerity measures

declined the proposal. President Mádl said, “National Orders are judged on the basis of whether or not the one violates the political and ethical principles of the system transformation, the constitutional value system of the Republic, and the legacy of the 1956 revolution and struggle for freedom”.

¹¹ I have maintained a good friendship with Bihari. He is very modest and sincere scholar. In the early 1990s, I translated an article by Bihari for a Japanese monthly magazine. Since then, we had several chances to meet at parties and excursions organized by Ferenc Kósa, a movie director and member of parliament.

¹² *Die Welt*, June 5, 2007.

(the Bokros package) and debt reduction through the sale of state assets was an unavoidable task. The issuance of Hungarian government bonds in Japan (Samurai bonds) greatly helped Hungary meet its accumulated debt obligations.

Horn was prepared for the possibility that the introduction of austerity policies would cause public displeasure and the Socialist Party would lose power in the next election. In that respect, Horn was clean. Although the people around Horn used their positions to commit economic fraud and economic crime, Horn himself did not pursue his personal economic interests and retired from the political front lines following the outcome of the next election, which brought a defeat for the Socialist Party. Horn certainly thought that he had accomplished his goal and had made a name for himself, and he therefore had no regrets when he left political life.

6.1.4 From Medgyessy to Gyurcsány

In the 1998 general election, the Socialist Party was defeated by the Orbán-led Fidesz by a small margin¹³ and Horn stepped down from his position as party leader. Ten years after the process of system transformation began, Horn ended his frontline political career at the age of 66. The newly elected leader of the Socialist Party upon Horn's retirement was László Kovács, who also had been a foreign affairs bureaucrat of the Socialist Workers' Party headquarters and had been in the field of foreign affairs for a long time. Although he was seven years younger than Horn, he could not be a candidate for the chancellor of the next election, given that Fidesz leader Orbán was 35 years old. The Socialist Party was unsure of its choice of prime ministerial candidate to stand in the 2002 general election. The opinion that Miklós Németh was the only one who could stand against Orbán grew stronger within the Socialist Party, but it was finally decided at the party's congress in 2001 to nominate Péter Medgyessy for the top job. Although Medgyessy was inferior to Németh in both name recognition and age, he was not an aggressive character, and his apparently modest appearance was expected to win him a fair amount of popularity. On the other hand, Németh, who returned from the UK to Hungary and lived a comfortable life, did not have any intention of going back to the difficult political stage except in an honorary position, such as president.

Having turned sixty years old in the year of the election (2002), Medgyessy had the unusual distinction of having served as finance minister under both the old and new regimes. Unlike his outward appearance of modesty, his underbelly is quite complex. Nothing tells us more about the life of the old regime's elite than the career of this man.

¹³ MSZP came out on top with 32.92 percent of the first round of voting, while Fidesz won the support of the other opposition parties in the runoff election, winning 147 seats. The Socialist Party remained with 134 seats, while its coalition partner SZDSZ also held 24 seats; Fidesz formed a coalition with the FKgP, which won 48 seats, and MDF, which won 18 seats, to take power.

The Socialist Party, with Medgyessy as its candidate for prime minister, defeated Fidesz in the 2002 general election¹⁴ and came to power again. Medgyessy, who had served as minister of finance under the old and new regimes, finally won the position of prime minister. But on June 18, less than a month after Medgyessy began to work, information about his past was released to the media. The big news was that Medgyessy had been a secret agent with the code name D-209. The source of the information was Fidesz. The secret of his peculiar career, in which he had held elite posts in both the old and new regimes, lay in Medgyessy's hidden past.

When Medgyessy failed his entrance exams to the Karl Marx University of Economics, he had been recruited by Antal Apró's eldest son, Antal Apró Junior, to become a secret agent. Thanks to this, Medgyessy successfully passed the university entrance exams the following year, and he also met and briefly fell in love with Piroska Apró, the eldest daughter of Antal Apró, who was also a student at the University of Economics. Medgyessy's career at the Ministry of Finance after graduation from the university was due to the support of Antal Apró, and so Medgyessy was deeply indebted to the Apró family.

However, Piroska is said to have given up her personal relationship with Medgyessy, and she married a Bulgarian, Petar Dobrev, whom she had met while working for the Hungarian Commercial Representative in Bulgaria. The daughter born to Piroska and Petar was Klára Dobrev, who became Ferenc Gyurcsány's third wife, as noted earlier.

After having graduated from university, Medgyessy worked as a bureaucrat in the Ministry of Finance. Initially, Medgyessy denied having been a secret agent, but half-way through the scandal, he admitted having served as an intelligence officer. However, he defended his main role in the Ministry of Finance as being to eliminate spies, saying that he had been given the task of protecting Hungary from international espionage. No one believes that contention. If he were given that assignment, it was only in the 1980s, when he was highly promoted to a high-level bureaucrat in the Ministry of Finance. It is certain that he would have been operating as a low ranking intelligence officer until then.

If one's past as an intelligence officer was exposed, he or she would be forced to resign in Poland and the Czech Republic. However, despite severe criticism from the coalition partner SZDSZ,¹⁵ a compromise was reached to keep the Medgyessy coalition government for the time being.

In accordance with Piroska Apró's wishes, Medgyessy appointed 30-year-old Klára Dobrev, Piroska's daughter, to serve as deputy director of the National Development Planning and EU Subsidy Agency attached to the Council of Ministers. In a cabinet reshuffle in May 2003, a year after having come to power, Medgyessy appointed Piroska's son-in-law Ferenc Gyurcsány to serve as minister of children, youth and sports. At the

¹⁴ Contrary to the 1998 general elections, the Fidesz-MDF coalition won 48.7 % of the seats (188 seats), but the 178-seat MSZP and the 20-seat SZDSZ formed a coalition again, and Fidesz lost power by 10 seats difference. The failure of the planned coalition FKgP to win any seats was a major factor for Fidesz in the failure of maintaining the coalition.

¹⁵ One of SZDSZ's founders and first chairman of the party János Kis left the party in protest against the decision of the party leadership to support Medgyessy.

age of 41, Gyurcsány was finally able to hold a key government position with Piroška's backing. To avoid criticism of cronyism, Klára resigned from the post attached to the Council of Ministers with her husband's appointment as a minister.

Gyurcsány's appointment as minister prompted a generational shift within the Socialist Party. In the summer of 2004, Prime Minister Medgyessy's intention to change Economy Minister István Csillag of SZDSZ was met with fierce resistance from SZDSZ. SZDSZ leadership supported Medgyessy in suppressing resistance within the party when Medgyessy past as a secret agent was exposed. Nevertheless, without consulting SZDSZ in advance, Medgyessy tried to change SZDSZ minister. Distrust of Medgyessy increased within the party when he intended to remove the Minister Csillag. On the other hand, the Executive Committee of the Socialist Party also decided to give up on keeping Medgyessy as prime minister due to the issue of secret agents and rejuvenation. The political decisions of the two parties that made up this coalition government were initially resisted by Medgyessy, but he eventually promoted Gyurcsány to the rank of deputy prime minister and prepared for a peaceful transfer of power.

At the time, the executive committee of the Socialist Party had decided to appoint Péter Kiss, who had been in ministerial positions in both Horn's and Medgyessy's cabinets, as the next prime minister, rather than Gyurcsány. Both Kiss and Gyurcsány are from the KISZ leadership, with Kiss being two years older than Gyurcsány. However, since Kiss had held important posts in successive governments, the Socialist Party had assumed that the experienced Kiss would be appropriate candidate for the prime minister.

As minister of children, youth and sports, Gyurcsány's growing popularity with local party organizations led to dissatisfaction of the party members with the decision to make Péter Kiss the sole candidate for the prime minister. Therefore, in response to its members, the Socialist Party held an extraordinary party congress (August 25, 2004) and held a vote on whether Kiss or Gyurcsány should be the candidate. The vote was 466 to 166, with Gyurcsány winning hands down. Despite the fact that they are both young politicians of the same generation from KISZ (Magyar Kommunista Ifjúsági Szövetség, Communist Youth League), Gyurcsány won a big win. He won because, though he was a young man, Kiss was not considered fresh, as he had built his career alongside old comrades within the Socialist Party. The demand of the local organizations for a fresh candidate who could compete with the Fidesz and Orbán overturned the decision of the Executive Committee of the Socialist Party.

This is where the generational change in the Socialist Party leadership began. Gyurcsány, who took over from Medgyessy, built his cabinet using former KISZ connections. After all, Medgyessy played a relief role in the changeover from the older generation of the Socialist Workers' Party, represented by Horn, to the younger KISZ generation, represented by Gyurcsány. Ironically, the role of the kingmaker in this generational change was played by Piroška Apró, the eldest daughter of Socialist Workers' Party politburo member Antal Apró.

Unlike Horn, Medgyessy is a man who pursued his own personal interests to the utmost and achieved both social status and economic benefits. Under the old regime, he had risen to become a key figure in the government, and soon after the regime was changed, he was promoted to the position of chairman of the Hungarian subsidiary

of a French insurance company because of his political connections. Under the Horn cabinet, he was again appointed minister of finance. He was always looking for a place in the sun, and he was keen to make a profit. Contrary to his modest appearance, he is a man who has pursued secular interests to the fullest extent. As detailed in Chapter 4, after resigning as prime minister, he signed an exorbitant advisory contract with Alstom, a French car manufacturing company, in connection with the construction of subway line 4. He used his position to gain economic benefits while holding the title of mobile ambassador to the Hungarian government. This was considered bribery and is still under investigation to this day.

One of the policies that led the Socialist Party to victory in the 2002 general election was the doubling of salaries for civil servants. This won the votes of people in the civil service for the Socialist Party. In fact, the coalition government of the Socialist Party and SZDSZ implemented an increase in the salaries of civil servants. In addition, Education Minister Bálint Magyar, who was from SZDSZ, not only increased the salaries of general teachers, but also raised the remuneration of the rector to an exorbitant level. This policy of the Medgyessy cabinet of increasing salaries has not only increased the remuneration of government agencies and the presidents of the National Bank, the Export-Import Bank and the Development Bank, but has also resulted in an increase in the remuneration of executives of public corporate entities and the formation of an arbitrary remuneration system for the top leaders of the institutions concerned. This promoted corruption in public corporate entities.

With Gyurcsány's appearance, the Hungarian Socialist Party facilitated a shift from politicians of the old Socialist Workers' Party to a younger generation of politicians of KISZ. Gyurcsány completed the remainder of Medgyessy's term in office when Medgyessy resigned midway through his term, and he prepared for the 2006 general election. With the rise of the young leaders of the Socialist Party, young activists also fed into the ministry's subsidy system and got involved in corruption.¹⁶

6.1.5 The Second and Third Gyurcsány Cabinet – Generation Change to the KISZ Politicians

The 2006 general elections brought victory to the Socialist Party in a closely contested struggle. This victory suggested that only Gyurcsány could compete with Orbán.¹⁷ The

¹⁶ One of the typical crimes was improper receipt of subsidies of ministries. The so-called Zuschlag case concerns the fraud of subsidies by János Zuschlag, a socialist MP who was arrested and sentenced to six years in prison. Another type of crime was improper selling of public real estate and the receipt of bribes by city mayors who are even popular now. The most famous case is that by György Hunvald, who was mayor of Budapest District VII. He was also sentenced to five years in prison. However, the fraud of subsidies and improper selling of the public real estate under the Fidesz ruling are incomparably larger in their scale than the crimes committed under the rule of the Socialist Party, as discussed in chapter 4.

¹⁷ In the national proportionally represented constituency, MSZP received 2,336,705 votes and the Fidesz-KDNP coalition received 2,272,979 votes, a difference of just over 60,000 votes. However, given the Socialist Party's dominance in the local constituency, the coalition won a

fact that Gyurcsány had the upper hand in the TV debate with Orbán and the fact that Fidesz created unnecessary friction with MDF gave the Socialists a narrow victory. The victory over the Orbán-led Fidesz gave Gyurcsány an unchallenged position in the Socialist Party.

Gyurcsány relied heavily on his comrades from his time in KISZ in his cabinet. György Szilvász and Gordon Bajnai got ministerial posts and supported Gyurcsány. Another young business owner of the emerging group was János Kóka, who was appointed economy minister from SZDSZ. Gyurcsány, as the de facto owner of an aluminum processing company, and Kóka got on well together on various market reforms. Fidesz labeled the Gyurcsány government “left-liberal” because of the market orientation of Gyurcsány-Kóka as a business owner.

Lights always cast shadows. On May 26, 2006, shortly after the election victory, a closed-door policy debate of the Socialist Party’s parliamentary group was held in Balatonöszöd. The conference was to finalize the government’s policy platform, and Gyurcsány gave an hour-long speech to close the conference. Gyurcsány, who was rapidly gaining ground in the Socialist Party, had a condescending attitude towards the old socialist leaders.

His remarks, which lasted for almost an hour, were not well prepared, and he spoke discursively of the Socialist Party’s incompetence in the tone of a chat among friends. From start to finish, he spoke as if chatting extemporaneously about what came to mind on the spot, and he showed a remarkable lack of respect for the delegation. Maybe he was tired, or maybe his policy proposals were not fully prepared.

In this speech, Gyurcsány spoke in a rambling style, as if complaining.

“We (the Socialist Party) do not have much of a choice. Because we have been dropping shit. There is no other country in Europe that is as dirty as we have been. Why? It is because we have been lying for the last 18 months to two years. What we have said was quite clear, but it was not true. It is true that in government with the Socialist Party and SZDSZ, something could have been done, but yet for four years, nothing was done. Nothing!”¹⁸

On September 17, 2006, three and a half months after the speech, a CD and mp3 recording of Gyurcsány’s speech were delivered to Hungarian Radio, RTL Klub (TV) and the website Origo,¹⁹ and in the afternoon, the various media reported the speech

majority of the final seats, 190 for the Socialists and 20 for SZDSZ; Fidesz-KDNP won only 164 seats, while MDF won only 11 seats.

¹⁸ According to a friend of mine, Ferenc Kósa, an MP who was present at the meeting, one of the MPs, Tamás Suchman, left the room in the middle of Gyurcsány’s speech. He apparently felt a strong aversion to Gyurcsány’s attitude, who in his view was overly disrespectful to the Socialist MPs.

¹⁹ The question of who leaked Gyurcsány’s speech has been a subject of prolonged scrutiny. Gyurcsány himself ordered the minister supervising the secret police, György Szilvász, to investigate the leak. There have been various investigations and inquiries, but all agree that there was no external wiretapping. Two copies of the official audiotope were produced, but someone made a copy of the tape and released it to the media. The prevailing story is that some group in the Socialist Party leadership was involved in the leak. It is believed to have been leaked by those dis-

and broadcasted one phrase from it over and over again: “We have been lying for the last 18 months to two years”. This set the opposition forces, especially the Fidesz activists, in motion.²⁰

Fidesz urged that “the Gyurcsány cabinet, which won the election by lying, has no legitimacy” and should therefore resign. In addition, increased street activity by Fidesz activists, a series of raids on state television stations and clashes with police officers on the streets led to periodic disturbances in the center of Budapest. These street activities caused people to lose confidence in the Socialist Party, and support for the Gyurcsány cabinet continued to decline. However, the Socialist Party and SZDSZ consistently defended the prime minister, and Gyurcsány never announced his resignation. Orbán persisted with his repeated claim that Gyurcsány was “legally a prime minister, but ethically and politically a disgraced politician, and we will not confer with such a person,” and the practice of Fidesz MPs leaving the chamber every time Gyurcsány took the stage in Parliament continued.

The Lehman shock that erupted in 2008 hit the Hungarian people hard, as they had a large amount of foreign currency-denominated loans. For the Gyurcsány cabinet, this was a second disaster. Having lost his way, Gyurcsány announced his resignation as prime minister at the Socialist Party’s congress on March 22, 2009, but he received the overwhelming support of party members and stayed on as party leader. Even after having stepped down as prime minister, he tried to maintain his influence by playing the role of kingmaker as party leader.

However, the selection of a new candidate for the position of prime minister was extremely confused. A number of socialist academics and intellectuals were named, but all of them declined the nomination. György Surányi, the former governor of the National Bank, made it a condition of his acceptance of the nomination that he have the support of all parties and, after consulting with Orbán, he ultimately declined. Bokros was willing to come on board, but the Socialists were reluctant to give him their support, as they feared that he was out of control, so Bokros also turned down the nomination. No one wanted to take on the role of a boatman on a sinking boat, even if it was only for the remainder of the term.

Fidesz insisted on a general election by dissolving parliament, but the Socialist Party made the political choice of choosing a new prime minister in parliament after a vote of no confidence in the prime minister. For the Socialists, a general election was certain to result in a catastrophic defeat, and that was the only thing they needed to avoid.

satisfied with Gyurcsány’s political style and those who were trying to oppose him. Gyurcsány himself seems to have obtained information from the secret police and identified most of the individuals involved in the leaks, but he did not name specific individuals on the grounds that he could not obtain definitive evidence or because he did not want to cause further confusion for the Socialist Party. Even if the source of the leak should ever come to light, the clock cannot be turned back. Therefore, it was meaningless for Gyurcsány to pry into the matter.

²⁰ Fidesz executives were allegedly in possession of the CD long before it was delivered to the media, and allegedly had a strategy in place to make the most of this revelation in order to win the local elections in the fall.

At the Socialist Party congress on April 5, 2009, less than a month after the party's March 22 congress, the decision was made to appoint Gordon Bajnai as the candidate of the prime minister, and Gyurcsány's resignation as party leader was announced. The reason for his resignation, which Gyurcsány himself gave, was that his presence would be an obstacle to the implementation of the Socialist Party's policies. Although he had once succeeded in his attempt to retain his post as party leader, Gyurcsány had already become a plague to the Socialist Party. Despite having once enjoyed confidence as party leader, Gyurcsány stepped down from the post of party leader two weeks after the vote of confidence, as the opinion within the Socialist Party grew stronger that if he stepped down from the position of prime minister, he should also step down from his place as party leader. Bajnai formed a cabinet with a number of experts to implement the post Lehman shock austerity policies, including the abolition of bonus pensions in the 13th month and the freezing of civil servants' salaries, which were traditional Socialist Party policies.

The 2010 general elections²¹ forced the leaders of the old regime's party (the Socialist Workers' Party) and youth organization (the Communist Youth League), which had been in charge of Hungarian politics since the process of system transformation had begun, out of the political arena, and they also annihilated the party of intellectuals (SZDSZ), which had been active in criticizing the regime during the socialist era.

Not only did Gyurcsány lose his reputation as a politician by scoring a goal in his own team, he also made destroyed the credibility of the Socialist Party. The retreat of the Socialist Party, symbolized by Gyurcsány's resignation, put an end to the history of governing by politicians from the former Socialist Workers' Party and KISZ. Twenty years after the process of system transformation had begun, the curtain finally fell on the regime change by the old politicians in Hungarian politics and Hungary entered a new era of politics.

After the Socialist Party's disastrous defeat in the 2010 general elections, Gyurcsány and his supporters left the Socialist Party, and he founded his own party, DK (Demokratikus Koalíció, Democratic Alliance), in February 2011. For the Socialist Party, to this day, Gyurcsány remains a pestilential figure and the cause of the Socialist Party's collapse.

²¹ After receiving 2.33 million votes in the local proportional constituency for the 2006 general election, MSZP received only 990,000 votes in the local proportional constituency for the 2010 general election. In individual constituencies, it received 1.3 million votes nationally, but won only two seats. The combined total of local and national proportional constituency seats was only 59, which meant a loss of two-thirds of its seats compared to the 2006 general election. SZDSZ, which broke away from the 2008 coalition with the Socialist Party, teamed up with MDF to run joint candidates in proportional constituencies, but MDF's share of the vote was well below the minimum of 5%. As a result, both SZDSZ and MDF lost their parliamentary seats.

6.2 The Disappearance of SZDSZ

SZDSZ (Alliance of Free Democrats) was a political party founded by dissident intellectuals; it was formed in November 1988 by a younger generation of intellectuals and researchers, around forty years old, who had been criticizing the regime through illegal publications and other means since around 1980. In the 1970s and 1980s, as the exhaustion and inevitable collapse of the one-party communist dictatorship became more and more evident, the talented intellectuals who belonged to the party and who were not involved in the socialist workers' movement were involved in illegal activities, though this movement was not anti-government public movement like the movements in Poland and Czechoslovakia, but consisted rather of people and researchers who left the party and began to engage in illegal activities.

The philosopher János Kis, who belonged to the oldest generation of these intellectuals, was a disciple of György Lukács and belonged to the Budapest school of philosophy. His criticism of Marxism led to his expulsion from the Socialist Workers' Party and his dismissal from the Institute of Philosophy of the Academy of Sciences. He continued to work as a translator and remained involved in the dissident movement as editor of the illegal publication *Beszélő*, published in 1981. As the most senior among the dissident activists, he was elected to serve as the first leader of SZDSZ, founded in 1988.

In March 1989, with the dismantling of the Socialist Workers' Party on the horizon, the dissident Roundtable (EKA, Ellenzéki Kerekasztal) was established. Representing SZDSZ at this meeting was Péter Tölgyessy (b. 1957), Bálint Magyar (b. 1952), János Kis (b. 1943) and Iván Pető (b. 1946). Leading the discussion at the roundtable was SZDSZ's youngest jurist, Péter Tölgyessy. The council meeting between the Socialist Workers' Party and the dissident roundtable (formally a "tripartite conference" which included a third force) was televised on state TV, and the quick-witted and eloquent Tölgyessy became a high-profile figure. It was Tölgyessy, a scholar of public law and an eloquent orator roughly 30 years of age, who devised Hungary's complex electoral system after the system transformation. He was elected head of SZDSZ's parliamentary delegation after the 1990 general election, and he replaced Kis as head of SZDSZ in 1991. Kis was more of a philosopher than a politician, and he lacked the ability to lead the growing SZDSZ organization.

Since SZDSZ was dominated by intellectuals and researchers, it was difficult to keep the party together. Because each of member have his or her own strong opinion, it was difficult to put together discussions. Even Tölgyessy, who was outwardly oratorical, was too inexperienced to organize the organization's inner workings. Tölgyessy was defeated by Iván Pető in the party's congress leadership election in November 1992, a year after he became party leader. Pető then served as party leader until 1997, which meant he served as party leader for longer than anyone else before the collapse of the party following the 2010 elections.

Tölgyessy left SZDSZ in 1996 after opposing the policies of the Horn government, which formed a coalition with SZDSZ. Kis also left the party in 2002 after expressing

dissatisfaction with SZDSZ leadership's confidence in Medgyessy, who had been exposed for his past as a secret service agent.

In 1997, Pető resigned as party leader. The Socialist Party and SZDSZ were deeply involved in a scandal concerning the privatization revenue distribution of public assets in the city of Budapest, and Pető took responsibility for it.²² In contrast, not a single member of the Socialist Party took responsibility for the scandal. Pető continued to work as a member of SZDSZ's parliament afterwards, but he left politics in 2010.

Bálint Magyar was minister of education in the Horn government and also served as minister of education in the Medgyessy-Gyurcsány government. He left SZDSZ in 2009 but remained in the SZDSZ parliamentary group until the 2010 term. Thus, as a party of dissident intellectuals, SZDSZ made great strides in the first free elections (1.05 million votes, 93 seats) and maintained momentum in the second election (1.07 million votes, 68 seats), but after entering into a coalition government with the Socialist Party, it quickly lost support, winning only 310,000 votes with 24 seats in the 1998 general election, 310,000 votes with 20 seats in the 2002 general election, and 350,000 votes with 20 seats in the 2006 general election, and it failed to win a seat in the 2010 general election. Clearly, the establishment of a coalition government with the Socialist Party canceled out the uniqueness of SZDSZ. The Party was perceived as a complementary force to the Socialist Party and lost its *raison d'être*. It was thus doomed to disappear with the fall of the Socialist Party. Between the preservation of its uniqueness and the lure of power, SZDSZ was unable to make an effective move, and it lost a series of key politicians and disappeared. Its weakness as an intellectual party led to the decline of the party.

SZDSZ had a variety of prominent figures with different pasts. The most iconic figure was László Rajk (Rajk Jr., 1949–2019), the son of Foreign Minister László Rajk, who was hanged in the 1949 show trial. László Rajk Sr. was forty years old when Rákosi's schemes led to his execution on October 15, 1949. Earlier that year, on January 26, his son László Rajk Jr. was born. The shocking execution of the foreign minister of the time took the world by surprise, but along with Rajk's arrest, his wife, Júlia Földi, was also detained, and their infant son, less than a year old, was placed in a children's institution of the Hungarian Workers' Party²³ (Magyar Dolgozók Pártja, MDP). The infant, László Rajk Jr., was given a new name at the institution. When Júlia was released from prison in 1954, mother and son were able to live together again, and László Rajk Jr. took his given name again. His father was rehabilitated in 1955, and a reburial ceremony was held on October 6, 1956. This was 17 days before the outbreak of the Hungarian uprising.

²² The scandal was known as the Tocsik case. Márta Tocsik was the attorney who served as an intermediary for the transaction. She was charged as an accessory to fraud.

²³ The party was formed on June 12, 1948, after the Hungarian Communist Party forcibly annexed the Social Democratic Party; after the 1956 Hungarian uprising, it was renamed the Hungarian Socialist Workers' Party (Magyar Szocialista Munkáspárt, MSZMP). The Hungarian Workers' Party and the Hungarian Socialist Workers' Party are different names for the Hungarian Communist Party in the postwar period.

Shortly after László Rajk's reburial ceremony, the Hungarian uprising began and the establishment of the Kádár regime was declared on November 4. Rajk Jr. and his mother defected to the Yugoslavian embassy on the corner of Hero's Square with a group of the Prime Minister Imre Nagy. On November 21, 1956, Kádár gave a false promise to guarantee the peaceful return home, and the entire Nagy group was taken in a Soviet military bus to a Soviet military base, from where they were transferred to and imprisoned in Romania. Mother and son Rajk Jr. were allowed to return to Budapest in 1958, after the Nagy trial ended.

Rajk Jr. enrolled in the architecture department of the Budapest University of Technology in 1967, where he studied architectural design, and in 1980 he founded an underground publishing house with Gábor Demszky (mayor of Budapest 1990–2010) and Jenő Nagy, which was raided several times by the police. As one of the founding members of SZDSZ, he was elected to parliament in the 1990 general election and became a member of parliament; he left SZDSZ in 2009, along with other members.

Thus, while Rajk Jr.'s life was tumultuous, his relationship with SZDSZ leadership was also very delicate. Tamás Bauer, a well-known reformist economist was another SZDSZ member of parliament, and his father, Miklós Bauer were known to have been interrogators for the secret police in the late 1940s.²⁴ Tamás's mother Judit had also worked for the secret police, and her brother, György Szendi, had been an interrogator, along with Miklós. These two interrogators, Miklós Bauer and György Szendi, both under thirty years of age, who spoke German fluently, interrogated Noel H. Field, who had been detained in a preliminary case prior to the arrest of Rajk, and also interrogated Foreign Minister Rajk after his arrest. Bauer and Szendi were rewarded for having done these interrogations after Rajk's execution. Iván Pető's father was also an interrogator for the secret police. A picture of László Pető hangs on the wall of the House of Terror, which was established on the site of the former communist Security Police headquarters.

The existence of Miklós Bauer was well known to those involved in the Socialist Workers' Party. This is because Kádár was deeply involved in the Rajk executions, and it was Kádár who conducted the last interrogation, and the two interrogators, Bauer and Szendi, were de facto subordinates of Kádár. Ten years after the system transformation began, Miklós Bauer's presence came to light at a parliamentary question in September 2000 at the time of the first Fidesz cabinet. In his questioning of Justice Minister Ibolya Dávid, one MP of FKgP asked her to "investigate the circumstances surrounding the sudden death of Justice Minister István Ries, who died suddenly in 1950 while being interrogated by the secret police". It was Miklós Bauer who was responsible for this interrogation. In addition, the Historical Fairness Commission sent an open letter to the law firm to which Bauer belonged in which it asked "how Miklós Bauer got quali-

²⁴ The sobriquet became known after György Marosán named Miklós Bauer "Bauer the denailer" (körmös Bauer), at the Central Committee of the Socialist Workers' Party in 1962, but there is no testimony or evidence that he actually carried out this form of torture. Marosán wanted to say that the young interrogators did not come from proletarian families, but rather from bourgeois families and were merciless.

fication of lawyer? There is provision that states that a person who commits murder cannot be a lawyer". This news was widely reported in the media.

Following the question raised by FKgP, Tamás Bauer immediately responded in parliament, saying that his father was recruited into the secret police for his language skills and not appointed as an interrogator. Iván Pető also said that his father was a warehouseman in the secret police, but he was an interrogator under Miklós Bauer. Tamás Bauer ran as an independent candidate in the 2002 general election, failing to gain SZDSZ's endorsement, and he also failed to win a seat. He became deputy leader of the DK, founded by Gyurcsány in 2011, but resigned in 2014. After the system transformation, Bauer has consistently proposed policies of market fundamentalism.²⁵

Thus, it became apparent that the relationship between father and son was extremely complex within SZDSZ. Gáspár Miklós Tamás, another philosopher and known dissident activist, became a member of SZDSZ's parliament and remained active until he left the party in 2000, while his mother was a Romanian Communist Party official in Kolozsvár (Cluj-Napoca). After returning to Hungary, she continued to receive a party pension and was able to lead a comfortable life in Hungary. Along with Tamás Bauer, Miklós Haraszti, who was active in spreading Maoism in the mid-1960s, was also a founding member of SZDSZ. His family fled to Israel in 1939 and Miklós was born in Jerusalem in 1945. His father was a founding member of the Israeli Communist Party, and returned to Hungary in 1948 as a member of the Hungarian Workers' Party (then the Communist Party).

In Hungary, the "father-son conflict" is one theme in the field of literature, but it is also an interesting theme in politics, as seen in the case of SZDSZ.

6.3 The Founding and Background of Fidesz

6.3.1 The History of its Establishment

From 1987 onwards, with the increased activity of dissident forces and signs of regime change, the movement for regime renewal within and outside the Socialist Workers' Party became more pronounced. The movement within the Socialist Workers' Party has already been described. In 1988, as the movement within the Socialist Workers' Party towards the retirement of Kádár began, young dissident activists, mostly university students, set up an organization to replace KISZ (Communist Youth League).

In contrast to the KISZ leaders Gyurcsány and Kiss or Szilvássy and Bajnai, who eventually became leaders of the Socialist government due to the change of generations

²⁵ When Tamás Bauer was invited to Japan by the Statistical Research Institute in 1987, I held an informal seminar in Hakone with my friend Ernő Zalai (Department of National Economic Planning, Karl Marx University of Economics), who was in Japan as an exchange professor at Hosei University. Bauer was an enthusiastic follower of Mao Zedong as a university student, and he then became a strong supporter of Polish Solidarity around 1980 at the Institute of the Economic Studies, Hungarian Academy of Sciences. Since the system transformation, Bauer has become a strong advocate of pure marketization of the economy.

of the Socialist Party, those who were members of KISZ but who were not willing to be subordinated to the Socialist Party left KISZ and founded Fidesz (Fiatal Demokraták Szövetsége, Alliance of Young Democrats). Although most of the founding members of Fidesz were members of KISZ, they decided that the KISZ leadership, which was only slightly older than they, was being taken in by the regime, so instead of devoting their energies to arguing with the leadership, they preferred to create a new organization. Thus, Fidesz was established by a group of young students working in the KISZ sub-structure in order to seek for new regime by breaking the relationship with the KISZ leadership, which sought a reform within the regime.

Fidesz was founded primarily by students at the ELTE (Eötvös Loránd University), School of Law. This was in March 1988. Key founding members were László Kövér (b. 1959; the current Speaker of the Parliament), Viktor Orbán (b. 1963; the current prime minister), and Gábor Fodor (b. 1962; former minister of education and environment, and the current leader of the Hungarian Liberal Party). It is said that it was Kövér who was the most radical of them all. Fodor, who was a liberal thinker, later moved to SZDSZ. János Áder (b. 1959; the current president), and József Szájer (b. 1961; retired member of the European Parliament), were also founding members. With the slogan “Radicalism, Liberalism, Alternative,” Fidesz was ideologically close to SZDSZ, but it had many different characteristics in terms of generation and organization. The founding statutes set an age limit for party membership (from 16 to 35 years of age) and prohibited dual membership with other political youth organizations (KISZ).

The founding members of SZDSZ were intellectuals already working as researchers and were older than the founding members of Fidesz. Moreover, each of them was an independent intellectual, and even though they were well known, they had problems with their ability to be active in developing a political organization. SZDSZ formed a coalition government with the established party, the Socialist Party, because it was able to make up for its lack of organizational activities by depending on the Socialist Party. Even without organizational activity, the party in power was able to promote itself.

In contrast, the founding members of Fidesz were young and active and did not hesitate to act as an organization. However, in the beginning of the period of system transformation, the forces that had supported the old regime still remained in power, and the stage on which the twenty-somethings could stand was limited. In the first general elections immediately after the system transformation, SZDSZ, a party of well-known dissident intellectuals, won a lot of votes, but Fidesz, which was still relatively unknown, did not get enough votes.

6.3.2 The Ideological Background

Although István Bibó's ideological influence is often conveyed by the fact that the founding members of Fidesz joined the Bibó István Szakkollégium (college of advanced studies), the current policies of Fidesz have nothing to do with Bibó's ideas.²⁶

²⁶ Political scientist László Kéri (b. 1951), the founder of the Bibó István Szakkollégium started a private seminar, the forerunner of the Bibó István Szakkollégium, after receiving his

István Bibó was born in 1911 in Szeged, a city in southern Hungary, and he received a law degree from the University of Szeged in 1934. He later became a court clerk and then an official in the Ministry of Justice; he was one of the authors of the charter of the March Front (Márciusi Front)²⁷ in 1937. In 1944, he envisioned a draft peace treaty and continued to prepare life-saving documents for Jewish Hungarians until he was arrested as Nazi Germany began its occupation. He was arrested on October 16, 1944 and held for several days before being released on bail, but he hid in the basement of the Budapest Protestant Seminary until the war ended. After the war, in 1945, Bibó joined the Ministry of the Interior and represented the National Peasant Party in the Reform Commission, where he helped to amend the electoral law. In 1946, he became a professor at Szeged University and a member of the Hungarian Academy of Sciences, but in 1951 he was deprived of his professorship amidst the ongoing annexation of the coalition parties by the Communist Party, and he was relegated to a position as head of research at the ELTE Library. In the midst of the 1956 upheaval, he joined the National Peasant Party on October 30, 1956 and rebuilt the Petőfi Party by renaming it. On November 2, he was appointed as a cabinet member of the third Nagy cabinet, and he became a minister of state. The Soviet invasion on November 4 sent the Nagy group and his family into exile at the Yugoslav Embassy, but Bibó continued to inform the world of the situation in Hungary until he left Parliament on November 6.

In May 1957, Bibó was arrested and sentenced to life in prison along with Árpád Göncz, who later became the president of Hungary, but was released in March 1963 due to a policy of appeasement. Later, he was offered a position as librarian at the

degree in 1977. This evolved into the founding of the Bibó István Szakkollégium in 1983, with the involvement of other professors, in which the present Fidesz leaders participated as students. Kéri affirms that the present policies of Fidesz and behaviors of the leaders have nothing to do with the ideas of István Bibó.

²⁷ “March 15” is a day of historical significance for Hungary: on March 15, 1848, the Hungarian parliament was created and the war for independence from the Habsburgs began. Almost 90 years later, on March 15, 1937, the March Front was announced by the progressive intellectuals of the time, and the front issued a demand to the government. The people’s writers’ group led by Ferenc Erdei, the Budapest University Circle led by Ferenc Donáth and the Debrecen University Circle led by Géza Losonczy were the main leaders in the movement. In front of a crowd of 5,000 people, the writer Imre Kovács read the 12-point request to government (<http://polhist.hu/programok2/75-eve-alakult-meg-a-marciusi-front/>) on the steps of the main entrance of the National Museum. The 12 points of the demand were as following:

“1. Transformation of the country into a democracy; 2. Liberalization of thought, speech, publication, assembly and organization; 3. Universal and equal secret voting rights; 4. Elimination of conflicts of interest for members of parliament; 5. Division of large landholdings; 6. Abolition of the control by banks, cartels and monopolies; 7. Introduction of a system of progressive taxation; 8. Work for all working people; 8. Introduction of a 40-hour workweek; 9. Introduction of a minimum wage above the level of survival; 10. Right of the working people to organize their economic demands; 11. Progressive tuition and grade selection in secondary and tertiary education to help the poor; 12. Respect for the self-determination of ethnic affiliation of the Danube Valley population.”

Central Statistical Office. But there he was forced to do physical labor for minimal wages, and he was forbidden to teach or publish. He began living on a pension in 1971, compiling and translating his writings, and he died in Budapest in 1979.

As seen from his career, Bibó was never obsequious to power for his own economic interests, but devoted his life to the future of the Hungarian nation. His belief in a democratic society and his dedication to its realization are still respected today as a way of life for intellectuals.

In the founding of Fidesz, the political slogan “Radicalism, Liberalism and Alternative” exemplified Bibó’s ideas, which were seen as an ideological foundation for Fidesz. However, as the seizure of power became a reality, the ideological background of the Fidesz leadership split in two: one group pursuing liberal policies close to those of SZDSZ and the other group seeking a conservative axis of opposition to the Socialist-SZDSZ government.

Although the role played by the Bibó István Szakkollégium in the creation of Fidesz was significant, its ideological impact diminished as the seizure of power approached. Ironically, the current policies of the Fidesz administration are based on the narrowness typical of dictatorship that Bibó criticized, the extreme elimination of dissenting opinions, the preferential treatment of supporters of Fidesz, and the conversion of public money into private assets. These are entirely incompatible with the ideas of Bibó.

From the point of seizing power, Fidesz gradually developed a typical power politics that was incompatible with Bibó’s ideas. This is why László Kéri, the founder of the Bibó István Szakkollégium, strongly criticizes present political leaders of Fidesz.

6.3.3 A Split between Liberalism and Conservatism

Fidesz won 22 seats in the first general election in 1990 and gained a base of activity in parliament. Having gained a place in parliament, Fidesz was faced with the need to reconsider its founding slogans and principles.

Orbán first decided to remove radicalism from Fidesz’s founding slogan of “Radicalism, Liberalism and Alternative”. If Fidesz were a dissident organization, the term could stay in place, but it was not appropriate for a party with a seat in parliament. As for liberalism, it retained its principles early 1992, when the party’s congress decided to apply for membership of the Liberal International. Although the party was increasingly divided over the line of conservatism or liberalism, it was confirmed in early 1992 that it would still retain its original principles. In 1993, major developments began to take place. First of all, the age limit of 35 years old had to be removed since otherwise the party would be restricted in its activities. With a second general election coming up the following year, Fidesz decided to abolish the age limit and at the same time sign an electoral pact with SZDSZ, the closest party in terms of ideology, with the aim of achieving a liberal government. Along with the pact, one SZDSZ MP and two MDF MPs moved to the Fidesz group, and on the other hand, from Fidesz, a founding member, Gábor Fodor, and two MPs, Péter Molnár and Klára Ungár, moved to SZDSZ. The move was not merely result of the signing of the electoral agreement but rather was

related to a reexamination of principles within Fidesz. The transfer of Fodor, a believer in liberalism, to SZDSZ hastened Fidesz's transition to conservatism.

In the 1994 general elections, Fidesz failed to increase its seats and its electoral cooperation with SZDSZ failed. Furthermore, SZDSZ formed a coalition government with the Socialist Party. In response to the Socialist Party's huge victory and SZDSZ's move closer to the Socialist Party, Fidesz was forced to make significant changes in its founding philosophy.

The first step was civic conservatism as a counter to the left-wing bloc led by the Socialist Party. Orbán believed that he could only take power by relying on the mass middle class who would be victims of the liberal market economy promoted by the Socialist-SZDSZ coalition government. At the party congress in 1995, the name of the party was changed to the Fidesz – Magyar Polgári Párt (Fidesz – Hungarian Civic Party). This allowed Fidesz to lower the flag of radicalism and liberalism and, conversely, to define liberalism, which promotes market-economic liberalism, as the enemy of the citizenry.

In the transition from liberalism to conservatism, the turning point was how to understand the process of the system transformation in Hungary. Given the economic wealth and profits obtained by Socialist Party members and the businessmen around them, the Fidesz politicians determined that this was an example of rampant "barbaric capitalism", and they found their political purpose in protecting ordinary citizens from this form of capitalism. The liberalist SZDSZ joined with the Socialist Party to promote this barbaric capitalism, and Fidesz therefore sought its new *raison d'être* in defending its citizens from "left liberals". From this came the slang term *Ballib* (baloldali liberális, left liberal) used by Fidesz to refer derogatively to those who defended the economic policies promoted by the Socialist Party and SZDSZ.²⁸

This political shift led to the victory of Fidesz in 1998, when the first Orbán government was established with a coalition agreement between MDF and FKgP. A pact with the Hungarian Christian Union was concluded in 1999. Fidesz applied for membership in the European People's Party by withdrawing from the Liberal International in 2000.

Fidesz also intensified criticism of the Socialist Party as a party that inherited the Socialist Workers' Party of the old regime and was guilty of the sins of the past, and it opened the former secret police headquarters on Andrásy Street to the public as a House of Terror (Terror Háza) and launched a campaign to criticize the Socialist Party in connection with its criticism of the old regime. It was part of this policy to expose the past of Miklós Bauer and the leak concerning Prime Minister Medgyessy's past as a secret agent.

The shift to civic conservatism and ideological criticism of the old regime became the axis of opposition to the Socialist Party-led coalition. The political usefulness of this shift should have brought out visible results in the 2006 general election.

²⁸ A press review of my Hungarian-language book (*Változás és örökség* [Budapest: Balassi Kiadó, 2009]) appeared in the Fidesz daily newspaper *Magyar Nemzet*. Since the review labeled me a "Ballib" without discussing the content of the book, I sent a letter of inquiry to the editorial board, but I never received any response.

Table 6.2. Results of the general elections in Hungary after the system transformation (1990–2018)

		MDF	Fidesz	KDNP ²	FKgP	MIÉP ³	Jobbik	MSZP	DK	SZDSZ	LMP ⁴
1990	first round voting in the individual constituency(%)	24.73	8.95	6.6	11.73	–	–	10.89	–	21.39	–
	total seats	165	22	21	44			33		94	
1994	first round voting in the individual constituency(%)	11.73	7.01	7.03	8.82	1.58	–	32.99	–	19.73	–
	total seats	38	20	22	26	0		209		70	
1998	first round voting in the individual constituency(%)	2.8	29.48	2.31	13.15	5.47	–	32.92	–	7.57	–
	total seats	17 ¹	148	0	48	14		134		24	
2002	first round voting in the individual constituency(%)	41.07		–	0.75	4.37	–	42.05	–	5.57	–
	total seats	188			0	0		178		20	
2006	first round voting in the individual constituency(%)	5.04	42.03		0.02	2.2		43.21	–	6.5	–
	total seats	11	164		0	0		190		20	
2010	first round voting in the individual constituency(%)	2.67	52.73		–	0.03	16.67	19.3	–	–	7.48
	total seats	0	263			0	47	59			16
2014 ⁵	voting in the national propotionally constituency(%)	–	44.87		–	–	20.22	25.57	–	–	5.36
	total seats		133				23	38 ⁶			5
2018 ⁷	voting in the national propotionally constituency(%)	–	49.27		–	–	19.06	11.91	5.38	–	7.06
	total seats		133				26	20 ⁸	9		8

Note: 1. all seats were gained as the common candidate with the FIDESZ, 2. no adovocation in 2002, 3. the party established on 1993, 4. the party established in 2008, 5. the total mandates were decreased from 388 to 199 in 2014, 6. common candidates of MSZP-EGYUTT-DK-PM-MLP, 7.EGYUTT and MNCO got one seta respectively, 8. common candidates of MSZMP-PAEBESZED.

6.3.4 The Turning Point and Counterattack

When Orbán lost power in the 2002 general election, he is said to have suffered from the loss of power syndrome. Realizing the misery of losing his position of power, Orbán saw the 2006 general elections as his last opportunity. The Socialist Party's establishment of Gyurcsány as an opponent of Orbán fueled Orbán's sense of crisis. Orbán decided to step down if Fidesz lost the election in 2006. Amidst reports of a close race in the 2006 general election, Orbán decided that he did not need to be prime minister himself, so he made the decision to field Péter Ákos Bod²⁹ as the candidate for prime minister, who had served as minister of industry in Antal's cabinet after the first free elections and then as governor of the National Bank. He appealed to the people with maximum concessions to wrest power from the Socialist Party by any means. There is no "what if" in history, but Hungary's politics would have been more balanced if the 2006 general election had brought the Socialists down from the power and created a Fidesz-led government. However, history has swung from one extreme to the other.

After losing the 2006 general election, albeit by a slim margin, Orbán announced his resignation as party leader. However, Fidesz did not have a charismatic figure capable of replacing Orbán with a strong leadership role. In this moment of disappointment and defeat, an unexpected opportunity to revive his political life was presented to him. The transcript of Gyurcsány's Balatonőszöd speech was obtained. In the fall, shortly after the general election, the opportunity arose to sway the Socialist government with protests in the streets.

In addition to the attacks on the legitimacy of the Socialist Party and the Gyurcsány government, the protests in the streets led by Fidesz-supporting activists spurred social unrest. For Orbán, a veteran of the student movement, this melee was the scene where his strongest point could be shown. His criticism of the Socialist Party of Gyurcsány and the regular street disturbances led to a sharp decline in support for the Socialist government. Moreover, the 2008 Lehman shock turned foreign currency-denominated loans, which relied on the extreme strength of the Euro and therefore the strength of the Hungarian forint, into non-performing loans. People whose mortgage payments doubled or tripled were forced to sell their homes.³⁰ Likewise, the passenger car market was filled with used cars that had been collected on loan collateral, leading to a pro-

²⁹ I became friends with Péter Ákos Bod when I was an economic adviser at the Embassy of Japan. In the early summer of 1990, soon after Bod became minister of industry in the Antal cabinet, Nomura Research Institute invited him to attend the Blue Ribbon Commission meeting in Tokyo, and he toured Suzuki Motors. Later, in 1991, Bod became the governor of the National Bank. I visited him with the top executives of the Nomura Security in order to underwrite Hungarian government bonds on the Japanese market in 1994. So-called Samurai bonds underwritten by the Nomura were issued in 1995.

³⁰ The foreign currency-denominated loans became popular in the countries undergoing transformation in the second half of 2000s because of the extremely appreciated euro and consequently extremely overvalued other European currencies. In Hungary, the foreign currency-denominated loans accounted for more than 70% of the total household loans in 2008, which was the highest rate in the central European countries.

longed slump in new car sales. Foreign currency loans put all the foreign exchange risk on the person who had taken out the loan, and the Socialist government, which had tolerated this policy, did not escape criticism of its misrule.

Originally, an earlier general election should have been held following the resignation of the cabinet, but the Socialist Party tried to regain its popularity by trying to retain power for all of its term. However, the results of the 2010 general election were clear to everyone before the election, even before the polls opened.

6.4 The Policy Mix of the Fidesz Government

As the political rule of the old regime continued in Hungary, many social reforms were neglected. Little progress was made in reforming the public broadcasting system, the educational system, the institutes affiliated with the Academy of Sciences, and the health care system under the socialist regime. With the accession to the EU in 2004, these institutions were in urgent need of reform, but the Socialist government had neither the expertise nor the capacity to steer them towards new institutional reforms.

Having won two-thirds of the seats in the 2010 general elections, the Fidesz government belatedly came to grips with these social challenges. Amidst the reorganization and consolidation of social institutions, measures were explored to ensure the stability of the government and to consolidate Fidesz's power.

6.4.1 The Compensation Cap and Punitive Tax Rates

After securing an overwhelming victory in the 2010 general election with two-thirds of the seats, Fidesz orchestrated a sweep of the Socialist Party and SZDSZ connections from state institutions and public media. Each election in Hungary has been marked by a simultaneous change of senior government and public sector officials, and Fidesz's strategy was to stifle the so-called Socialist Party sympathizers.

The first measure introduced was a 98 % personal income tax on the monthly income of public officials or retirement benefits exceeding HUF 2 million (or HUF 3.6 million for retirement benefits, depending on the conditions).³¹ Moreover, it was declared that this tax rate would be implemented retroactively. Particularly targeted are the high-income earners who earned retirement benefits and voluntarily retired in anticipation of a change in government. This is because there will be a surge of people

³¹ A monthly income of HUF 2 million was about \$9,000 at the exchange rate at that time, so it is enough large amount of money as monthly income, but as severance payment HUF 2 million is very small amount of money. The net amount of HUF 2 million income after deducting income tax and social security contributions will be less than \$6,000. As we saw in Chapter 4, the severance payments made by public sector entities like the BKV under the Socialist regime for executive retirement ranged from tens of millions to HUF 100 million. While there was a reason to impose a punitive tax on such high earners, imposing a punitive tax on some millions of HUF retirement benefits was just a form of harassment.

rushing in, so to speak, to find another job with a hefty severance package before a change of government takes place.

The Fidesz government initially declared the 98 % taxation rate, going back five years to 2005. However, the Constitutional Court rejected this because of the principle of the “non-retroactivity of the law”, but it allowed this tax rate to “apply retroactively” from January 2010. The social behavior of rushing into retirement was recognized as eligible for retroactive application.

Those who earned high retirement benefits during this period paid the tax once, but in October 2011, they appealed to the European Court of Human Rights in Strasbourg, which ruled in May 2013 that a special tax of 98 % violated their personal property rights.³² Without filing an appeal, the government decided to enact another law to reduce the tax rate from 98 % to 75 % from 2014. Winning the case in the European Court of Human Rights did not mean that the full amount of punitive taxes collected would be returned.

Prime Minister Orbán, who won the general election, justified the introduction of a punitive tax rate of 98 % and a salary cap of HUF 2 million per month for public officials, stating that “given the challenges facing the country, we cannot accept remuneration of HUF 4 million, 5 million or 7 million per month” (speech in parliament on June 8, 2010). There is a problem with setting the tax rate, but his recognition is not wrong as a perception. Under this cap, the Fidesz government reduced the monthly remuneration of National Bank Governor András Simor, who was appointed during the Socialist government, from \$8.1 million to 2 million. It was also meant to force Simor’s resignation. The same income cap was also applied to György Matolcsy, who was appointed as National Bank governor in March 2013, succeeding Simor.

However, research done at the end of 2011 revealed that public sector executives were looking for various loopholes, keeping their monthly salaries below HUF 2 million while obtaining bonuses which were more than their annual salaries. For example, the president of the Hungarian Development Bank had an annual bonus of HUF 23 million, the presidents of MÁV (Hungarian Railways) and Magyar Posta (Hungarian Post) had an annual bonus of HUF 19.2 million, the president of Magyar Vízművek (Hungarian Water Corporation) had an annual bonus of HUF 15.2 million, the president of the BKK (Budapest Transport Corporation), which had chronic deficits, had an annual bonus of HUF 7.6 million, and the president of Csatornazási Művek (Sewerage Corporation) had an annual bonus of HUF 7.4 million. Thus, many executives of the public corporations decided their own bonuses in various ways. In addition, a survey at the end of 2012 revealed that 32 mayors of local governments suffering from accumulated debt had received a bonus of HUF 50 million.³³

Initially, Orbán was irritated by this, but he became aware of the impossibility of setting a monthly income cap of HUF 2 million. The *Magyar Közlöny* (Government

³² European Court of Human Rights, CASE OF N.K.M. v. HUNGARY, 14/05/2013.

³³ https://tenytar.blog.hu/2015/09/21/igy_lett_oriasi_bukta_a_2_millios_allami_berplafon (September 21, 2015, 08:08 Kate Beckett).

Gazette) of September 15, 2015 set new monthly income caps for the following three categories:

(1) The monthly income of the managers of financial institutions and Hungarian Post shall be capped at HUF 5 million.

(2) Up to a maximum monthly income of HUF 4 million for managers of energy sector and strategically important companies.

(3) The monthly income of managers of other public enterprises shall be capped at HUF 3 million.

If the company concerned is not operating at a loss, it may pay a bonus of 20 % of the basic remuneration. In addition, “under special circumstances, in accordance with a decision of the government, the monthly income may be set in excess of the cap set for each category”. Thus, the HUF 2 million cap was removed.

Based on this government decision, in March 2016, Fidesz proposed an amendment to the National Bank Act, and a new remuneration (monthly) structure for national bank management was approved by Parliament as follows:

(1) Governor’s remuneration of HUF 5 million

(2) Remuneration of HUF 4.5 million for the three deputy governors (90 % of the Governor’s remuneration)

(3) Monetary Policy Committee members’ remuneration of HUF 3 million (60 % of the governor’s remuneration)

(4) Chairman of the Audit Committee remuneration of HUF 3.5 million (70 % of the governor’s remuneration)

(5) Audit Committee members’ remuneration of HUF 3 million (60 % of the governor’s remuneration)

According to Governor Matolcsy,³⁴ the new remuneration amount of the governor was the third lowest among the 28 EU countries. Only Estonia and Lithuania had lower remuneration amounts than Hungary’s. Of course, Matolcsy’s income comes not only from his governor’s salary. He has been a board member of various foundations and organizations and earns more than the governor’s salary. In addition, officers of the National Bank are eligible for private loans for the purchase of homes, with interest on the loans set at the National Bank’s basic rate of interest plus 1 percent.

At the end of June 2019, the government proposed an amendment to the media law that would set the monthly remuneration of the Chairman of the Media Council (NMHH), described in the next section, at 80 % of the National Bank governor’s remuneration (HUF 4 million). The monthly remuneration of the council’s chairman,

³⁴ During the period when György Matolcsy was appointed minister of economy in the first Orbán cabinet, I had the opportunity to meet with him privately and visit his office on a few occasions. The Fidesz government politicians and officials began to engage in the accumulation of private assets at the end of the second Orbán cabinet, and during the third Orbán cabinet, various approaches to the private accumulation of wealth have begun to be used, including fraudulent use of subsidies, diversion of public funds through the establishment of foundations, and breach of trust through the use of state institutions, which are described in chapter 4 of this book.

Monika Karas, was reported to be HUF 1,296,000, so this is indeed an increase of more than three times. As in this case, the remuneration of government officials and the head of public institutions are set on the basis of the remuneration of the governor of the National Bank, which is the highest remuneration.

Thus, the remuneration cap for public officials and managers of public business entities, introduced by the Fidesz government in 2010, has effectively been removed.

6.4.2 The Restructuring and Consolidation of Public Broadcasting

An important lesson Orbán learned from the 2006 general election defeat was the importance of “media domination”. For Fidesz, which has seized power, the urgent task was to get hold of television, magazines and newspapers that could promote their own camp’s policies and propaganda.

On the other hand, the Hungarian public media were not only divided into television, radio and news agencies, but each owned several media in different locations apart from the main body of the company. The organizational restructuring of public broadcasting as a whole was an urgent task. For example, both Hungarian Television (MTV) and Duna TV are public broadcasters, but Duna TV, which was established later, functioned autonomously, far from the Hungarian Television headquarters building. The relocation of the Hungarian Television building in the center of Budapest had begun in 2009, and the Fidesz government enacted a new media law and reorganized the public media in conjunction with the move to the new building. The framework for these changes was established in the “Media Services and Mass Communication Act” (2010. évi CLXXXV. törvény).

On January 1, 2011, Fidesz established Médiaszolgáltatás-támogató és Vagyonkezelő Alap (MTVA, Media Services and Support Trust Fund), the organization responsible for managing the assets of the entire public broadcaster, and as the organization responsible for the operation, the Nemzeti Média- és Hírközlési Hatóság (NMHH, National Media and Infocommunications Authority, commonly known as the “Media Council”) was established, the budget of which is approved by parliament. In 2015, MTVA was given programming functions, while on the other hand, the overall broadcast execution and management was given to the company Duna Médiaszolgáltató Zártkörűen Működő Nonprofit Részvénytársaság, for short Duna Médiaszolgáltató (Duna Media Services). Accordingly, all public broadcasters (television, radio and news agencies) were to be handled by this Duna Media Services.³⁵

The opposition parties criticized the domination of the media under the centralized control by the ruling government. Indeed, the Fidesz government, which holds two-thirds of the parliamentary seats, can exercise overwhelming influence over parliamentary budget deliberations and the Media Council, and can intervene implicitly and

³⁵ The Hungarian television broadcasts of M1, M2, M3, M4 and M5 channels, as well as the program broadcasts of Duna TV, Kossuth Radio, Petőfi Radio, Bartók Radio, Dankó Radio and Duna World Radio were placed under the jurisdiction of Duna Media Services.

explicitly in the personnel appointments of the MTVA and Duna Media Service. However, the essence of the problem does not lie in the centralized management itself.

The public broadcastings were left untouched even after the system transformation. The lack of organizational integrity was a waste of budget and human resources, so media restructuring and consolidation is not necessarily a partisan restructuring. The organizational consolidation of public broadcasting should not be dismissed as a “centralized, partisan reorganization by the administration,” but rather the old anarchic, expansionary *laissez-faire* approach should be amended.

The problem is in the editing of the programs. The M1 channel, the main public broadcaster, has been converted into a 24-hour news program broadcast. However, the Fidesz administration has cut off former government connections within the TV station, forcing it to refrain from reporting that is critical of the Fidesz government and preventing opposition politicians and intellectuals and experts critical of the government from appearing on the channel. As a result, the M1 news channel has degenerated into a government public information (or propaganda) channel. News critical of the government is kept to a minimum. Such program editing has a significant impact on the behavior of voters, especially those living in rural areas. A public service broadcaster that allows the party in power to advertise its policies all the time is grossly unfair, and Fidesz is using the public service broadcaster entirely to serve its own interests. The promotion of fairer public broadcasting is an issue that should be discussed in the Parliament. However, with Fidesz holding two-thirds of the seats in Parliament, the debate cannot be done productively.

Although Fidesz’s strategy in public broadcasting is undoubtedly to influence public opinion by using the M1 channel, it is difficult to be partisan in all public broadcasting programs. For this reason, it was necessary to integrate the Fidesz-affiliated media independently, and therefore as a media strategy, Fidesz has brought about the integrated organization of commercial broadcasters, print and magazine media and websites that surround public broadcasting. This will be discussed in detail in the next section (6.5).

6.4.3 The Organizational Integration of the Educational System

An organizational integration similar to the organizational integration which took place in public broadcasting can be seen in the field of education. Until now, the day-to-day jurisdiction of compulsory education in the region has been left to the respective local governments. As a practical matter, however, local governments, struggling with chronic budget deficits and accumulated debt, have not only been unable to provide effective advice on school management but have also diverted part of their school budgets to other uses. In the case of some municipalities in which foreign corporations have set up shops and factories, the local governments have been able to provide higher salaries and renovate school buildings, but many schools have been unable to grapple with poor facilities and budget shortfalls.

The Fidesz government announced in 2011 that it would take on the accumulated debt of HUF 1.369 trillion by local governments. In exchange for being freed from

debt, local governments were thereafter required to seek government approval for acquiring loans that would incur significant debt. The municipal debt shouldering by the government, implemented between 2011 and 2014, freed two-thirds of the nearly bankrupt municipalities from the debt spell.

At the same time as this debt cancellation was underway, the transfer of control of compulsory education to state control was declared.³⁶ Schools were decoupled from the jurisdiction of the municipalities, and an organization was established in each region that was responsible for the management and operation of the schools in the region. This system is called KLIK (Klebensberg Intézményfenntartó Központ). It was established in September 2012. When the initiative was announced, it was criticized by opposition parties and intellectuals who opposed the government's measures as a centralization of education. However, the old school system had been largely untouched even after the process of system transformation, and schools belonging to municipalities without effective financial support had been left in a state of disrepair.

From January 2017, KLIK has divided the country into 58 school districts, each of which has its own elementary through high-school institutions belonging to a regional center (Tankerületi Központ, Regional School District Center). The regional centers serve as intermediaries between the educational institutions and the Ministry of Education (Ministry of Human Resources).

Fidesz's policy of trying to change the *laissez-faire* system that has been in place since the old regime should be properly evaluated, and a distinction should be made between the issue of systematic restructuring-integration and the issue of intervention in education by the ruling party. However, organizational reorganization alone will not solve all problems. Regional centers are suffering from lack of experience and financial difficulties, and it is necessary for the government to redirect more of its budget to education.³⁷

³⁶ János Kornai argues that the integration of public broadcasting and state control of compulsory education indicate a return to the centralization of the socialist era. However, the real issues are not as simple as this contention suggests. With the introduction of KLIK, a system of teacher self-evaluation (portfolio) and periodic assessment of qualifications was introduced. This type of evaluation system is familiar in many European countries, but in Hungary, even twenty years after the regime change, this type of evaluation system had not been introduced. The requirement for all teachers to prepare a PC-based portfolio and the introduction of regular teacher assessments were met with strong opposition, but are now well-established.

³⁷ Institutional reorganization and fiscal issues are two entirely separate issues. Traditionally, towns with a large influx of businesses have seen an increase in tax revenues, which has resulted in more money being available for municipalities to spend on improving the school environment in those areas. On the other hand, many municipalities that do not see an increase in tax revenues do not see an increase in the amount of money directed to schooling. Consolidation by regional school district centers has opened the way for problems on the ground in schooling to be communicated directly to the superintendent, creating the conditions for problems to be shared. Schools in poor towns, which had been virtually neglected in the past, were only assured of an avenue to communicate their problems to the Ministry of Human Resources. On the other hand, the current lack of increase in school budgets has not resulted

6.4.4 The Reorganization of the Academy of Sciences

The Hungarian Academy of Sciences (MTA) is one of the most important organizations that had remained entirely untouched after the system transformation, and since it was founded in 1825, it has been difficult to reform. In countries in which there are academies of science, a clear division of labor is made between research and education, with universities serving as educational institutions and academy-affiliated institutes as research institutions.

However, times have changed dramatically. As a matter of fact, research and development activities are also carried out in universities, and it is outdated to position the Institutes of the Academy of Sciences as the only research and development institution. In the case of engineering research institutes, the time when they can promote research independent of actual production sites and future product development has passed. In the former socialist countries, however, there were no research institutes attached to the private sector, and research and development continued in the laboratories of the academy, which had nothing to do with actual production. This is one of the reasons why the socialist companies lost in the competition with the capitalist companies.

Considering these situations, it was inevitable that, sooner or later, the Academy of Sciences, which had been left behind by the times, would be reorganized. Since the state supports the Academy of Sciences with huge funds, it is necessary to demonstrate the social utility of the Academy of Sciences. However, since the system transformation, many researchers have left the Academy's research institutes to start their own companies or to seek research bases abroad. Many academy-affiliated research institutes have suffered an exodus of personnel and a lack of budget, and they have been left in a state of disrepair, unable to update their facilities and equipment to pursue innovative research agendas. For example, gone are the days when high-profile studies were published by the Academy's affiliated economic research Institute, and now they continue to do only minor individual research with a reduced staff. The building has been left un-renovated, and many vacant rooms have been leased to small outside firms to maintain and supplement the institute's infrastructure. The Central Physics Institution, which was located on a large plot of land across the Buda Hills, was dismantled into several institutes, and today there are only two: the Wigner Central Institute of Physics and the Central Institute of Energy Sciences, and the various buildings are leased out to small private developers. The budget for the renewal of the existing Academy laboratories and for the purchase of new research equipment is extremely limited.

If the academy-affiliated institutes are not responsible for the research and development necessary for Hungarian companies, there is no point in their existence. It

in an improved educational environment. On the contrary, schools in some of the richer municipalities are no longer receiving special salaries as a result of leaving the municipality, which has led to frustration.

This is the same problem as that of improving the environment of public hospitals. Even after the system transformation, the failure of the Socialist government to invest resources in these two areas to improve them continues to be a serious problem.

makes sense to review, reorganize and consolidate the current institute structure and focus funding on it. It would require an organizational change in the existing Academy of Sciences. This is the challenge for the Academy of Sciences, and it is an issue over which the government and the Academy of Sciences have been at odds. The Academy of Sciences worked from the position that the Institutes must protect their personnel and assets, while the government had the conviction that it could not reform the Institute without separating it from the Academy. This rivalry had been underway for the past year.

The Hungarian government, under the leadership of Minister of Technology and Innovation László Palkovics,³⁸ had been negotiating with the president of the Academy of Sciences, László Lovász, but without reaching a basic agreement with the academy, the government decided to change the Academy of Sciences radically. Minister Palkovics presented the bill to the Parliament on June 4, 2019 on the law for “amendment of the laws and regulations necessary for the restructuring of the institution system of research, development and innovation and the supply of funds”. The bill was passed without significant debate and came into force on July 12, 2019.

The main points of amendments to the law proposed on June 4 are as follows:

(1) The 15 institutes attached to the Academy of Sciences will be separated from the Academy and organized into the newly created the Eötvös Loránd Kutatási Hálózat (ELKH), a 13-member body, of which the government and the Academy of Sciences may appoint six members each. As for the chairman of the ELKH, the prime minister makes the decision based on the recommendations of the government and the Academy of Sciences.

(2) The ELKH shall make decisions to reorganize, consolidate, and create new institutes or abolish them.

(3) Accordingly, the assets of the institutes attached to the Academy of Sciences will be converted to state assets, and the ELKH will decide how to use them.

(4) The Nemzeti Tudománypolitikai Tanács (NTT, National Science Policy Council) is established as a governmental body, with 11 members headed by the minister of technology and innovation to determine the national science policy. The members will be appointed by the minister of technology and innovation.

As a result of the amendment, the Academy of Sciences, which has been detached from the Institutes, will continue to be an organization with the primary mission of awarding doctoral degrees and appointing Academy members, but its involvement in the research Institutes will be very limited. As of 2019, the Academy of Sciences has a quorum of 365 Hungarian members, with full members receiving HUF 455,000 per month, associate members receiving HUF 353,900 per month, and Academy of Sci-

³⁸ Palkovics is a member of the Academy of Sciences specializing in automotive mechanics and is an engineer who had experience to work for a brake control system manufacturing company in Germany. In the third Orbán cabinet, he was appointed to serve as the vice-minister of the Ministry of Human Resources, and he was appointed to serve as the newly created minister of technology and innovation in the fourth Orbán cabinet after the 2018 general election.

ences PhD holders receiving HUF 90,000 per month.³⁹ It cannot be ruled out that the remuneration rules for members of the Academy of Sciences will change once the reorganization of the institutes has been completed.

Obviously, these legislative changes are the biggest reorganization of the Academy of Sciences, which has existed for nearly two hundred years, and the Academy of Sciences will be deprived of organizing and carrying out tasks in the field of research and development. These tasks are being transferred to the government. However, no details concerning the processes and procedures under the new organization have been decided upon. In the case of Hungary, there is always a huge discrepancy between the decision to adopt a new scheme and the actual implementation of the scheme. The persons (organization) who created the scheme and the persons (organization) who execute it are different, and the scheme initiator is never responsible for completing the process. Therefore, confusion always accompanies the implementation of a new scheme. The government rushes to reach a decision, but there is no collateral for the system actually to work.

The government reached a conclusion on this major reorganization endeavor in less than a year. The government neglected carefully to explain and negotiate with the Academy of Sciences, and it submitted the amendments to the law to Parliament as if there were no need to debate the matter. The Academy of Sciences issued a statement calling for a resolution of protest by the General Assembly, an appeal to lawmakers and the support of outside scientists. Researchers and intellectuals criticized the government for its heavy-handed approach, which was unprecedented even in the socialist era, but in vain.

The Fidesz government, on the other hand, has taken the attitude that it does not need to listen to the opinions of a few privileged researchers because the overwhelming majority voters supports the government. There is no need for the Fidesz government to be afraid of intellectuals, since their support for Fidesz is negligible compared to that of ordinary people in the towns. However, political involvement does not mean that technological development will advance. Without the close relationship between engineers and researchers on the production floor, scientific and technological development cannot contribute to Hungary's future. Political arrogance could be a major obstacle to the restructuring of institutes. It would be a big mistake to think of academy restructuring as a political issue. A close eye should be kept on Hungary's science and technology policies.

6.4.5 The Decline of Daily and Weekly Newspapers

After the system transformation, national daily and weekly newspapers were exposed to market forces and struggled to attract regular subscribers. Moreover, the transition from paper to electronic media has begun, making it difficult for all print magazines to operate. The main sources of revenue for these magazines have been the sponsorship

³⁹ This is like a permanent qualifying reward, which is paid in addition to the salary paid by the research and education institution to which the researcher belongs.

of foundations set up by political parties and advertising revenue from government publicity placements. The latter, in particular, can be handled in any way by the party in power. Advertising revenues from the government have come to determine the life or death of a newspaper. Newspapers which support the government can survive on public advertising revenues, while newspapers that do not support the government do not get any advertising revenue from the government and are in a dire state.

In particular *Népszabadság*, a daily newspaper that was known as the organ of the Communist Party in the postwar era and continued to serve as the organ of the Socialist Party after the system transformation, closed its doors after 60 years when the management of the paper decided to discontinue publication on October 8, 2016, as it was unable to stop its accumulated losses. It is difficult to maintain a daily newspaper at the level of 20-30,000 regular subscribers. There was an option for the Socialist Party to buy the paper, but the Socialist Party, which was out of power and unable to afford it, could not take on a daily newspaper publication with an ongoing deficit.

The daily newspaper *Magyar Nemzet*, founded in 1938, became the organ of the Patriotic Peoples' Front (Hazafias Népfront) during the socialist era. After the system transformation, the paper was sold to the private sector, and in 1996, the Postabank became the owner at the behest of the leader of the Socialist Party, Horn. Following Postabank's bankruptcy, it was purchased by the conservative newspaper *Napi Magyarországnak* in 2000, and it gradually became more and more aligned with Fidesz, and with the inauguration of the second Fidesz government in 2010, *Magyar Nemzet* became de facto the newspaper of Fidesz and the government.

However, in 2015, when Lajos Simicska, an ally of Orbán and de facto owner of *Magyar Nemzet*, took action to split from Orbán,⁴⁰ the Orbán faction of *Magyar Nemzet* left the paper's editorial board. Simicska rebuilt the editorial board and continued to

⁴⁰ Simicska and Orbán were sworn friends who shared a room in a student dormitory when they were at ELTE University. Simicska, who had expanded his business under the Fidesz government, had kept media-related companies in his control. He suddenly acted to cut ties with Orbán by announcing, in March 2015, that Orbán had been recruited by the intelligence services during his military draft training days.

The deterioration of relations between Orbán and Simicska dates back to the 2014 general elections. Until then, there was a kind of separation of powers between Orbán and Simicska, which Orbán dominating the political sphere and Simicska dominating the economy. However, following Fidesz's major victory, Simicska sought to increase his influence in politics, while Orbán began to meddle in areas that were supposed to be off limits to him, such as telling Simicska which companies to take over (e.g., the RTL TV channel and the website INDEX), and a sense of mutual distrust began to grow between the two parties. The introduction of taxes on advertising on TV broadcasts was one such example, and Simicska is said to have been angry about the introduction of the new tax without prior consultation. Subsequently, Orbán began exclude Simicska from the government's economic decisions, and relations between the two deteriorated at once. This deterioration led to the "recruitment of intelligence officers in the draft era" story in 2015. After that, Simicska began cursing Orbán, saying "Orbán egy geci" ("Orbán is a motherfucker"), at every opportunity, and this is where the logo "O1G", a logo that makes fun of Orbán, comes from.

publish, and gradually *Magyar Nemzet* became more assertive in its criticism of the government. Simicska owned not only *Magyar Nemzet*, but also Lánchíd Radio and Hír TV. These were the bridgeheads of Fidesz media group. Simicska's decision was seen by Fidesz as an act of betrayal and a disruption of the media network that Fidesz had built up, and Orbán did everything in his power to stop it. Orbán increased the pressure on Simicska-owned business groups, thoroughly excluded Simicska's business groups from public procurements and subsidies, and financially clamped down on the daily *Magyar Nemzet* and the weekly *Heti Válasz* by suspending the publication of government advertisements.

Following the results of the April 2018 general elections, Simicska admitted his defeat and decided to let go of all media companies. *Magyar Nemzet* was discontinued after April 11, 2018, Lánchíd Radio stopped producing programs on April 10, and Hír TV's financial woes led to job cuts, and ultimately, it was sold to Gábor Liskay,⁴¹ who has a good relationship with Prime Minister Orbán, in July 2018. Since then, Hír TV once again revived good relations with Fidesz, and *Magyar Idők*, which was founded by Fidesz in 2015 in opposition to *Magyar Nemzet*, bought the name "Magyar Nemzet" in February 2019, and once again the newspaper *Magyar Nemzet* became a Fidesz-affiliated daily. *Heti Válasz* stopped publishing its print edition on after the June 7, 2018 issue, and it has only been published online since. Thus, the Orbán vs. Simicska battle ended with Orbán's complete victory.

In any case, it remains financially difficult to publish print material, whether government or anti-government. Even government-affiliated newspapers find it difficult to secure 50,000 subscribers. Already in Hungary, the social influence of print journals has diminished to an infinitesimal degree, and websites have become more active in their place, with governmental and anti-governmental portals competing with each other. Given this shift, as we shall see in the next section, Fidesz decided to create a new system of media domination.

6.5 The Rebuilding of the Fidesz Media Empire and Manipulation of Public Opinion

6.5.1 Rebuilding of the Fidesz Media Empire

In a context in which the dissemination of information through paper media is becoming increasingly difficult, the government-backed free newspaper *Lokál* has begun to conduct an opaque business. It is published by a media company (Modern Media Group Befektetési és Vagyonkezelő Zrt.) owned by Árpád Habony, who was heavily involved in the sale to foreigners of the state bonds with the right to settle, and Tibor Győri, who had previously served as deputy minister in the prime minister's office.

Metropol, which was distributed free of charge in Budapest's public transport system (BKK), especially in metro stations, was owned by Simicska's business partners, but it

⁴¹ Though he was initially on Simicska's side, Gábor Liskay then took Orbán's side and took over the task of rebuilding the Fidesz media empire instead of Simicska.

Table 6.3. Weight of government sponsored companies
in the private media market in Hungary (2017)

business field	total revenue hundred million Ft	KESMA companies hundred million Ft (%)	KESMA + public companies hundred million Ft (%)
printing (17 companies)	600	468 (78 %)	481 (80.2%)
radio (5 companies)	36	3 (8.0 %)	31 (86.7%)
TV(5 companies)	777	65 (8.4%)	410 (52.8%)
portal site (4 companies)	115	56 (49.2%)	5.6 (49.2%)
Total	1 527	592 (38.8%)	979 (64.1%)

Source: <https://mertek.atlatszo.hu/mindent-beborit-a-fidesz-kozeli-media/>

was discontinued in June 2016 after 18 years of existence due to declining advertising revenues and accumulated losses due to the conflict with Orbán.

In response to this closure, Habony and others, who have been strongly credentialed by Prime Minister Orbán, launched a new free newspaper, *Lokál* (the daily *Lokál* and the weekly *Lokál Extra*) since June 2016, with advertising revenues from the government and public companies. The daily *Lokál*, with a circulation of around 150,000, is distributed in every subway station, and the weekly *Lokál Extra* is distributed in every house in Budapest. The weekly *Lokál Extra* from the first week in June 2019 contains four government advertisements and two ads by the government-owned lottery company (Szerencsejáték Zrt.). It is assumed that the government and the government-owned company's advertisements raise money for printing and make a profit for the company from other advertising revenues. However, there is not a single article worth reading in the weekly *Lokál Extra*, which is distributed door to door in Budapest. It is nothing more than an enterprise to generate advertising revenue for the company.

However, the problem goes beyond the small matter of publishing *Lokál*. The publisher of *Lokál* was transferred to the Közép-Európai Sajtó és Média Alapítvány (KESMA, Central European Newspaper and Media Fund), which was established in 2018, which Fidesz established in order to integrate all government-leaning media in September 2018. ECHO TV, OPUS Press, New Wave Media Group and Magyar Idők Kiadó,⁴² a Fidesz-affiliated TV and publishing house, have been drawn into the jurisdiction of KESMA. Furthermore, alongside *Lokál*, newspapers published in the provinces with government subsidies have also been put under KESMA. Thus, the organi-

⁴² KESMA brought these four companies under its umbrella by taking ownership of them. In a decree dated December 5, 2018 (Kormany 229/2018. (XII.5) Korm. Rendelet), the government identified "the acquisition of these four companies by KESMA as one of national strategic importance" (signed by Prime Minister Orbán). The implication of this decree is that "the acquisition of these four companies is not subject to the review and audit powers of any other governmental body (the Competition Authority and the Parliament's "Media Council")." It was decreed in advance that they would not be subject to review and audit for fear of violating the provisions of market monopoly and restriction of competition. It is an arbitrary decree by the political party in power.

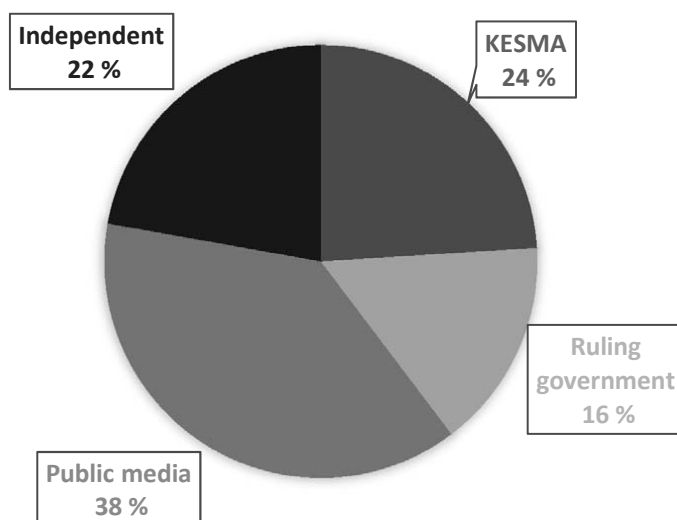


Figure 6.1. Structure of media market in Hungary (2017)

zation integrates 470 media, including magazines and websites of the whole country. Being under the umbrella of this organization means that public subsidies and public advertising revenues can be calculated. This is media domination by the government using public money.

In response to the launch of the organization KESMA, the opposition parties collectively condemned the government and filed a complaint with the Constitutional Court, arguing that removing KESMA, which acquired four companies, from the government's review and audit was a violation of the constitution. The European Commission has launched an investigation into the alleged "government-led attempt to harm the independence of the Hungarian press and political intervention in the media market". The issue was taken up by the European Parliament's Culture and Education Committee on February 20, 2019. On this occasion, Fidesz MEP Andrea Bocskor argued that the Commission's concerns were not justified because "69 % of Hungarian media are critical of the government and only 31 % are favorable to the government".⁴³

On the other hand, the anti-government website Mérték és Átlatszón found that 64.1 % of the media market is dominated by government-leaning media if one adds government-owned media companies to those under KESMA. In addition, we must take public media into account. If one calculates the MTVA's 2017 budget of HUF 94 billion and assumes that all of the budget is used for government advertisement, this means that 77.8 % of the media market is government-funded media. Of course, it is not proper to judge all of the public broadcasters as government-friendly media.

⁴³ https://index.hu/kulfold/eurologus/2019/02/20/a_magyar_media_69_szazaleka_kormanykritikus_mondta_a_fidesz_brusszelben/.

In any case, KESMA has become a Fidesz media empire functioning on government subsidies and donations from Fidesz-supporting businessmen. The KESMA establishment was spearheaded by Gábor Liszkay, who bought Hír TV from Simicska.

6.5.2 The Exclusion of Criticism

On September 25, 2018, the news broke that the latest issue of the magazine *Századvég* (88, no. 12 [2018]), which was to be published by the government affiliated thinktank Századvég, had been stopped and removed from its website. Only after learning this news did more people download the PDF of the magazine which had been removed.⁴⁴ Along with this news came the news that the editorial staffs of the magazine *Századvég* had been disbanded.

Századvég was a social theory journal published by the Bibó István Szakkollégium, but its head, István Stumpf, became the head of the Századvég Foundation, which began receiving government funding with the inauguration of the Fidesz government in 2010. Since then, the magazine has become de facto a government-funded thinktank that receives huge public orders from the government every year, and Prime Minister Orbán is on the magazine's editorial board. Due to the nature of the magazine, until then, there had been no direct intervention by politicians.

The second issue of the journal in 2018 was on the theme of "Rent", and it invited several scholars to contribute. The opening article in the volume was a translation of an article published by former SZDSZ economist Péter Mihály (Corvinus University) and US-based Hungarian sociologist Iván Szelényi (New York University) originally published in *Comparative Sociology*.⁴⁵ The original title of the article is "The Role of Rents in the Transition from Socialist Redistributive Economies to Market Capitalism". As the title suggests, the authors are known to be critical of the Fidesz government. However, the direct reason for the suspension of publication was a paper by Péter Ákos Bod, who had enjoyed Prime Minister Orbán's support in the 2006 general elections as a Fidesz candidate for prime minister. The title of the Bod paper is "Bérek, profitok és járadék harca magyar szemmel" (Struggle of Wages, Profits and Rent in Hungarian Eyes), and it argued that the reason for Hungary's slow wage growth is that the government monopolizes rents. Furthermore, he posted tables comparing indicators for Hungary, Austria and the Czech Republic from the Worldwide Governance Indicator published by the World Bank.

According to the table, the Czech Republic's level of governance has been improving since 2010, while Hungary's level of governance has been deteriorating since 2005. Although the reliability of this indicator is questionable, this comparison caught the attention of Fidesz politicians, who could not accept the conclusion that the level of governance has declined since the Fidesz came to power.

⁴⁴ The PDFs removed from Századvég's website were circulated to a number of portals before they were removed, and many people viewed and downloaded from there. As the uproar grew, more and more people read the deleted magazine, contrary to the government's intentions. Currently, a PDF of this issue is available at <https://transparency.hu>. However, it is in Hungarian.

⁴⁵ 16 (2017): 1–26.

Table 6.4. Comparison of governance

indicators	year	Hungary	Austria	Czech Rep.
efficiency of government	2005	0.80	1.72	0.97
	2010	0.67	1.84	0.91
	2015	0.49	1.47	1.05
quality of rules	2005	1.11	1.61	1.11
	2010	1.02	1.46	1.30
	2015	0.77	1.43	1.08
rule of law	2005	0.83	1.86	0.82
	2010	0.75	1.81	0.93
	2015	0.40	1.85	1.12
control of corruption	2005	0.62	1.96	0.46
	2010	0.25	1.63	0.26
	2015	0.10	1.49	0.39

Note: 5 points evaluation from +2.5 to -2.5. Low point shows low evaluation.

Source: WGI 2017. The table was shown in the Bod's article.

It is the position of the Fidesz government that it is “unpardonable” for a thinktank that operates with public funding to publish papers that undermine the government. Moreover, the conclusion that “wages do not rise because the government uses rents to monopolize profits” was seen as unacceptable.

Not only was the journal in the issue removed and publication was suspended. The entire editorial staff was replaced, as the editorial team that allowed the publication of such an article was judged to be anti-government. The basic stance of Orbán or any politician who guesses Orbán's intentions is that even those who support the regime should be excluded if they cannot express full support for the Orbán government. Publicly subsidized institutions are not allowed to criticize the policies and achievements implemented by the Orbán government.

On February 4, 2019, as the issue concerning Bod's article was cooling down, news broke that István Varga, a former Fidesz MP who had been appointed chairman of the advisory board of the newly established Fidesz media empire KESMA, had “resigned as chairman” of the board. The resignation was caused by a lengthy interview⁴⁶ of Varga published on the portal 24.hu two weeks earlier.

In t/his interview, Varga candidly expressed his opinion: “One of my goals is to raise the level of articles in the KESMA-owned journal to that of the *ÉS (Élet és Irodalom)*, which is critical of the government, but worth reading”; “I read both the right-wing and left-wing press, and I have subscribed to *ÉS* since 1976 and keep a monthly bound copy of the *ÉS* newspaper”; “The public media is not perfect. Street demonstrations criticizing the government should also be taken up”; “KESMA was founded at the idea of Gábor Liskay, and I was appointed board chairman at Liskay's request”, he said. The interview caught the attention of politicians who were working hard to be loyal

⁴⁶ <https://24.hu/belfold/2019/01/22/varga-István-interju-media-alapitvany/>.

to Orbán. Two weeks after this interview article circulated online, Varga presented his resignation to Liszky.

As these two examples show, the Orbán system increasingly resembles the communist rule of the old socialist system. The parochial idea is that “everyone who is not 100 % on our side is the enemy”. It is a political rule that has nothing to do with the ideas of István Bibó. The taxes that support the government are paid by both those who support the party in power and those who do not support it. It is unacceptable from the point of view of social justice that taxes are used preferentially for the benefit of those who support the government. Governments need to be tolerant enough to take criticism. This is an essential element of modern democratic politics and a basic prerequisite for freedom of speech and freedom of the press.

6.5.3 Anti-intellectualism, Almsgiving Policies, Nepotism, Nationalism, and the Main Enemy Strategy

(1) Anti-Intellectualism

After winning two-thirds of the seats in the 2010 general election, Fidesz began to lay the groundwork for its support base. Its main goal was to consolidate the support of rural voters. Budapest has a strong left-wing base by nature, and the influence of intellectuals is significant, but in the provinces, almsgiving policies are sufficient to consolidate the base. The influence of intellectuals, whether they are governmental or anti-governmental, is very limited and does not help a given party garner many votes. So even Fidesz intellectuals can be cut off if they express dissatisfaction with the government, because this will only destabilize the administration. It is far more efficient to develop policies that appeal to the emotions of local populations than to use time to engage with the logic of intellectuals. Nearly all of the daily and weekly newspapers published in the provinces are funded by government subsidies and advertising. In return, major articles are prepared on the government side in bulk. This is why most of the local newspapers are under the KESMA umbrella.

(2) Almsgiving Policies

Introduced by the government in 2013, the “*rezsicsökkentés*” (utility price reduction) policy forces electricity and gas distribution companies to offer a 10 % discount. In order to emphasize that the government-ordered 10 % discount has been implemented, the companies are required to indicate on their monthly electricity and gas bills the amount of the discount for the month in question and the cumulative discount since the policy was introduced. It is a policy that makes people believe that every month they are getting so much more (paying so much less) thanks to the government. This policy was invented by Antal Rogán, who came up with the idea of issuing the state bonds with the right to settle to foreigners, which was introduced in January 2013.

On the one hand, the government imposes the highest rate of value-added tax in Europe, and on the other hand, it advertises that it is the Fidesz government that has made it possible for people to get a discount on their electricity and gas bills. As expected, Budapest residents are not fooled by this childish scheme, but local residents,

who only read the government's propaganda papers, are grateful for the government's charity. Rogán has gotten a huge amount of intermediary fees by issuing state bonds with the right to settle while implementing a childish charity policy. It is truly a "give but obey" policy by the government. While developing this charity policy, he has committed shameless and blatant breaches of trust by using the state apparatus. The Jobbik party posted huge posters across the country stating, "Let's get our money back from Rogán and Habony, who loot state assets," but Rogán and Habony have not sued the party for this political advertisement.

(3) Nepotism and Bribery

Orbán is no different from Horn was during his government in that he overlooks the economic crimes of his aides. However, he is more vicious than Horn in that he himself has acquired vast amounts of wealth. To be sure, it is not clear that Orbán himself was directly involved in the acquisition of wealth, but the monies which have been directed to his children have been noteworthy. He has acted as if he is indulging in poverty by publishing photos of himself carrying a knapsack to EU meetings and going out on trains, but he has turned a blind eye to the profiteering of his own circle, including his family.

On the other hand, in his private life, he has received lavish entertainment from companies that have received public orders. Orbán received a private jet service (Bombardier) provided by the owner of football club MOL-Vidi FC (István Garancsi) to watch the World Cup football match between Argentina and Croatia in Russia on June 12, 2018. On July 25, he flew to Varna by private jet from Vienna to watch the European Champions League qualifier between MOL-Vidi FC and Ludogorec (Bulgaria).⁴⁷

The owner of this football club is the owner of Mobil Adat, the company that won the exclusive order for SIM cards to be inserted into the cash registers of retail stores when the system was introduced to connect the cash registers directly to the tax office. He is also the owner of Market Építő, which has underwritten the construction of large construction projects, such as the 2017 FINA Swimming World Championship venue. On October 11, 2018, Prime Minister Orbán awarded this company Market Építő the "Company of the Year" award (the top 200 companies selected by the weekly magazine *Figyelő*) in the gala party. The magazine's owner is Orbán's ally, former historian Mária Schmidt. Prime Minister Orbán does not have any notion of inducing profit or bribery at all.

Prime Minister Orbán is a big football fan, and he chose France as his first foreign visit after coming to power in 1998, taking his eldest child, a preschooler at the time, on an official visit to France on July 12, the day before the final of the World Cup in France. The goal, of course, was to watch the final in the VIP seat. The TV screen

⁴⁷ When asked by an opposition MP in the Hungarian parliament on October 1, 2018, about the hospitality of companies that have received public procurements, Prime Minister Orbán deflected the question by saying, "I don't understand what the problem is. I've been doing this for thirty years and I'm going to Hungarian sporting events next week". Orbán believes that "there is nothing wrong with receiving entertainment by my friends" and that "there is nothing to be ashamed of".

showed Orbán watching the final with his child between his legs. Orbán has no notion of mixing private and public affairs, profit inducing and bribery. In this respect, he is not different from the Communist Party leaders of the old regime.

(4) Nationalism

In its bid to take power, Orbán's Fidesz has dropped the banner of "radicalism and liberalism" and put forward "conservatism and nationalism" in its place. Rather than relying on Budapest, it has sought to consolidate its base of support by targeting voters in local cities outside of Budapest. The most effective ideology for this strategy is "Hungarian nationalism". By putting forward solidarity and support for Hungarian minority in its neighboring countries and giving them the right to vote in Hungary, Fidesz has not only recruited support for the party, but also used the opportunity to inspire Hungarian nationalism and strengthen its base of support.

The surge of refugees and migrants into Europe in 2015 became an issue that required a major political decision for Hungary, but the Fidesz government used it to consolidate its power. Rather than adhere to the EU's opaque refugee and migration policies, Prime Minister Orbán's advocacy of tighter EU border controls and the elimination of refugees won the support of people. In this respect, the forces of the left have failed to go beyond the idealistic principle. When it comes to a confrontation between real intentions and abstract principle, it is only natural that real intentions will prevail. The leftist forces have exposed the limits of their inability to go beyond idealism. That's where Prime Minister Orbán used it to consolidate his power.

(5) Main Enemy Strategy

Another technique used to steer the population towards Hungarian nationalism was the strategy of creating an "enemy of Hungary". The arrogant immigration advocacy of George Soros, who was supposed to be an outsider, became the best target that the Orbán government could ask for. By criticizing the Hungarian-born Soros for supporting smuggling and insisting on unrestricted immigration, Orbán created the "main enemy" of Hungary by insisting that "The EU's refugee and immigration policies are manipulated by Soros. Soros is the devil. The enemy of the Hungarian people". The simple main enemy strategy was created by using Soros's statements. From here, Fidesz developed the conspiratorial historical enemy propaganda that "the root of all problems is Soros" in order to justify its policies.

These points are mentioned in detail in the next chapter.

Addendum: The Future of the Fidesz Empire

Since 2010, Fidesz has run an aggressive campaign, winning over 50 % of the vote in most elections. In the 2018 general election, it won 49.27% of the vote in the national proportional constituencies, securing 133 seats, more than two-thirds of the 199-seat quorum. The opposition won just 63 seats. The opposition won only 15 seats to Fidesz's 91 seats in the individual constituency. Moreover, eight of those seats were won out of 13 Budapest constituencies, so only seven seats were won outside the capital city. In-

deed, Hungary outside of Budapest has become a Fidesz empire. In the 2019 European Parliament elections, Fidesz did indeed get 52.56 % of the vote and won 13 of the 21 seats allocated to Hungary.

Thus, the opposition forces were dominated by the pessimistic outlook that Fidesz's long-standing regional strategy was working and that the Fidesz-Orbán political rule would continue for a fairly long time. However, something unusual happened in the simultaneous local elections held in October 2019. In the elections for the mayor and the district mayor of Budapest and the prefectural capital, where the opposition parties united their candidates, the opposition unity candidates defeated Fidesz candidates one after another.

István Tarlós, who has been mayor of Budapest since 2010, had made no policy errors and there was no groundswell of public opinion calling for his replacement, with government-affiliated pollsters reporting that he would be reelected by more than 10 points. However, the results of the vote showed that the opposition's united candidate, Gergely Karácsony of the MSZP – Párbeszéd Magyarországért (Dialogue for Hungary), was elected with 50.86 % of the vote, beating Tarlós by 5.76 %, and the opposition also won a majority in the Budapest City Council. Furthermore, the election of the district mayors in the Budapest 23 ward, the opposition unity candidate won 14 wards, while Fidesz's ruling party only managed to win 7 wards (2 independents). Especially in the heart of Budapest, Fidesz suffered a disastrous defeat and ended up retaining its ward leaders in Budapest's periphery. Thus, Fidesz was completely defeated in the capital Budapest in the 2019 simultaneous local elections. Not once in the past decade has Fidesz suffered such a defeat.

Furthermore, in the elections for the heads (governors) of the 23 prefectural capitals across the country, with the exception of Budapest, the opposition unity candidate won 10 cities, while Fidesz won 13 cities, including the independent candidates. Again, the opposition unity candidates were closely matched by the Fidesz candidates.

Although Fidesz still received more than 50 percent of votes, it was mainly confined to small municipalities in regional cities, towns and villages, with defeats across the board in the larger cities. Although Prime Minister Orbán stressed that Fidesz's majority of the vote gave his government credibility, the painful urban defeats have given the Fidesz camp a sense of defeat that it has not experienced in the last decade.

There are several factors that have contributed to the opposition's significant progress in the 2019 local elections.

The first is the consolidation of opposition forces. A change of government can never be achieved if the minority opposition parties fight individually against Fidesz, which holds an almost dictatorial position. This rallying of opposition forces worked effectively.⁴⁸

⁴⁸ I applied for the renewal of my residency permit and obtained a migration permit in 2019. The reason for this is that, due to a change in the law, the long-term residence permit was unified into a migration permit. This gave me the right to vote in the local elections, of which I was informed by an English-language appeal from the Secretariat of the opposition unity candidate. Many foreigners live in Budapest's District II, where I reside, and many of the foreigners

Second, this is a criticism of Prime Minister Orbán's heavy-handed political approach. Although many people support the government in its refugee and immigration policies, the no-questions-asked stance shown in the attack on the CEU (Central European University) and the restructuring of the Academy of Sciences made even Fidesz-affiliated intellectuals fed up. The attitude of underestimating academics and intellectuals and the daily populist tactics of capturing the local population, which is weak in its critical spirit, have antagonized not only the intellectuals, but also the city's residents.

Third, while the integrated media dominance deployed by the Fidesz government has solidified support for the ruling party among rural populations, urban residents feel it is unfair to the daily election campaigns, as the public media and free newspapers have degenerated into government gazettes. *Magazine*, which is distributed mainly in Budapest and was discussed in this chapter, supported the candidate of the ruling party with a picture of him on the front page during the elections. It is not acceptable for a weekly newspaper, published with advertising money from state-owned companies and the government, to unilaterally support the candidate of the ruling party. A method that works in the countryside provokes only antipathy among citizens in cities like Budapest. Mayor Karácsony, who was elected mayor of Budapest, has promised to immediately abolish the contract signed by *Lokál* and the Budapest Transport Authority.

Fourth, the "extraordinary loyalty" of government-affiliated opinion survey agencies of the vote (<https://szazadveg.hu/>, <https://nezopontintezet.hu/>) has become an issue. Allegations have emerged that they deliberately reported that the ruling party's candidate had an overwhelming advantage. Moreover, just before the vote, it was revealed that there was an internal report on the potentially narrow margin of victory for the ruling party. There should be no such thing as a public opinion survey body that is flattering to the party in power.

Fifth, there is widespread corruption, and this has become increasingly apparent as the Fidesz regime's hold on power has become more prolonged. This corruption does not simply include giving the Mészáros family huge subsidy projects. The leaders of the government have made no excuses for the massive drain on state funds by the politicians of the ruling party through the sale of state bonds with the right to settle. On the contrary, Orbán and other politicians have received all sorts of entertainment from companies that have won subsidized projects. The city's intellectuals are dismayed at the ethics of this, for which the Fidesz politicians seem to feel no shame or guilt. The attitude of contempt for everyday people has met with retaliation.

Sixth, an "orgy video" of the mayor of Győr city caused a huge uproar in the closing days of the election. A video of the Fidesz mayor Zsolt Borkai having an orgy with six Croatian celebrity women on a luxury yacht in the Adriatic Sea circulated online just before the vote. Panicked by this, the Fidesz leaders pressed Borkai to withdraw his

who have obtained immigration permits are believed to have voted for the opposition unity candidate. There was no call for votes from the ruling party. There was a looseness in the ruling party compared to the seriousness of the opposition.

candidacy, and the government affiliated daily newspaper *Magyar Nemzet* also published an unsigned article calling for his resignation. Budapest Mayor Tarlós and Parliament Speaker Kövér also moved to minimize the impact of Borkai's scandal on the election by his resignation. When the "orgy video" was released, Prime Minister Orbán was in Italy and France, and Fidesz leaders were hoping to get out of the situation by forcing Borkai to resign for the time-being. However, when the leaders succeeded in getting into contact with Orbán, they asked him for a final decision. Orbán stopped the Fidesz leaders from pushing Borkai to resign, saying that there was no need for him to resign. This led to the cancellation of the planned Borkai resignation press conference, with *Magyar Nemzet* also having to defend the fact that an allegedly unsolicited article had been published, allegedly in error.

What has been clear from this internal uproar is that no politician within Fidesz has been able to admonish and persuade Prime Minister Orbán on a matter as serious as this one. It is clear from previous descriptions in this book that Orbán himself does not maintain a high level of ethics when it comes to scandals and corruption, and this is once again confirmed by the Borkai scandal. "Such an incident does not reduce Fidesz's support. We should not give the opposition party the mayor's chair without fighting." This fact shows Orbán's immense arrogance. In fact, Mayor Borkai received significantly fewer votes, but was re-elected by a margin of 644 votes over the united opposition's candidate. However, the Fidesz leaders have not denied the impact of the Borkai scandal on the Budapest mayoral race and other elections for mayor.

Borkai informed Fidesz that he was leaving Fidesz, and the Fidesz leaders thought this would put an end to the incident, and he eventually resigned as mayor. There was no way for him to perform his work after the shameful incident came to light. This scandal is not just a crime of indecency, but one that is deeply connected to the economic interests of the city of Győr. A mere mayor cannot afford a luxury yacht in the Adriatic Sea merely from the salary he earns in his position as mayor. Someone was doing him a favor. Zoltán Rákosfalvy, a friend of Borkai, was also onboard the luxury yacht. Rákosfalvy is a lawyer who made billions of Forint from land sales to AUDI. There were other businessmen from the city of Győr on the yacht. It is natural to assume that Rákosfalvy covered the expenses of this excursion. His law firm is also a real estate company which he owns. The company acquired the site adjacent to the AUDI plant for almost nothing in 2013 and sold it to a company⁴⁹ once established in

⁴⁹ The actual transaction was a bit more complicated: the Luxembourg company did not sell the factory expansion site directly to the AUDI, but to a company established in Hungary, which then leased it to AUDI. After a certain lease period, AUDI bought the site in question.

The company, Luxemburg Akonia S.A.EU, an offshore company owned by Rákosfalvy, is effectively run by Gábor Kacsóh, a Hungarian who lives in Luxemburg. Kacsóh is the one who bought ELIOS, the company owned by Tiborcz, the son-in-law of Prime Minister Orbán, who is accused of subsidy fraud. From this, it is suspected that Tiborcz may also be involved in Győr's economic interests (*HVG*, October 17, 2019, 11). This would also have influenced Prime Minister Orbán's decision on Borkai's resignation, i.e., his push not to make Borkai resign.

Luxembourg. This company again sold the property to AUDI via a domestic company and acquired nearly HUF 4 billion in proceeds from the sale.

Rákosfalvy is not a lawyer. Rather, he is a dark businessman in these ventures who used his political connections to acquire control of casinos around the country and become the second-largest casino owner in Hungary. The “orgy” was attended by several Győr entrepreneurs who got big businesses by using city concessions, including Ervin Szabó. He runs an extensive restaurant business in Győr, and he sold one of his restaurants to Borkai’s eldest daughter (Petra) five years ago, but the contact information is still said to be the address of the restaurant run by Ervin Szabó. Rákosfalvy reportedly appointed the eldest son of Borkai (Ádam Borkai), aged twenty or so, as managing director of his own company (Akonia Kft.) in 2015 and paid him a salary of HUF 1 million per month, though the company did not record any sales in 2016–2018. In addition, Borkai’s wife, a publicschool teacher, owns 4 hectares of land in the scenic village of Sokorópátka. This is an investment that the mayor and teachers’ salaries cannot possibly cover. These assets are clearly results of the mechanisms through which the money made by Rákosfalvy and Szabó is distributed to the Borkai family. In short, the participants in the “orgy” were the mayor of Borkai and businessmen enriched by the exploitation of the economic interests of the city of Győr.

The explanation for Borkai’s reelection despite the revelations of such serious scandals lies in the way in which the interest of the city of Győr are controlled by several businessman who work together with Borkai. I am thinking not only of AUDI, but also of the huge subsidies at work in the redevelopment of Győr. The strength of the desire to protect these interests made Borkai’s reelection possible. On the other hand, people excluded from these interests are believed to have exposed the orgy video. The sender of the video posted online is signed “Ördög Ügyvédje (devil lawyer)”. If the accusations are aimed at Rákosfalvy’s dark business rather than at Borkai, we can assume that someone in business trouble with him exposed the video. Furthermore, it is possible to assume that the Croatian organizers or their related persons who gathered the celebrity women may have targeted and exposed Fidesz politicians.⁵⁰ AUDI would have been willing to buy the site next to the factory to construct logistics center at the asking price as long as the key persons of the Győr city could benefit from the sale of the site, because through the transaction, AUDI would have been able legally to give them rebates. Of course, all kinds of concessions arise with the expansion of a factory,

⁵⁰ Political relations between Hungary and Croatia have not always been good: in 2008–2009, when the Hungarian Oil and Gas Corporation MOL acquired a majority ownership stake in the Croatian Oil Corporation INA, MOL paid then-Croatian Prime Minister Ivo Sanader \$10 million. Shortly before the case came to light, Sanader abruptly resigned as prime minister; by December 2010, when Croatian prosecutors attempted to arrest Sanader on bribery charges, he fled to Austria. However, he was extradited from Austria to Croatia in July 2011 and sentenced to 10 years in prison in the first instance. In response, Croatian prosecutors obtained an arrest warrant for Hungarian MOL President Zsolt Hernádi and placed an international warrant for Hernádi through Interpol. At the same time, the Croatian government requested that the Hungarian government extradite Hernádi. The Hungarian government and the courts rejected this extradition request, which continues to this day.

not just the acquisition of sites. The greed of those involved in the process, who did not want to give up concessions for nothing, made it possible for Borkai to be reelected as mayor. However, after the Borkai-Rákosfalvy scandal became public, the civil surveillance of the city has been stricter, and it will be harder for them to monopolize the economic interests of Győr.

For Fidesz, the exposure of corruption, lack of ethics, and dishonest behavior is a major blow to the party. A little leak will sink a great ship. Just as the collapse of the Socialist Party began with the Gyurcsany's Balatonőszöd speech, there is no denying that the Borkai sex scandal could be the beginning of the fall of the Fidesz Empire.

Hungarian Prime Minister Orbán is a patron of his football club Videoton, which is based in his home town of Székesfehérvár. It seems that he lobbied Hernádi to make MOL, Hungary's largest company, a sponsor of Videoton. Obviously, in exchange for protecting Hernádi, MOL's money was put into a favored football club. The MOL-sponsored club was renamed and became MOL Vidi FC (MOL Fehérvár FC from 2019). As already mentioned, Prime Minister Orbán traveled to watch the World Cup in Russia on a private jet owned by this club. Also, as noted in Chapter 4, note 22, Prime Minister Orbán and his ally Mészáros have an inexplicable relationship with the Croatian football world, as Mészáros has a stake in a Croatian football club. While relations between the two countries have been strained on the political stage, Orbán and Mészáros have kept a strange relationship with the Croatian football world.

In this context, as also noted in Chapter 4, note 22, the anti-Orbán-Mészáros forces in Croatia are keeping a close eye on the movements of the Orbán-Mészáros family. It cannot be ruled out that the Borkai "orgy" and Rákosfalvy could have been caught in this surveillance network.

Chapter 7: Post-Socialism and Populism

The East-West Divide on the Refugee and Immigration Issues

7.1 The Great National Move 2015

7.1.1 Who and where did they go to Europe from?

In the twenty-first century, the flow of “refugees” and “migrants” from Africa and the Middle East to Europe has been accelerating. Ethnic conflicts and the collapse of regimes in African countries, as well as the collapse of the Middle East since the US invasion of Iraq, have created an unbroken torrent of “refugees” and “migrants” into Europe. Although the term refugee or asylum seeker is used for political refugees and the term migrant is used for economic refugees, most refugees and economic migrants are defined as people engaged in “illegal border-crossing”, meaning that they do not have proof of identity or a passport and have not been formally screened for entry.

Since the beginning of 2015, there has been a dramatic increase in the number of illegals traveling north along the Western Balkan route, replacing the Eastern Mediterranean (Eastern Balkan) route. The so-called Eastern Balkan route is a route from Turkey to Bulgaria and then to the Schengen countries through Hungary, but the route of illegal immigration from the Middle East has changed dramatically since the Bulgarian government put a barbed wire fence across the 80km-long Turkish border area in early 2015.

Table 7.1. Number of the illegal border-crossings (land border and sea border together)

	2012	2013	2014	2015	share of total (%)	2015/2014 (%)
Syria	7,903	25,546	78,764	594,059	33	654
Not specified	2,113	3,571	386	556,432	31	144,053
Afganistan	13,169	9,494	22,132	267,485	15	1,109
Iraq	1,219	537	2,110	101,285	5.6	4,700
Pakistan	4,877	5,047	4,059	43,314	2.4	967
Eritrea	2,604	11,298	34,586	40,348	2.2	17
Iran	611	404	468	24,673	1.4	5,172
Kosovo	990	6,357	22,069	23,793	1.3	7.8
Nigeria	826	3,386	8,715	23,609	1.3	171
Somalia	5,038	5,624	7,676	17,694	1	131
Others	33,087	36,101	101,997	129,645	7.1	27
Total all borders	72,437	107,365	282,962	1,822,337	100	544

Source: Frontex, *Risk Analysis for 2016*, 63.

Table 7.2. Detection of illegal border-crossing by routes and top three nationalities at the external borders

	2011	2012	2013	2014	2015	Share of parent row total	2015/2014 (%)
Eastern Mediterranean route	57,025	37,224	24,799	50,834	885,386	49	1,642
Sea	1,467	4,370	11,831	44,057	873,179	99	1,882
Syria	76	906	5,361	27,025	489,011	56	1,709
Afganistan	310	1,593	4,080	11,582	212,286	24	1,733
Iraq	76	47	57	382	90,130	10	23,494
Others	1,005	1,824	2,333	5,068	81,752	9.4	1,513
Land	55,558	32,854	12,968	6,777	12,207	1.4	80
Syria	1,216	6,216	7,366	4,648	7,329	60	58
Iraq	1,054	987	372	483	2,591	21	436
Afganistan	19,308	7,973	2,049	893	1,349	11	51
Others	33,980	17,678	3,181	753	938	7.7	25
Western Balkan route	4,658	6,391	19,951	43,357	764,038	42	1,662
Not specified	75	39	38	153	556,258	73	363,467
Syria	34	178	1,171	7,320	90,065	12	1,130
Afganistan	983	1,665	2,174	8,342	53,237	7.0	538
Others	3,566	4,509	16,568	27,542	64,478	8.4	134
Central Mediterranean route	64,261	15,151	45,298	170,664	153,946	8.4	-9.8
Eritrea	659	1,889	10,398	33,559	38,791	25	16
Nigeria	6,078	449	2,824	8,233	21,914	14	166
Somalia	1,416	3,403	4,506	5,785	12,430	8.1	115
Others	56,108	9,410	27,570	123,087	80,811	52	-34
Circular route from Albania to Greece	5,269	5,502	8,728	8,841	8,932	0.5	1
Albania	5,022	5,398	8,592	8,757	8,874	99	1
FYR Macedonia	23	36	21	31	16	0	-48
Georgia	21	7	23	14	13	0.1	-7
Others	203	61	92	39	29	0.3	-26
Western Mediterranean route	8,448	6,397	6,838	7,272	7,164	0.4	-1
Guinea	392	261	142	769	1,991	28	159
Algeria	1,772	2,015	1,436	734	1,052	15	43
Morocco	775	508	282	476	828	12	74
Others	5,509	3,613	4,978	5,293	3,293	46	-38
Eastern borders route	1,049	1,597	1,316	1,275	1,920	0.1	51
Afganistan	105	200	149	209	491	26	135
Vietnam	23	158	149	257	461	24	79
Syria	4	22	64	98	153	8.0	56
Others	917	1,217	954	711	815	42	15
Western African route	340	174	283	276	874	0	217
Guinea	4	2	12	50	365	42	630
Côte d'Ivoire	0	0	5	16	136	16	750
Gambia	2	39	3	22	85	10	286
Others	334	133	263	188	288	33	53
Black Sea route	0	1	148	433	68	0	-84
Syria	0	0	80	14	42	62	200
Iraq	0	0	0	90	12	18	-87
Iran	0	1	0	45	9	13	-80
Others	0	0	68	284	5	7.4	-98
Others	1	0	4	10	9	0	-10
Syria	0	0	0	0	5	56	n.a.
Russian Federation	0	0	0	4	2	22	-50
China	0	0	0	0	1	11	n.a.
Others	1	0	4	6	1	11	-83
Total	141,051	72,437	107,365	282,962	1,822,337	100.0	544

Source: Frontex, *Risk Analysis for 2016*, 17.

The Western Balkan route, which became mainstream in 2015, is a route that crosses the Mediterranean Sea from Turkey to Greece and from there goes north into Hungary via Macedonia and Serbia. A large number of stowaways were operating off the Turkish coast, and the Turkish government had given up trying to maintain control. Among Syrian refugees languishing in Turkey, those who were relatively rich and young created a stream of refugee heading from the Turkish coast to Greece. In response to this flow, people from all over the world flocked to the Mediterranean coast of Turkey, the starting point of this route, to reach Europe. This created a massive torrent of illegal immigration through Macedonia, Serbia and Hungary. Even though Syrian “refugees” accounted for the majority of illegal arrivals via the Western Balkan route in 2015, we can see that a mix of “economic refugees and migrants” from a great variety of countries blended together to form a major flow towards Europe. And this flow reached a major turning point in September 2015.

By August 2015, Hungary had dealt with around 200,000 “refugees” who had passed through the country over the course of a year. Refugees should have been registered in Greece, the first EU country they entered, but they passed through Greece without registering, forcing Hungary, the next boundary of the Schengen Agreement, to deal with the refugees as an EU member state.

Therefore, before the summer of 2015, the Hungarian government decided to put a barbed wire fence across the border with Serbia. When this decision was made public, neighboring countries made accusations according to which this step represented a move backwards to the Cold War and the Dark Ages. However, it is impossible for Hungary to carry out its obligations stipulated in the Schengen and Dublin Agreements if more than 1,000 people, both refugees and migrants though virtually impossible to identify clear as one or the other, flood the border every day. Moreover, the border area with Serbia is a small hill of grassland which can easily be crossed. The Hungarian government had to make a tough decision on whether to let the illegal crossing of the border go unchecked or to impose strict immigration controls. This is because were Hungary to try to implement strict immigration controls, many refugees would be kept in border areas for a long time, whereas were Hungary to let them cross the border freely, this would have meant abandoning immigration control as a Schengen country.

In the face of such an urgent situation, neighboring countries sat on the sidelines and only condemned the Hungarian government’s response. The Austrian government even criticized the transport of refugees and migrants on trains to refugee camps, calling it an evil act reminiscent of Jewish concentration camps. However, it is hardly surprising that Hungary, a sovereign and Schengen bordering country, cannot allow large numbers of people of unknown nationality to enter the country without screening.

Further refugee and migrant influxes, mainly Syrians, increased since September 5, 2015, when German Chancellor Angela Merkel announced that Germany would receive refugees. Chancellor Merkel temporarily suspended the Dublin Agreement, which determined the EU’s measures for dealing with refugees (refugee application and registration in the first country of arrival in the EU) and declared that Germany would accept refugees from Hungary. This accelerated further the “refugee” influx.

Tens of thousands of people who left Syria after hearing Merkel's declaration were joined by refugees and migrants from other countries, and over the course of five or six days, large numbers of people reached the Hungarian border via Greece, Macedonia and Serbia.¹

Thanks to Merkel's generous gesture, the number of "refugees" to Germany increased so rapidly that the chaos on the border from Salzburg to Munich became so great that she was forced to revise her decision. Chancellor Merkel's announcement of unrestricted acceptance was heavily criticized domestically, and she was forced to make a revised statement saying that Germany would not take on anyone unconditionally and that migrants who were leaving their countries of origins for economic reasons were not eligible for asylum. Accordingly, the government implemented immigration controls at the border with Austria and made clear its stance to exclude economic migrants. Austria followed Germany's example and implemented immigration controls at the border with Hungary, closing not only the trains but also the highway between Vienna and Budapest. Thus, both Austria and Germany introduced measures to narrow the entrance to the "refugee and migrant" influx by temporarily halting international train operations and introducing immigration controls. The German and Austrian politicians, who had blamed the Hungarian government unilaterally, underestimated the seriousness of the situation.

The Hungarian government, which has completed the barbed wire fence along the Serbian border, passed a law which went into effect on September 15 that strictly enforces the entry of people across the Hungarian border without an entry checkpoint and prohibits traffic outside the designated entry and exit points.

7.1.2 Entry to Schengen Countries

With or without barbed wire fences, border crossings that do not go through a border checkpoint are illegal. That is the common rule of law-abiding countries in the world. The reports that criticize building a fence on the border as inhumane because it is reminiscent of the "Guantanamo base" and because the refugees are allegedly treated in careless way misunderstand the nature of the situation. The absence of a fence does not mean that anyone can freely enter another country at any time. Proper entry through an immigration checkpoint at the border is a legal obligation that everyone must undergo, and signs have been put up in border areas announcing that any person who attempts to enter without going through the checkpoint is committed a crime. The simple fact that the people who are attempting to cross the border are refugees or the fact that Germany has announced that it will welcome them does not mean that these individuals can bypass immigration screening to cross another country's border.

¹ The "migrants" from Algeria and Morocco took a cheap flight costing about €40 to Istanbul, and from there they took a bus trip costing about €10 to the Mediterranean coast, where they paid a Turkish stowaway to take them to Greek islands. From there, they went to Austria and Germany via Macedonia, Serbia, Hungary or Croatia, and Slovenia.

Even for tourists entering the EU Schengen countries, their travel history as recorded in their passports is carefully checked. Japanese companies operating in Europe sometimes dispatch Japanese staff on long-term business trips in order to save residence expenses. However, if a Japanese business traveler without a work visa has spent more than six months in an EU member state in the past year, he or she will be rejected by immigration officials and ordered to return to Japan on the spot. This happens quite often among employees of Japanese companies.

As an international rule, a residence permit must be obtained if one wishes to stay in the foreign country or an EU country for more than six months. A residence permit is required for a stay of six months or more. A Japanese employee who has been in the EU for more than six months in the past year but does not have a residence permit will be rejected to enter the EU region when he or she tries to re-enter the EU.

Entry into the country not for tourism, but for economic activities that involve monetary payments, even for a short period of time, will not be permitted unless a short-term work permit has been obtained in advance. For example, in order to obtain a work visa (residency permit) for Japan, one must obtain in advance a "Certificate of Eligibility" from the Japanese immigration authorities. Then, one has to attach it to an application for and acquisition of a work visa obtained at the Japanese embassy where one lives. It is not easy to obtain a work visa for long-term work, and the degree of difficulty in obtaining a work visa varies from country to country, but it takes a certain amount of time for all countries.

Thus, although it is possible to travel within the EU without immigration checks, there is a strict screening process when a person first enters an EU member state. In some cases, the history of one's passport is not checked as much, but these days, all countries have much stricter checks in place.

Hungary completed the closure of its border with Serbia as of midnight September 15, 2015. Until just before the closure, "refugees" seeking to reach Germany flowed freely into Hungarian territory without immigration control or registration. The Hungarian government had abandoned immigration control at this point.

Dozens of men among the hundreds of "refugees" who arrived to the border area after the border closure and were left behind by those who had made it across the border began vandalizing the checkpoints the next day, September 16. Just before that, men with megaphones staged an agitation, urging the others to destroy the checkpoint by force if the border were not opened within an hour. Of course, this megaphone had not been purchased by the "refugees". It is believed to have been lent by a "refugee" support organization in the vicinity of the scene (there was a similar raid on a checkpoint at the Macedonian border at the end of November/early December, where megaphones were also used).

The youths threw stones at the entrance to the checkpoint, to which the Hungarians responded with water and tear gas. The international media used this scene as a basis for criticism of Hungary, broadcasting the headline "Hungary fires tear gas at refugees" and showing an image of a child crying from the tear gas, which was blown away by a child. The intention was to convince the world of the simple headline: "Hungary ruthlessly excludes refugees".

The Serbian government condemned Hungary's response as inhumane and as an attack on Serbian territory. In a press conference, the Serbian prime minister, who was on a visit to the United States at the time, insisted that Hungary's "outrageous act" should be condemned internationally, and the UN secretary general went so far as to express regret. But this kind of over-the-top reporting and criticism does not accurately convey the situation. There were articles in the Japanese press² condemning Hungary's response and praising Serbia's "support" for refugees, which is a factual error. Since Serbia is not a member of the EU and therefore not part of the Schengen Agreement, it does not need to be involved in refugee protection or immigration. Serbia granted 72-hour visas to refugees and migrants entering Serbia from Macedonia with a simple immigration process, and then transported the refugees and migrants from the Macedonian border towns to the Hungarian and Croatian border towns. Taxis and buses were waiting in Serbian towns on the Macedonian border to transport them to the next border by negotiating individual rates. In the case of transportation by bus, about 100 people were packed and transported in one car at a charge of about €50 per person. The revenue per bus was €5,000. Far from being an example of transport for humanitarian reasons, it was a "refugee" transport business. To praise Serbia's response and condemn Hungary without knowing these circumstances is mere sentimental, uninformed moralizing.

The Western European media criticized not only Hungary, but also former Eastern European countries such as Slovakia, which oppose the acceptance of refugee quotas, with the contemptuous tone of "anti-refugee sentiment in Eastern Europe, frightened by ignorance and fear".³ But Spain, for example, has erected a six-meter fence on the border between Spanish Ceuta and Morocco in the African enclave to prevent refugees and migrants from crossing the border.

After the Serbian-Hungarian border was closed, the "refugees" were to move to neighboring Croatia. Initially, Croatia stood on the sidelines and condemned Hungary's handling of the refugees, but then it became a party to the refugee response itself.

Initially, Croatia, like Serbia, thought that it should allow refugees to pass freely and leave the country for Austria. Therefore, they said they had no problem with the handling of refugees. Although Croatia is a member of the EU, it is not a member of the Schengen Agreement. For Croatia, which wanted to join the Schengen Agreement, the handling of refugees was a case of testing its ability to handle them properly, in accordance with the requirements it would face if it were a Schengen country.

After Croatia had received instructions from Brussels to register refugees under the Dublin Agreement, the refugees had to be temporarily housed and registered in refugee camps, contrary to the original plan of the Croatian government. However, Croatia was not prepared to accept large numbers of refugees, and on September 17, less than two days after the refugee movement began, it declared that it had given up and was forced to mobilize the military to close the border between Croatia and Serbia. Dur-

² For example, Toshiya Umehara, "Crisis Seen beyond the Fence", *The Asahi Shimbun*, October 24, 2015.

³ <https://www.afpbb.com/articles/-/3060085>.

ing this time, German Chancellor Merkel asked the Croatian prime minister Zoran Milanović to take in 20,000 “refugees,” but he refused, saying that the country was not prepared to do so.

Commenting on this situation in Croatia, the Hungarian foreign minister said ironically, “Hungary has been defending its borders as a Schengen country and dealing with refugees for eight months, but after throwing all kinds of accusations at the Hungarian government, Croatia has proven itself unable to deal with refugees in just two days. This teaches us that Croatia still needs to prepare itself to become a Schengen Agreement country”.

However, criticism back and forth and an exchange of accusations do not solve the problem. Croatia requested Hungary’s help in getting the “refugees” out of the country, starting with those who had completed a simple registration, so that they would not stay in the country. Hungary complied with this request and decided to organize the movement of “refugees” by so-called “corridors”, in which buses would be placed on the Croatian border. From there the “refugees” would be transported to the train stations and then moved to the Austrian border. In addition, a route was opened for the departure of people from Croatia to Austria via Slovenia, and all the duties of managing and registering “refugees” as provided for in the Dublin Agreement were left to Germany.

Thus Hungary was freed from the task of processing “refugees” at home by closing its borders and enforcing a policy of removing illegal immigrants, and it turned all the seriously difficult tasks over to Germany. The chaos in Hungary has been resolved, but the problem has not been solved. The “refugee problem” was upgraded from a Hungarian problem to a problem of the major EU countries, especially Germany.

7.1.3 International Media Criticism of Hungary

Even more stringent than the examination of those engaged in normal economic activities is the refugee status process. In the case of Hungary, the certification period is set at 30 days, but that period is extended indefinitely if the necessary documents are not in order. Even in Germany, it can take anywhere from a few months to a year for a person to be granted refugee status.

In 2015, most of the “refugees” pouring across the Hungarian border were Syrians, but the reality was diverse, with a diverse mix of nationalities, including Kosovars, Pakistanis, Afghans and Iraqis. Some had passports, while others did not. It is common for people to have multiple forged passports, and it is quite possible that IS fighters are mixed in with them. If more than 1,000 such “refugees” arrive at a country’s borders on a daily basis, the country’s immigration control will be out of control. If the refugee status is strictly enforced, tens of thousands of refugees will be left at Hungary’s borders.

The unimaginable volume of refugees pouring into Hungary made it impossible to rigorously implement border controls and refugee registration and recognition under the Dublin and Schengen Agreements. Any attempt at rigor would have to be tough on the refugees. This sparked international criticism of Hungary.

International media contributed to the harsh response to illegal immigrants as “inhumane treatment” to the world. Footage of a Hungarian camerawoman attempting to make a mother and child fall over as they tried to escape from a police officer to stop them, was distributed worldwide. CNN tracked down the camerawoman and reported that “a Syrian father and son were heading for the border when they were tripped and fell over by the camera woman”.⁴ CNN took great care, furthermore, to report the beautiful story of the Syrian father and son being warmly welcomed in Spain and his father being employed at a soccer training school.

From the beginning of the incident, some of CNN’s reporting team was poised to criticize Hungary for its “anti-refugee” actions. There is another video of the scene CNN aired filmed from a different angle (the camerawoman’s angle).⁵ It shows that when the father freed themselves from the grip of a policeman who had his hand on his shoulder, the father and son were caught in a hole in the ground and, as a consequence of their momentum, they fell down. The camerawoman in this case is nearby and reflexively raises her foot as the father and son fall, but she is too far away to reach them. Of course, the act of putting one’s foot up as she did, regardless of whether someone else trips over it, merits criticism, but the camerawoman was criticized and condemned around the world for “putting her foot up to refugees on two occasions”. In addition, the CNN covered the Syrian father and son afterwards and even aired a report on the Syrian father and son’s welcome in Spain. Clearly, the story depicts a refugee abused in Hungary being welcomed in Spain, and CNN’s coverage of the “as they head for the border” is also wrong. The situation was filmed as illegals entering Hungary were trying to flee from police officers because they did not want to be led to the refugee camps.

The reason for the international media’s condemnation of the Hungarian government’s handling of the “refugees” and the European West’s condemnation of the Hungarian government’s inhumanity is that the right-wing nationalist government does not have good relations with the West. On the other hand, the “left” forces in Hungary, which have been riddled with corruption and have lost the support of the Hungarian people, have been criticizing the Hungarian government from the outside with the help of the European Left. So any policy measure taken by the Hungarian government is labeled as anti-democratic, and Prime Minister Orbán is dubbed a narrow-minded right-wing nationalist and chauvinist, no matter what action the government takes. Learning from this, Western journalists who have never been to Hungary easily use this label as a simple term to criticize the Hungarian government.

It is true that the Orbán government’s policies have shown a parochial nationalist bent, but that cannot be lumped in with border control and refugee issues. It is not fair to accuse Hungary of exercising its sovereignty unilaterally just because the govern-

⁴ CNN, September 9, 2015, CET 01:30 (twitter.com/@GissiSim/Reuters/Sept.8, Roszke, Hungary).

⁵ The video was uploaded on YouTube (<https://www.szeretlekmagyarorszag.hu/megsem-az-operator-miatt-zuhant-a-foldre-a-szir-apa/>). However, it has been removed as violating the terms and conditions of the YouTube.

ment is nationalistic. The problem of refugees in the twenty-first century goes beyond ideology and involves issues of national sovereignty and social identity. Furthermore, it is ongoing at a scale and scope that is far beyond what can be addressed by mere humanitarian aid.

7.2 Mandatory Quotas for Refugees and Migrants

On September 3, 2015, the European Commission decided that 160,000 “refugees” languishing in Greece, Italy and Hungary would be taken in by the EU member states. However, the situation changed with Hungary’s closure of the Serbian border and Germany’s unrestricted acceptance announcement, and this 160,000 quota became unrealistic.

The quotas were decided again at the end of September by the EU’s Justice and Home Affairs Council. The decision was made to allocate “refugees” to the EU countries over a two-year period for a total of 120,000 “refugees”, 66,000 “refugees” who at the time were in Greece and Italy and 54,000 who were in Hungary. However, Hungary opposed the quota and refused to cover the “refugees” staying in Hungary, so the quota table covered 66,000 people, excluding those staying in Hungary. The decision was taken by majority vote, but Hungary and other former Eastern European countries voted against it (Slovakia, Czech Republic, Hungary and Romania). In November, Slovakia appealed to the European Court of Justice to confirm that the decision was not enforceable, and the quotas were invalidated. Hungary followed suit. The question was whether the majority decision of the Judicial and Home Affairs Council was enforceable or not.⁶

Following the proposal for mandatory quotas at the end of September, Chancellor Merkel proposed the introduction of permanent quotas in October. She proposed not only temporary quotas, but also a scheme to automatically allocate the refugees expected in the future. However, the proposal failed to materialize due to opposition from 15 of the 28 EU member states.

Furthermore, in November, Chancellor Merkel and the leaders of eight Western European countries active in accepting refugees invited the Turkish prime minister to Brussels to discuss \$3 billion in refugee assistance to Turkey and the acceptance of 400,000 refugees from Turkey (details of the meeting were not released). In response, Turkey was said to have committed to strict controls on “refugee” smuggling. The 400,000 people were to be accepted by air transport, but no details were given as to how the refugees would actually be selected and how long they would be accepted. It was also extremely unclear whether the eight countries would be able to accept 400,000 refugees. In fact, the figure of 400,000 was later thrown into wastebasket, with

⁶ Ultimately, the European Court of Justice rejected Slovakia and Hungary’s case two years later, in September 2017, but the feasibility of compulsory quotas was already a long way off and remained a mere judicial decision.

the changed goal of accepting about 50,000 refugees by air for the time being, and the matter itself was soon forgotten.⁷

The terrorist attacks in Paris on November 16, 2015, which broke out after a meeting with the Turkish prime minister, changed the public sentiment on refugee reception. One of the perpetrators turned out to be a person who had entered Hungary in September and from there had crossed into Germany. The gap between politicians who are active in accepting refugees and the public's concern about future social unrest has been only widening. The European Left, led by the Social Democrats, has been active in accepting refugees, but has continued to suffer defeats in the general and local elections held since the fall of 2015. There are many obstacles to the implementation of the refugee quota, and it is not working in practice.

The treatment of refugees under the Dublin Agreement places a significant burden on the EU member states where refugees first enter the Union. Therefore, in April 2016, a proposal to share the responsibility for refugee processing, which is concentrated in specific countries (Italy and Greece), across all EU member states was proposed as a new mechanism for EU refugee reception.⁸ Its main points are as follows.

(1) In order to ensure fairness, each Member State determines its own reference for the number of refugees to be handled, and if the number of refugees needing to be handled exceeds that by more 50 %, the refugees are automatically allocated to another Member States until the number of refugees handled by that Member State falls below the default reference. Member States are obliged to accept the allocated refugees as long as there is room on each indicator.

However, Member States may exercise the option not to participate in this sorting mechanism for the time being, in which case they will pay €250,000 for each refugee claim they refuse to accept to ensure solidarity among and fairness to Member States.

(2) The migration of refugees directly from third countries outside the EU will also be an element of this new mechanism. This will be done from the perspective of safe and legal refugee protection.

⁷ In the agreement with Turkey, what was actually implemented was the payment of refugee assistance money to stay in Turkey. In exchange, the Turkish government stepped up its crackdown on smugglers along the Mediterranean coasts, which has resulted in a sharp decline in the number of refugees and migrants from Turkey via the Western Balkan route since 2016. This tells us that without the smuggling business, the flow illegal migrants would never have reached such an extraordinary scale (more the one million). The alignment of the interests of stowaways and those seeking to immigrate to the West and the Turkish government's failure to control the stowaways and turn a blind eye to them led to a huge rush of refugees and migrants.

⁸ EU, REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL establishing the criteria and mechanisms for determining the Member State responsible for examining an application for international protection lodged in one of the Member States by a third-country national or a stateless person (recast), Brussels, May 4, 2016 COM(2016) 270 final.

(3) Avoid the imposition of responsibility for the transfer of refugee claimants between Member States and ensure that claims are processed within a short period of time.

(4) Clarify the legal obligation that a refugee claimant must not move from the country of application without permission, to discourage arbitrary movement.

(5) Priority protection for children arriving without a guardian and appropriate provisions for the extent of their families. The UK and Ireland will not be compelled to participate in the scheme (hence no refugee acceptance index and no solidarity payments).

The reference share of each country in the EU is determined by two factors: the ratio of the population of the 25 EU member states to that of the country in question and the ratio of that country's GDP to the GDP of the 25 EU member states as a whole. The weighted average of each of these factors at 50 % is the country's acceptance index (quota ratio).

For example, if Hungary's population ratio is 2 % and its GDP ratio is 1.5 %, then the Refugee Acceptance Index is calculated as following.

Refugee Acceptance Index = $0.5 \times 2 \% + 0.5 \times 1.5 \% = 1.75 \%$.

Based on this formula, if, for example, the EU allocates 100,000 refugees to a member state, Hungary's acceptance index would be 1,750, and it would have to automatically accept 1.5 times that number, until it reaches 2,625, and the number of refugees above this number could be allocated to other countries. In case of refusal to accept applicants, Hungary must pay a solidarity payment equal to the number of people not accepted multiplied by €250,000.

These are the permanent automatic quota proposals developed by the EU bureaucracy as of the spring of 2016. However, this proposal also failed to gain national support and became a de facto desk plan. It is that difficult to allocate refugees and migrants forcibly. Automatic quotas mean "unconditional acceptance of EU decisions," so countries cannot easily agree to them.

On the other hand, Greece and Italy, as states which anticipated correctly that mandatory quotas would not materialize, adopted a policy of reducing the number of refugees and migrants in the country by effectively allowing them to move within Europe. If other countries are not willing to take it on the refugee/migrant issue in unison, the counter-measure, these countries felt, was to allow refugees and migrants cross the national borders into other countries. In practice, the refugees and migrants were headed to Germany, France, Denmark, the Netherlands and the Scandinavian countries. Therefore, the politicians in these countries are not pleased with the attitude of or measures taken by the Hungarian government, which refuses to accept the mandatory quotas.

7.3 The Battle between the Hungarian Government and George Soros

Although the Hungarian government is now busy with a nationalist, inward-looking ideological campaign, in the early stages of the mass influx of refugees and migrants in early autumn 2015, it was making some very legitimate policy recommendations. When

the European Justice and Home Affairs Council decided on September 22 to set a quota of 120,000 “refugees” languishing in Greece, Italy and Hungary, Hungarian Prime Minister Orbán, who opposed this, made the following six proposals (September 23, 2015).

- (1) The Greek border should be jointly defended by EU countries.
- (2) Refugees and migrants must be sorted outside Schengen’s borders.
- (3) The EU must draw up a list of peaceful countries (which should receive refugees).
- (4) The EU must raise EU budget revenue by 1 % and lower spending by 1 % to raise €3 billion to deal with the large number of refugees and migrants.
- (5) The refugee and migrant crisis needs to be addressed by involving friendly countries such as Turkey and Russia.
- (6) Global quotas should be introduced to address the refugee and migrant crisis with the cooperation of all relevant countries.

At the time, the proposal was not given any notice by other EU countries, but the proposal itself was timely. Governments of the EU member states at the time were too preoccupied with the urgent issues to discuss the basic principles of how to handle the problem. Three years later, the resolution adopted at the EU summit in June 2018 essentially follows the Orbán proposal. This will be discussed later in this chapter, in section 7.6.

The Orbán proposal was immediately countered by George Soros, who made the following six-point counter-proposal (September 26, 2015).

- (1) The EU should take in at least one million refugees a year for the time being.
- (2) The EU should launch a global fundraising campaign to support four million refugees.
- (3) The EU should establish a Refugee and Migration Agency and create a single EU Border Force.
- (4) A safe route for refugees should be laid down.
- (5) The EU’s approach to refugees and migrants should become the global standard for the future of refugee and migrant handling and financing.
- (6) The EU should mobilize private NGOs, churches and industry to help refugees and migrants.

In response to the Soros proposal, Prime Minister Orbán claimed that “(Soros’s proposal) seeks to undermine European nation-states and change the traditional way of life in Europe. Activists in support of migrants are operating in a smuggling network” (October 30, 2015). In response, Soros immediately replied that “The (Prime Minister Orbán’s) plan is to treat refugees as a hindrance and only think about protecting its borders. Our plan (on the contrary) considers the border as an obstacle and aims to help refugees”.

This is where the violent rivalry between the Hungarian Fidesz government and Soros began. However, since then, both Prime Minister Orbán and Soros have intermittently revised their views. Soros has already dropped his one million per year acceptance claim, and Prime Minister Orbán has dropped his claim of a “global quota” (making clear his rejection of UN quotas). But despite these shifts in claims, the initial fierce rivalry has dominated their relationship ever since.

Since the fall of 2015, the Hungarian government has been a consistent critic of Soros, and in 2017 it launched measures to tighten control over refugee and migrant aid organizations believed to be funded by the Soros Foundation.

With the Law on Transparency of Foreign-Supported Organizations, which came into force on June 27, 2017, the government has stepped up to monitor the NGOs receiving foreign support. Organizations that are covered by this law are those that receive more than HUF 7.2 million (approx. €20,000) in annual aid from abroad, which must register with the authorities and report the name and address of the organization. Individuals who donate HUF 500,000 (approx. €1,500) per year must also be registered. Those who fail to do so are subject to penalties. This is the first law of its kind to be adopted by any EU member state. It is aimed at clamping down on foundations and organizations linked to Soros.

Following the 2017 NGO Crackdown Act, the Hungarian government introduced the “Special Tax on Migrants” (*bevándorlási különadó*), which came into force on August 25, 2018. Commonly known as “Stop Soros”, it imposes a special tax on NGOs that reach out to refugees and migrants. The law covers organizations that work to promote migrants, such as migrant education organizations, migrant support networks, and organizations that engage in pro-migrant propaganda activities.⁹ By the 15th of the month in which they receive material support, these organizations must report to the tax authorities the name and location of the organization that provided the funds and the amount of support, and they must pay 25 % of the amount of support as a “special tax”. The first filing date under this law is September 17, 2018. Organizations which fail to meet the expectations set by this law are subject to additional taxes and sanctions.¹⁰ It would be common practice for the government to provide subsidies to NGOs that respond to refugees on behalf of the government to support their activities, but the Fidesz government has formulated a law that “punishes” aid activities with taxation.

In 2018, as part of the anti-Soros campaign, a questionnaire was sent to all voters asking them to approve or disapprove of seven questions in the framework of the “National Consultation on the Soros Plan”. The questionnaire is a summary of what Soros, an international investor and philanthropist, has been saying in books, newspapers and other media over the past two years, and it is called “Soros’s Seven Plans”. It contained claims that Soros had already withdrawn, as well as inaccuracies and misinformation,

⁹ At the end of August 2018, the website of CEU (Central European University) announced that the “Education Program for Registered Refugees” had been suspended as of August 28, 2018, due to the amendment of the law of August 24, 2018 to the 25% tax on this kind of educational program. This education program would be suspended until the situation is clarified. Thus, the Hungarian government’s decision to impose a “special tax on migrants” is fraught with a great many problems.

¹⁰ According to the portal news site index.hu (July 26, 2019, 09:20), no organization has filed a tax report as of June 15, 2019, nearly a year after the decree came into effect. The National Tax and Customs Administration (NAV) reports that it has no plans to investigate organizations in this matter. Both the government and NAV seem to be afraid that the mandatory implementation of the decree with the political intentions would attract international criticism.

and it was little more than a political smear campaign for domestic political purposes. What the Hungarian government referred to as the “Soros Plan” was as follows:

Plan 1: Soros is persuading Brussels to let one million migrants into Europe.

Plan 2: Soros is working with Brussels leaders to cut the border barbed wire.

Plan 3: Brussels’ mandatory immigration quotas are part of the Soros plan.

Plan 4: Brussels seeks to force aid of HUF 9 million per migrant under the Soros plan.

Plan 5: Soros seeks to reduce criminal penalties for immigrants.

Plan 6: The purpose of the Soros Plan is to promote immigration, which threatens the languages and cultures of European countries.

Plan 7: Soros increases political attacks on countries that oppose immigration and calls for harsher penalties.

After a long period of government propaganda and political campaigning by the ruling party, more than 2 million responses to the questionnaire (against the Soros plan) were received, and the government hailed this as a great success. However, Tibor Navracsics, the European Commissioner for Education, Culture, Youth and Sports delegated from the Hungarian government, said to the press that “the government could make a few questions based on Soros’s words and actions in 2015. However, to my knowledge, there is no such thing as a Soros plan in the Commission or in the Working Group”.¹¹ Géza Jeszenszky, who served as minister of foreign affairs in Antal’s cabinet after the first free elections (1990–1994) and ambassador to the United States in the first Orbán cabinet (1998–2002), also criticized the questionnaire as “a political campaign that is condescending to the people”.

This national consultation was a political campaign by the Fidesz government to consolidate its domestic support base by portraying Soros as an “Enemy of the Hungarian State = the Devil”. In fact, two years before the Soros Foundation was targeted, there was a violent political attack by the Hungarian government against the Norwegian Foundation.

Since his reelection in 2014, Prime Minister Orbán has become overly nervous about criticism of his administration from abroad. What he particularly disliked was foreign foundations and funds. With the opposition unable to adequately oppose the government at home, he became very nervous about criticism of Fidesz’s government from outside the country, because the oppositional parties, he felt, are using politicians and parties of the European Parliament or the foreign media to articulate criticism of the Hungarian government. In laying the foundations for a stable government, it became one of the key policies of the Fidesz government to cut channels of criticism from abroad.

Norway is not a member of the EU, but on the occasion of the accession of Central and Eastern European countries to the EU, it decided to support the social liberation of

¹¹ Orbán decried Navracsics’s words and actions as being “contrary to the Hungarian government’s stance”, and he listed Navracsics as 44th on the Fidesz candidate list, which meant it would be absolutely impossible for Navracsics to get a seat in the 2019 European Parliament elections. The number of MPs allocated to Hungary is 21. Clearly, this was a punitive step taken by Orbán against Navracsics.

Central and Eastern Europe through the establishment of the Norwegian Fund. However, there are conditions on the use of the fund, which require that 10 % of the total amount be given to civil society organizations that are independent of the government of the time. The management of this 10 % of the fund was entrusted to Ökotárs Alapítvány¹² (the Hungarian organization of the Environmental Partnership Association), an organization that is contracted to manage and use various non-governmental funds. However, the Fidesz government judged that through the Ökotárs Alapítvány, the Fund's money was flowing to organizations which were critical of the government, and it used force to block the flow of this part of the Fund. The Fidesz government considers Ökotárs Alapítvány to be consciously funneling money to anti-government organizations, and it has mobilized the police and the tax authorities to conduct repeated enforcement raids since 2014.

In 2014, the Hungarian police searched Ökotárs Alapítvány on several occasions at the behest of the government, but not only did these investigations fail to demonstrate anything, but the investigations themselves were found to be illegal, and the Norwegian government took the opportunity to freeze the disbursement of funds. Until 2014, Hungary was supposed to receive a total of €503 million in funding, and although it had already received roughly 40 % of the funds, nearly 60 % of the remaining funds were frozen.¹³

The Fidesz government has been trying to withdraw the remaining Norwegian Fund balance, which stands at just over €300 million, and it has lobbied the Norwegian government to transfer the balance to fund the purchase of a missile defense system. This is the so-called NASAMS (National/Norwegian Advanced Surface to Air Missile System), and the sale of the system was being discussed with the US and Norway. The Hungarian government took advantage of this and proposed to divert the Norwegian funds to the Hungarian placement of this system. Hungary's minister of foreign economy and foreign affairs, Péter Szijjártó, proposed this idea at a meeting with the Norwegian minister of foreign affairs (February 22, 2019), but the Norwegian side rejected the idea.

Later, during his May 2019 visit to the United States, Prime Minister Orbán made a direct appeal to President Trump to put pressure on the Norwegian side. There was probably a shallow expectation that President Trump would think positively about this, as Hungary and the United States under Trump could cooperate on refugee and immigration issues and, moreover, the issue was a business matter for the USA, too. However, under normal diplomatic commonsense, it would be unthinkable for President Trump to combine the Norway Fund and the missile defense system. Even Presi-

¹² In 1991, American foundations formed a consortium that became the Environmental Partnership Association (EPA) Foundation, which supported environmental civil society organizations in Bulgaria, Romania, the Czech Republic, Slovakia, Hungary and Poland. The Hungarian chapter received independent legal entity status in 1994 and has been entrusted with managing the administration of the Norwegian Foundation and other fund operations.

¹³ The then Hungarian ambassador to Norway, Géza Jeszenszky, made efforts to return to normal relations with the Hungarian and Norwegian governments, but he resigned as ambassador in protest at the Fidesz government's firm stance.

dent Trump, who has the potential to make abnormal statements and decisions, would never interfere in a bilateral issue between Hungary and Norway, much less urge the Norwegian government to tie it up with the different issue of the missile defense system. According to reports, President Trump only said “I really like Norway” and then dropped the subject. That’s just the Trump way of answering the question. The issue was not discussed further.

The Orbán government has been nervous about the flow of funds from abroad to various NGOs and other private organizations, and it has not been able to abandon its preconceived notion that foreign funds will be used for anti-government campaigns. The basic position of the Orbán government is to strengthen its monitoring of various funds and NGOs by using taxation to strangle them.

7.4 Persistent Retaliation against the Soros Foundation

The Hungarian government’s retaliation against Soros has been continuous. The Hungarian government amended the Higher Education Act in April 2017 in order to crush the Central European University (CEU), a graduate university established with Soros funds. Prime Minister Orbán is sensitive to criticism of his administration and is committed to crushing his political opponents by any means.

However, no matter how Soros may have provided funds for the university, the actual university education is not based on his ideology. Moreover, CEU’s education and research is internationally acclaimed and has a high European university ranking.¹⁴ The politician Orbán tends simply to evaluate organizations and individuals on the basis of their ideology, putting his own ideology above academic and research freedom. Fidesz is trying to destroy a university with a simple political campaign: “The university Soros founded provides a welcoming education for refugees and migrants, which is detrimental to Hungary’s national interests”.

CEU does not have a campus in the United States, but is a graduate university established in Hungary under a New York State educational license. At the direction of Prime Minister Orbán, Hungarian officials saw a weakness in the establishment of the CEU and amended the Higher Education Law. The main idea was to force universities that did not meet this requirement to close down their campuses by making it a requirement that “all foreign universities recognized in Hungary must have campuses in the home country”.

In response, CEU tried to open a campus in New York State to meet the requirements of the institution of higher education and avoid closure. New York State also

¹⁴ CEU’s letter to MPs describes how much the CEU contributes to education and tax revenues in Hungary. The main contributions and concerns are noted as follows. “In the 2017 Quacquarelli Symonds (QS) rankings, CEU is ranked 42nd in the world for political science education. The university employs 600 people from 130 countries around the world and has 1,440 students from 108 countries. In 2015, CEU paid HUF 5.9 billion in taxes to Hungary and consumed an additional HUF 3.5 billion in Hungary. If CEU were to close down, not only would Hungary lose tax revenues, but it would also mean that 823 workers will lose their jobs.”

moved to conclude an agreement with the Hungarian government, and in April 2018, two undersecretaries of the Hungarian Ministry of Human Resources (Ministry of Education) visited the New York campus, and a draft agreement between New York State and the Hungarian government (the Hungarian signatory was the minister of foreign affairs) was prepared (the minister of foreign affairs subsequently denied the existence of the draft agreement).¹⁵ However, time passed without the minister in charge signing the agreement, as he clearly had been instructed not to do by Orbán, and CEU, paralyzed, decided to move the part of the educational program awarding American degrees to Vienna (December 2018).

The CEU closure maneuver has been harshly criticized by the European People's Party group in the European Parliament, to which Fidesz belongs, and is still a contentious issue between Fidesz and the European People's Party leadership.

7.5 The Hungarian Government's Criticism of the EU

In October 2016, Hungary held a referendum on the pros and cons of the "mandatory quota of refugees and migrants in the EU". Although the referendum did not pass, as turnout was low (40.41 %), the Fidesz government claimed internally and externally that the will of the people had been demonstrated by highlighting the fact that 98.33% of the votes cast and 39.68 % of the absolute voters were against the mandatory quotas. The referendum itself had a modest effect in demonstrating Hungary's stance.

In 2017, the government began to launch a referendum-like political campaign called the "National Consultation". The government mailed voters a questionnaire titled "Stop Brussels" with six questions critical of the EU and asked them to return it with a note of approval or disapproval for each in order to stop EU intervention in Hungary's economic and foreign policy. The six questions are as follows.

- (1) Brussels is trying to stop the forced reduction of electricity and gas prices.
- (2) Brussels is trying to force illegal immigrants into Hungary.
- (3) Brussels is supporting international organizations that assist illegal border-crossing.
- (4) Brussels is supporting foreign-funded organizations aiming to intervene in Hungary's internal affairs.
- (5) Brussels is critical of Hungary's job creation policies.
- (6) Brussels has criticized Hungary's tax relief measures.

The European Commission has launched an investigation into the campaign, stating that "there exists no institution called Brussels" and that the national consultation campaign critical of the EU is regarded as a routine election campaign by the Hungarian government. Although the campaign was not a success, with only about 100,000 responses from voters, despite the huge expense, the "national consultation" was promoted through the government-controlled media. This referendum-like political campaign has a historical background. When Fidesz came to power in 2010, the govern-

¹⁵ There is a draft contract circulating on the Internet with Péter Szijjártó in the signature column, but the foreign minister has claimed never to have known about it.

ment began a series of institutional reforms. The European Commission questioned its adherence to EU rules. The reforms were investigated and corrective action was recommended. Both the consistency of the legal mechanism and the level of Hungary's state budget deficit were met with harsh recommendations by the EU Commission.

To prevent foreign interference with the government deficit, the Fidesz government attempted to raise tax revenues by establishing special taxes on the retail, telecommunications, and energy supply industries after coming to power, and it also introduced a special tax on banks at a high rate. The government also took measures to reduce the size of the national budget deficit by incorporating some of the pension assets (outsourced to the private sector), which had been separated from the social insurance fund, into the national coffers. Furthermore, in 2011, as part of a series of reforms, the Hungarian government decided to integrate an independent governmental body, the Financial Supervisory Board, into the National Bank (the new National Bank Act). The issue was brought up in loan talks with the IMF, but instead of listening to the IMF's recommendations, the government strengthened pressure to resign on the Governor of the National Bank, András Simor, who was appointed during the previous Socialist Party government.

Because this series of Hungarian government measures targeted foreign companies, the European Commission opened an investigation into each of these measures, while foreign banks intensified their lobbying of the EU and demanded that special taxes on private companies be corrected. In response to this, the Hungarian government repelled external criticism and took a stubborn stance of not allowing external intervention in domestic policy decisions, which accelerated the speculative sale of the Hungarian forint in late 2011 and early 2012 and led to an unstoppable decline in the value of the forint. Prime Minister Orbán, who had been aggressively rejecting the recommendations of the EU and the IMF since he came to power, was reminded for the first time of the limits of his domestic power by the counterattack from the international financial community. This was the first time he realized that his firm stance was ultimately useless and not a good idea, neither from the perspective of the country's economy nor from the perspective of maintaining domestic political support.

Thereafter, the Orbán government considered it essential to stabilize public finances in order to avoid intervention from international financial institutions, so it turned to policies that would further raise tax revenues.

As we have already seen in detail in chapters 3 and 4, Hungary's national tax burden is very high. Even after the second Fidesz cabinet, it was necessary to raise the value-added tax by 2 %. Since Hungary's accumulated external debt remains high, it is not possible to reduce the tax burden easily. Therefore, the Fidesz government developed a policy called "rezsicsökkentés" (utility price reduction), which enforces reductions in electricity and gas prices by law. It was an "almsgiving (populist) policy" under the difficult circumstances to decrease level of national taxation.

The policy, introduced in January 2013, is a government-ordered policy to reduce electricity and gas bills by 10 %, enforcing electricity and gas distribution companies to send each household a 10 % discount bills. The monthly bills show the "price without discount" and "the amount of the discount", as well as the cumulative amount of dis-

count enjoyed by households since the policy was introduced. Thus, the bills also serve the function of monthly letters reminding citizens not to forget that the government is giving a gift to the household budget every month. It is nothing more than a routine political campaign by the ruling party.

Even with a flat 10 % discount, as long as the electricity and gas distribution companies are still profiting, then either their initial rates were too high or energy prices are falling. Therefore, if the government had not intervened and had left prices to market trends, electricity and gas prices could have been lowered, but it is a cunning policy to gain public support by making the lower prices seem as if they are the product of prudent policy by a caring government. A reduction in VAT of one or two percent would have resulted in the same degree of spending reduction for households. However, this utility price reduction is being presented as a warm-hearted paternalistic government policy.¹⁶ The populist nature of the current administration is evident.

The European Commission insisted that the government's orders to private electricity and gas distribution companies were contrary to the EU's market policies. Therefore, with a referendum-like political campaign called a "National Consultation", the Fidesz government had to try to give the impression to people that it was fighting against EU interference and at the same time sought to show the will of Hungarians to the European Commission.

In 2019, ahead of the European Parliament elections, the Hungarian Fidesz government began a political campaign to openly criticize European Commission President Juncker. Huge posters with the mugshots of George Soros and Juncker were plastered all over Hungary, and leaflet versions of these images were mailed to every household. The criticism was that President Juncker was conspiring with Soros to carry out forced quotas for refugees, and Hungarians were warned that "we need to know their conspiracy".¹⁷

The president of the European Commission, Jean-Claude Juncker, is an elected politician from the People's Party group in the European Parliament, to which the Fidesz belongs. In response to the new anti-EU campaign, the nine national parties of the European People's Party group have criticized Fidesz and called for its expulsion from the group. In response to this, Manfred Weber, head of the European People's Party's

¹⁶ Under the Socialist government, a pension bonus of one month's pension was paid at the end of the year as a "13th month's pension". The current Fidesz government is paying out pension bonuses as a "pension premium", a premium rate that is based on economic growth. The government has announced that, in 2021, the 13th month pension will be rebuilt. These policies are designed to maintain the support for the government among pensioners.

¹⁷ The leaflet mailed to each household described seven "schemes". Soros and Juncker are (1) trying to introduce mandatory quotas; (2) trying to weaken the authority of member states to control their borders; (3) trying to simplify the influx of migrants by having member states issue immigrant visas; (4) trying to provide more money to organizations that support migrants; (5) handing over HUF 9 million worth of bank cards to migrants and trying to help them settle in; (6) Trying to start experimental migration projects from African countries; (7) trying to reduce funding to countries that monitor migration.



The huge poster: “You have a right to know what Brussels is conspiring to do.”

parliamentary delegation, put forward to the Fidesz the following three conditions for remaining in the European People's Party group:

- Stop the political condemnation campaign against Brussels (EU);
- Apologize to the brother parties of the People's Party group and to Mr. Juncker;
- Keep CEU in Budapest.

In response to these demands, the Fidesz administration officials made no concessions. The head of the parliamentary delegation, Mr. Weber, made a hasty visit to Budapest on March 12 and met with Prime Minister Orbán. Prior to this meeting, Weber went directly to CEU and had discussions with university officials.¹⁸ He did this because, from the point of view of academic and research freedom, the CEU issue could not be overlooked by the People's Party group. Mr. Weber pressed Prime Minister Orbán on the above three demands, but he never got a clear answer.

Subsequently, at a meeting of the European People's Party Group on March 20, a proposal to suspend Fidesz's status was passed by an overwhelming majority of 190 to 3. A compromise was reached between the leadership of the European People's Party and

¹⁸ Weber suggested to the CEU university executives that he would propose a partnership with the Technical University of Munich and that he himself would act as an intermediary in this partnership. Just as the BMW plant is being built in Debrecen, he seems to have convinced them that it would make sense for both parties to place a satellite campus at CEU for the Technical University of Munich, which also has a research and development partnership with BMW. Although CEU only has a humanities department, the university apparently responded that it would welcome any concessions from the Hungarian government that could be made by partnering with an engineering university. Weber apparently made the same proposal to Prime Minister Orbán, but he did not receive a clear response. Subsequently, CEU signed its own agreement with the Technical University of Munich: CEU's American degree-granting postgraduate programs were moved to Vienna, while its undergraduate education and masters' of business administration programs remains in Budapest.

Fidesz according to which Fidesz has its credentials suspended instead of being immediately expelled. The European People's Party set up a three-member Council of Wise Men to deal with the Fidesz issue. The leadership of the European People's Party could not simply dismiss Fidesz, which held 14 seats in the group, while expulsions from the group would force Fidesz to move to a populist subgroup, which was not Fidesz's intention. In the end Fidesz left the European People's Party Group in March 2021.

7.6 The EU Summit Resolution

With the effectiveness of the refugee and migrant mandatory quota policy in question, the EU was forced to reconsider the development of a unified refugee and migrant policy.

One of the main themes of the EU Summit held on June 28–29, 2018 was the issue of refugees and migrants. During this meeting, a shift in the traditional refugee and migration policy took place. A large number of arguments so far in the European Commission and the European Parliament have been for a policy of tolerance for refugees and migrants, represented by Germany, France, the Netherlands, Belgium and the Nordic countries, and there have been condemnation and demands for sanctions against former socialist countries in Central and Eastern Europe that resist “refugee quotas”.

However, the change of government in France, Italy, Austria and Slovenia, which led to a change in policy of tolerance for refugees and migrants, forced the EU to rethink its existing policies. Moreover, there were strong demands from within the German administration, which had been the most tolerant in accepting refugees and migrants, to reconsider its policy on refugees and migrants, and the administration itself was in danger of collapsing if it continued with its “tolerance” policy. These developments forced a change in EU policy.

7.6.1 The Resolution

The Summit Resolution¹⁹ reaffirms the importance of strengthening EU border controls and foreign policy and domestic measures with relevant countries to limit the uncontrolled illegal immigration experienced in 2015. To this end, it calls for the implementation of measures to address illegal migration via the Western Mediterranean route from the Libyan coast, which has been increasing rapidly since 2017, with the help of the Libyan Coast Guard. It also hopes that by ensuring the implementation of the Turkey-EU agreement on illegal migrants via the Eastern Mediterranean route, the Turkish side will deal with the smuggling organizations that mediate illegal migration.

In order to address the problems created by smuggling organizations that act as intermediaries for illegal migrants, measures are needed to break their incentives, underlining the need for clear guidelines on the treatment of rescued people. It was emphasized that countries should draw a distinction between illegal migrants and refugees

¹⁹ European Council conclusions, June 28, 2018; <https://www.consilium.europa.eu/en/press/press-releases/2018/06/29/20180628-euco-conclusions-final/>.

through their own voluntary efforts, and each should be dealt with in accordance with international law.

The Summit Resolution continues to emphasize the importance of maintaining cooperation with African coastal countries and Turkey to prevent the movement of illegal migrants, and it calls for stricter measures to deal with illegal migrants and a clearer distinction between them and refugees.

It also stresses the need for EU member states to continue to take steps to protect the borders of the EU and to properly implement the repatriation of illegal migrants.

With regard to the secondary movement of refugees within the EU, under the EU's refugee policy and the Schengen Agreement, the unity of the EU needs to be undisturbed and member states are required to deal with the arbitrary movement of refugees, for example by enacting national legislation.

There was a commitment to report to the Council in October on new measures under the reform of the Dublin Agreement, balancing the responsibilities and solidarity of member states on the unified treatment of refugees in the EU.

7.6.2 The Importance of the Summit Resolution

It is important to clarify the distinction between refugees and illegal migrants, which has been blurred in the past. Refugees are people who should be protected unconditionally, while illegal immigrants are subject to repatriation; in the massive influx of refugees and migrants in 2015, at most 20-30 % of people could genuinely be said to be refugees, and even those who qualify as refugees were mostly refugees whose status was close to the status of migrants, as most of them were trying to make their way to Germany. This is because, in principle, refugees are granted asylum in the first peaceful country in which they arrive, and those who designate their own final destination are not refugees, but are considered migrants. A refugee who designates his or her country of residence is considered an immigrant rather than a refugee.

However, the problem is that most self-proclaimed "refugees" do not hold official documents proving their status or usually hold a few forged passports, making it very difficult to distinguish between refugees and migrants. 2015 saw a massive influx of people into the EU with little or no rigorous screening. As a result, the Schengen Agreement lost its effectiveness, and the EU became a federation of sorts which essentially had no external borders.

The EU has responded to the crisis by proposing a scheme to automatically allocate a growing number of refugees and migrants to member states and impose huge fines on member states that refuse to accept it, rather than strengthening external border controls. In response to this, not only did the four Central and Eastern European countries show resistance, but Austria, which had strongly criticized Hungary until then, came up with a tougher policy on refugees and migrants after a change of government. Moreover, with the new Italian government joining this line in 2018, the argument in support of mandatory quotas has been retracted and new policy developments are needed.

Thus, for the first time, the EU stressed the importance of border control, going so far as to discuss the selection of refugees and migrants through the creation of camps outside the region and the establishment of refugee camps within the member states. In fact, these various points were proposed by Hungarian Prime Minister Orbán in 2015, but the EU leaders at the time, who prioritized practical handling, rejected the Hungarian proposal. Three years later, the ring is finally ready for a calm discussion.

Following this summit resolution, the activities of “refugee” rescue ships in the Mediterranean were restricted. Non-governmental organizations and Mediterranean rescue ships, which Soros is believed to be financially supporting, are working to rescue refugees and migrants at sea. However, more than 90 % of the people who reach Europe via the Mediterranean route are currently economic migrants, and refugees make up only a small percent of the total. For this reason, the most active relief vessel (the Aquarius with the NGO SOS Méditerranée) has been denied entry to port by European countries, and in September 2018 was forced to cease its relief work after being de-registered by the Panamanian government, where it is registered as a vessel. In effect, it was found to be aiding and abetting the smuggling of illegal immigrants.

Thus, the clear distinction between refugees and economic migrants is being tightened at European borders, and the anomalies that have persisted since 2015 appear to be normalizing. It is important to note that there has been a shift in policy away from discussions of mandatory quotas, which have no prospect of a solution, and towards tighter border controls.

However, there is a conflict within the EU between the groups demanding mandatory quotas and those demanding water-based interdiction of illegal immigrants through stricter border controls, creating a situation in flux with the changes of governments in each country. Both of these policies are difficult to implement, and the power relationship between the mandatory quota group and the strict border control group fluctuates depending on the intentions of the countries involved and domestic power relations.²⁰

7.7 The Sanction Resolution in the European Parliament

On September 12, 2018, the European Parliament passed a proposal for sanctions against Hungary²¹ proposed by Dutch MEP Judith Sargentini, a member of the “Green Party”. This is the first time that the European Parliament has passed a proposal for

²⁰ The withdrawal of the “League” from the second Italian Conte government, which was established in September 2019, and the replacement of Minister of Justice Salvini led to a shift in the response to illegal immigration. For more on the situation since then, see the “Addendum” at the end of the chapter.

²¹ *DRAFT REPORT* on a proposal calling on the Council to determine, pursuant to Article 7(1) of the Treaty on European Union, the existence of a clear risk of a serious breach by Hungary of the values on which the Union was founded (2017/2131(INL), Rapporteur: Judith Sargentini, European Parliament.

sanctions on a member state, following the Commission's launch of sanctions proceedings against Poland in December 2017.

The European Parliament, which was preparing for a parliamentary election the following year, became a place where individual members of the parliament and political denominations demonstrated to appeal their political actions. From the establishment of the Fidesz Orbán administration up until this point, the Hungarian government has repeatedly received recommendations for improvement from the European Commission, which has alleged that the Hungarian government's domestic policies are in contradiction with the principles and laws of the EU. Unlike the Polish government, which has kept a non-cooperative attitude, Hungary has always shown a conciliatory stance on rectifying recommendations. Therefore, the sanctions proposal this time seemed to appear suddenly, but it is also a fact that there are still pending issues.

The Sargentini proposal lists the recommendations and concerns that the Hungarian government has received so far, by sector, and is not based on any new facts or findings. The longest section of the proposal concerns "fundamental rights of migrants and refugees", which are in fact expressed by the Office of the UN High Commissioner for Refugees. However, there is no mention of the mandatory quotas for refugees proposed by the Justice and Legal Council and rejected by Hungary. Nor does it reflect the resolution of the June EU summit, because the sanctions proposal was prepared over time a year ago and does not take into account the latest policy developments.

There is irritation in the Nordic countries, including the Netherlands and Belgium, with Hungary's refusal to accept refugees and migrants. There is a strong opinion that Hungary should be sanctioned in some way. However, the debate on refugees and migrants has taken a new turn, taking into account the resolution of the June EU summit. Nevertheless, without considering the latest developments, the Sargentini proposal was prepared and passed.

Fidesz belongs to the European People's Party, the largest faction in the European Parliament, and two-thirds of the members of this party are said to have voted in favor of the proposed sanctions. Manfred Weber, the head of the party's parliamentary group, announced that he himself voted in favor of the sanctions. He said that "It was a difficult decision, but we voted for it because we cannot support the repressive policies towards CEU and private volunteer groups. However, Hungary is not the only one to be blamed; there are other issues that need to be looked at more closely, such as the demonstrations against corruption in Romania and the murder of a journalist in Slovakia for exposing the corruption of the ruling party."²²

²² Weber was the candidate for president of the European Commission, who was supposed to be nominated by the People's Party after the 2019 European Parliament elections. However, Western European countries did not support him, citing his lack of experience. Prime Minister Orbán had made it clear early on that he was going to disapprove of Weber and support another candidate. He stated clearly that Hungary would not approve a politician for the position of president who did not understand Hungary's position. Orbán's refusal to support Weber was also a way of taking revenge on Weber for his support of the Sargentini proposal.

Thus, with the exception of lawmakers from some countries such as the Netherlands, the People's Party leaders' criticism of Hungary has been less about criticism of the refugee and immigration response than about the Fidesz government's insistence on the unfailing wisdom of its policies, its crack-down on NGO groups in the country, and political intervention in academic institutions like CEU. These acts are cited as evidence that Hungary fails to conform to EU principles and values.

In response to the European Parliament's vote, the Hungarian government has deployed tactics to appeal the invalidation of the vote. The European Parliament's sanctions resolution requires two-thirds of the votes cast in favor of the resolution, but in voting on the resolution, a procedure was used to exclude abstention votes from the vote count (693 votes, 448 in favor, 197 against, 48 abstention). Excluding the 48 abstention votes from the population parameter, the 448 votes in favor of the proposal would be almost 70 % in favor, but if the abstention votes were included in the population parameter, the vote would be only slightly less than two-thirds of the total. The Hungarian government argues that "the exclusion of the abstention vote is contrary to the voting provisions of the Basic Treaty and the vote is invalid". In 2019, under the sanctions resolution, Hungary was investigated by Finland, which has intermittently rotated its presidency, but it is not clear how the sanctions resolution will be implemented.

Ahead of the vote on the sanctions resolution, Prime Minister Orbán addressed the European Parliament, stating that "the sanctions are an insult to the Hungarian people and a conspiracy of pro-immigration groups" and reiterating Hungary's determination not to become a state welcoming to immigrants. This Hungarian-language speech was aimed at the Hungarian people.

Hungarian opposition lawmakers voted for or against the Hungarian sanctions resolution, with Jobbik abstention and LMP absent, while other opposition lawmakers voted in favor. Opposition parties that are in a weak position domestically are routinely criticizing their own government in the international arena with the help of other countries' lawmakers.

7.8 Left and Right Populism

7.8.1 Is the policy of refugee and immigrant intolerance right-wing populism?

As previously mentioned, in the fall of 2015, there was widespread criticism within the EU that closing the Serbian border and refusing to allow refugees and migrants cross the border unconditionally, as Hungary had done and was doing, was a form of inward-looking populism based on nationalism. At that time, Serbia, Croatia and Austria all criticized Hungary, and the Japanese media also criticized Hungary for its narrow-minded nationalist populism. Particularly in Germany and Austria, the establishment of refugee camps was strongly criticized as being something reminiscent of Nazi concentration camps during World War II, and the claim was made that refugees and migrants should have the right to move freely within the EU, even if the vetting process had not been completed.

However, communities hit by the mass migration of refugees and immigrants suffered major changes in social life. A small number of migrants would have been less of a problem, but the influx of large numbers of migrants transformed daily life in the community. People who were either refugees or migrants but whose actual status would not be reliably determined in the vast majority of cases hung out on the streets in the daytime, and the atmosphere of the community changed. In some areas, “refugees and migrants” temporarily outnumbered the local population. People in areas that do not accept refugees and immigrants are comfortable with them, but for those who have been forced to live in close proximity to them, it is difficult to deal with people who have different lifestyles, religions, and cultures. There are very few people of Muslim descent who are prepared to assimilate into European society from the outset. Who can speak for the feelings and concerns of those in the community who have been forced to live together with people of different cultures? This urgency is the reason why Germany’s ruling party is struggling in the elections and the party Alternative für Deutschland (AfD), which advocates tougher policies for refugees and migrants, is making headway. If the government’s ruling party does not take into account the feelings of community members, the only way for voters to gain the attention of the ruling party is to support a party that opposes the government’s policies. If this is dismissed as narrow-minded ethnic discrimination, there is no way for the community to survive.

For example, it is not difficult to welcome a refugee student as a family member, get him/her to graduate from university and work in the community. However, one day, when a family of refugees suddenly becomes neighbors and brings in all their relatives, daily life changes dramatically and the atmosphere of the community changes as well. The house next door becomes a mosque, and large numbers of refugees and migrants gather regularly. This will make the community feel like “give knaves an inch and they will take a yard”.

This may not cause problems in the Netherlands or Belgium, both of which are former suzerain (imperial) states with large Muslim populations, but it surely causes problems in a community that had no connection to the Muslim community at all, and suddenly they have to sit back and watch it become more influenced by Islam. When Horst Seehofer was chancellor of Bavaria, he was in charge of the influx of refugees and migrants to Germany and was forced to negotiate with Merkel in the face of strong pressure from the local community. The real problems of these communities are not solved by idealistic humanitarianism and idealism. The problem is how to secure the social life of the people who live there.

7.8.2 Idealistic Humanism is Left-Wing Populism

The idealism of European integration underpins the European Union, and the European Left fundamentally values liberalism and solidarity. However, the idealism of the European Left sometimes ends up being not a realistic, idealistic response to real problems. The problem of refugees and migrants is a typical example.

Allowing the free inflow and free movement of people who are indistinguishable between refugees and migrants is more like anarchism than idealism. There has always been an anarchist tendency on the European Left, and this has been evident in dealing with the massive influx of refugees and migrants. Idealistic humanitarianism alone is not enough to deal with the real problem, and accepting illegal immigrants (whether refugees or migrants, since even refugees must enter a country legally, in principle) almost unconditionally will only create a sense of anxiety surrounding the potential Islamization of a community, rather than solving the problem.

Idealists, not just on the European Left, tend to be overly concerned with principles and sometimes fail to face reality. In reality, a community with a large influx of refugees and immigrants will see the traditional social norms break down, and social life will be transformed. If one ignores the changes in the living conditions of the people who live there and only promotes idealism, it is only natural that one will lose support.

Idealism tends to ignore people's emotions and rely solely on reason. Of course, judgments based on reason are important, but ignoring people's emotions and sensibilities will not help one gain their support. In social life, emotions are far more powerful than reason. If the European Left ignores people's sensibilities and relies on reason alone, it will fall into pure idealism. If there is a clear social agreement to transform European society into a symbiotic Muslim-Christian society, then the matter is different. However, most people in European societies do not expect the social life to be transformed into a world of mixed cultures.

Blanket condemnation of policies of intolerance towards refugees and immigrants as populism and proclamations based purely on idealistic assessments of a crisis can be criticized as utopian left-wing populism. The accusation that not accepting immigrants unconditionally is a form of "ethnic discrimination" and "nationalist populism" is a kind of ideological criticism. Even in Hungary, there are tens of thousands of Chinese immigrants. The argument that immigrants from the Middle East and Africa must be accepted unconditionally is little more than an appeal to idealistic sentimentalism.

7.8.3 Soros's Intentions and the Folly of the Anti-Soros Campaign

George Soros, a Hungarian-born American investor, was supporting refugees and illegal immigrants even before the problem of refugees and illegal immigrants came to the fore. Although various private organizations supported by the Soros Foundation are still providing support for refugees and immigrants, it is sometimes thought that they may be providing support for smuggling operations. If they are providing assistance to smugglers, then they are clearly providing support for illegal immigration.

Soros is clear in his thinking, arguing that Europe's borders should be abolished and people should be able to move freely within and to Europe. Based on this belief, he financially supports various refugee and migrant support organizations. Soros criticizes the Hungarian government for closing the borders by arguing that the borders are a hindrance and that they should be eliminated so that people can enter Europe. Clearly, Soros seems to believe, from his own philosophy and the logic of capital, that all bor-

ders should be opened and thus markets should be opened. This attitude is typical of market fundamentalism.

Why would Soros, who is a billionaire and philanthropist but only a mere American citizen, go to Europe to advocate the elimination of borders and the promotion of immigration, rather than advocating the acceptance of refugees and immigrants in the United States? Moreover, European leaders have exchanged views with Soros quite frequently. Soros has traveled to EU headquarters and held private meetings with leading politicians. Could it be that the anarchist idealism of the European Left and the market-fundamentalist anarchism of Soros share the same goals?

In response, the Hungarian government has been waging a fierce anti-Soros campaign in the country, claiming that Soros is the mastermind behind the EU's refugee and immigration policies that are having a profound effect on the EU's refugee and immigration policies. However, the Hungarian government's claim that Soros is determining EU refugee and immigration policy lacks validity, as the June 2018 summit resolution arrived at conclusions that are diametrically opposed to Soros' ideas. Treating someone who is only a mere American citizen as if he were a political enemy of the Hungarian state is little more than political propaganda which transforms an individual into a specter threatening national interests. If Hungary has such concerns, they should be raised by Prime Minister Orbán at the European Commission. However, instead of raising the issue head-on in the external open arena, for the Hungarian government to launch an anti-Soros campaign in its domestic arena is an extraordinary political move, and could be seen as a political campaign to force support for the ruling party by using the refugee and immigration issue at public expense.

7.9 Social Factors in the European East-West Divide

Western European countries are actively accepting "migrants" without making a clear distinction between refugees and immigrants. While industry may have a thirst for labor, Western European politicians and intellectuals have a strong sense of atonement for historical original sin, and a sense of historical culpability for the sins of colonialism and racism (the persecution and massacre of Jews) of the nineteenth and twentieth centuries is evident in their policies and attitudes towards refugees and immigrants.

On the other hand, France, the Netherlands, and Belgium, which were accepting immigrants from their former colonies even before the World War II, and Germany, which has accepted many guest workers, have not succeeded in assimilating Muslim immigrants into their societies, even after decades of history. Unlike Christian immigrants, many Muslim immigrants place religious norms above the norms of their societies, and this has led to major social conflicts. In his best-selling book *Strange Death of Europe* (Bloomsbury, 2017), Douglas Murray, a best-selling author in Europe, argues that the historical sense of atonement for the original sin has given rise to an attitude of acceptance of refugees and immigrants' cover-up of crimes and refusal to assimilate, and the "turn a blind eye" attitude is a blank stare at the process of the gradual disintegration of traditional Western values.

For a few days, the German federal and state governments remained silent on the mass assault against women²³ (over 1,000 victims), which included theft, committed by nearly 1,000 Muslim refugees and migrants in the area of the Cologne Central Station and the cathedral on the night of New Year's Eve 2015. German politicians seem to think that admitting that the refugees and migrants whom they have accepted into their societies have committed crimes makes it impossible for them, as Germans, to make historical atonement. The same thinking can be observed in the Scandinavian countries that have actively accepted refugees and migrants. Murray says that the sense of historical original sin has created a "tyranny of guilt", which plays the role of "moral

²³ Both the North Rhine-Westphalia Ministry of Justice and the Federal Ministry of Justice remained silent about the case after it broke out, but the video showing the incident can be found, for example, at Online FOCUS video (https://www.focus.de/politik/videos/gewalt-in-der-silvesternacht-wer-ist-asylbewerber-und-wer-nicht-das-sind-die-verdaechtigen-von-koeln_id_5202899.html) and on other sites. There are also videos of Bild and Kölner Stadt-Anzeiger uploaded on YouTube. Finally, on January 4, the state's Ministry of Justice announced that a major incident had occurred, and the media was all over the place to cover the incident (<https://www.faz.net/aktuell/feuilleton/debatten/nach-silvester-in-koeln-muss-es-um-die-taeter-gehen-13999062.html> AKTUALISIERT AM 05.01.2016-18:47, <https://www.spiegel.de/panorama/justiz/koeln-was-in-der-silvesternacht-am-bahnhof-geschah-a-1070625.html> 05.01.2016-21:34).

On January 19, the minister of the interior of North Rhine-Westphalia, Ralf Jaeger, announced details of a massive assault on women and acts of theft in the vicinity of Cologne's main train station and cathedral on New Year's Eve. A summary of the incident is as follows.

(1) A total of 1,049 victims of the mass assault on New Year's Eve, 80 % of whom were women. A total of 821 reports were received by the police. (2) The difference between the number of victims and the number of reports was due to the fact that many of the reports were filed as a group. (3) Of the 821 reports, 359 were for sexual assaults. (4) 207 of these reports involved sexual harassment and robbery at the same time. (5) Between 11:00 pm and 11:30 pm on New Year's Eve, 52 incidents of sexual harassment or sexual assault were reported. (6) Of the 30 suspects, 13 are Moroccan and 12 are Algerian. (7) The suspects range in age from 16 to 32 years old. (8) Fifteen of the suspects are refugee claimants in Germany and two are minors. (9) None of the suspects is a resident of Cologne. (10) No evidence has been obtained that the New Year's Eve incident was organizationally carried out. The assaults were committed by various groups from different cities in Germany, and the perpetrators were of different nationalities.

This is the summary of the incident announced at the press conference: on New Year's Eve, about 1,000 migrants and refugees had gathered in the spot, and nearly 100 of them in various groups committed the assaults. However, the perpetrators have been difficult to identify, with only about 30 suspects identified. On a smaller scale, similar incidents are reported to have taken place on the same New Year's Eve in major cities across Germany.

The investigation into the Cologne case has continued and the number of cases of assault on women has been even higher among the victims. The case shocked the whole of Germany, and investigations and studies related to the case have been published. On the other hand, most of the perpetrators of the assaults were never arrested, and those who were arrested were released on the grounds of insufficient evidence. The names of the 19 confirmed suspects are listed in a report of the North Rhine-Westphalia Interior Ministry dated January 10, 2016 (Bericht des Ministeriums für Inneres und Kommunales über die Übergriffe am Hauptbahnhof Köln in der Silvesternacht).

self-absorption”. Liberal politicians in Western Europe have accused countries that do not readily accept refugees and migrants of “ethnocentrism” and “parochial nationalist populism”. Therefore, they cannot easily admit that refugees and migrants can be a criminal group, even if they form comparatively small groups. The psychology of hiding inconvenient facts is extremely peculiar at best.²⁴ It has been reported that the perpetrators of the French terrorist attacks live in Belgium. It is less well known in Europe that Belgium and the Netherlands have more social problems with Muslim populations than France.²⁵

The Muslim population of Belgium is about 650,000, or 6 % of the total population. However, since most of them live in Brussels, the capital city, Muslims make up nearly 30 % of the population of one million. That does not mean that one in three people you see on the streets of Brussels is of Muslim descent. This is because they live en masse in certain areas. Muslims account for about half of the residents of Molenbeek. Especially the lower area of the town is essentially a ghettoized Muslim community that has become a haven for terrorists.

The Netherlands is more Islamized than Belgium. The population of Muslim residents exceeds 900,000, and most major cities have significant Muslim populations. The proportion of Muslim residents is high across the board: 25 % in Rotterdam, 24 % in Amsterdam, 14 % in Hague, and 13 % in Utrecht.

Although Muslims make up 7 % of the population of France, the problem of the Muslim population in Belgium and the Netherlands is worse than in France because Muslims in these countries live mostly in urban areas. The conflicts between the Muslim populations of Belgium and the Netherlands and the non-Muslim populations of those countries form the front line of the Muslim problem in Europe.

The countries with comparatively large Muslim populations (compared to other EU member states) are all former suzerainty (imperial) countries. These countries have their own reasons for accepting immigrants from their former colonies, and they

²⁴ In November 2015, in the midst of the ongoing mass “refugee” and “migrant” flows from the Muslim world to Europe, indiscriminate shootings and suicide bombings by Islamic State (IS) fighters took place in the city of Paris. Although EU President Tusk declared that the terrorist attacks are unrelated to the current influx of refugees and that there would be no change in the EU’s refugee policy, things are not so simple.

Syrians who had entered the country via Hungary as “refugees” in September were among those who carried out the attack. Of the large number of “refugees”, only about 30 percent are from Syria, but most of the young men are said to have received military training from government forces or IS. There is no denying that there are IS fighters who have crossed into Europe to blend in with the hundreds of thousands of “refugees”. This is because, with no functioning immigration controls at the European borders, anyone can get into Europe. Of course, it is difficult for IS fighters to enter Europe and operate immediately, but there is no problem for them to work together because there is already a firmly established Islamic society in Europe. This point is not adequately recognized in Europe.

²⁵ The information in the three paragraphs below is based on Soeren Kern, *The Islamization of Belgium and the Netherlands in 2013* (<http://www.gatestoneinstitute.org/4129/islamization-belgium-netherlands>, January 13, 2014 at 4:30 am).

have their own sense of atonement. However, Central and Eastern European countries, including Hungary, do not have the same historical sense of original guilt as Western European countries. Therefore, there is no social sentiment to accept refugees and immigrants for the purpose of atonement. There is no reason why countries that have finally escaped Soviet rule should actively accept Muslim residents who are reluctant to assimilate into their societies. Simply accusing them of ethnic discrimination and nationalist populism because of this misses the point.

If a society could maintain European Christian cultural values despite the acceptance of refugees and migrants, the arrival of refugees and migrants would not cause any problems. However, in Western countries with large Muslim populations, Islamic norms are gradually eroding civil society values. Are people willing to accept Islam and Muslim culture and thereby allow Christian culture and values to recede? Is the coexistence of Islamic and Christian, European culture the way to integrate the EU? Is that the desired step towards a multicultural Europe? The countries of Central and Eastern Europe do not see it that way.

Strict conditions are essential for the acceptance of refugees and immigrants into society. The conditions of settlement should be that they do not place their religious norms above the social norms of the society concerned, that they learn the language of the country and strive to assimilate, and that they contribute to the development of the society concerned. Without making assimilation into society a condition for settlement, the social and cultural values of Europe will eventually decline. That is the essentially thesis statement behind Douglas Murray's notion of the "Suicide of the West".

Seen in this light, there is reasonable grounds for Hungary's initiative and the joint opposition of the surrounding Central European countries (V4 countries = Hungary, Czech Republic, Slovakia, and Poland) to the forced quotas of refugees and migrants. Precisely as the Western and Northern European countries are steering towards multiculturalism at the expense of traditional values, the Central European countries are insisting on the preservation of traditional European values and the continued maintenance of the nation-state. Clearly, the EU is entering an era of conflict and division between different values in the West and East. While it is true that the Hungarian Fidesz government is trying to consolidate its domestic political base with its nationalist populist policies, its social vision for Europe's future is another matter. In this regard, Western Europeans see European integration as a form of multiculturalism, even if it means a decline in traditional European values. However, the countries of Central and Eastern Europe do not envision this kind of integration.

It is wrong to decry these different views of the society of the future as ideologically "parochial nationalism and ethnic discrimination". The East-West divide in Europe will not be repaired until Europe is clear about the values it needs to defend and the cultural values it actively incorporates from the outside.

Also, with the current economic disparity between East and West within the EU still large, the small countries of Central and Eastern Europe are wary of being swallowed up by rapid European integration. There is a sense of anxiety that if integration, like multiculturalism, is forced as it stands, the countries of Central and Eastern Europe will degenerate into peripheral societies on the EU frontier. If the mandatory quotas

for refugees and migrants mean “forced adaptation to multiculturalism”, then these states cannot easily compromise on the issue of mandatory quotas.

European integration has historically been a long-term process. However, politicians and EU bureaucrats in countries that are already multi-ethnic societies seem to think that mandatory quotas of refugees and migrants can push integration forward in one fell swoop. However, given the huge economic disparity and differences in values between the East and the West, using the refugee and migrant issue as a lever to promote European integration into multiculturalism will only deepen the East-West divide in the EU.

Addendum: Border Control vs. Forced Quotas

The Italian Conte government which came into office in June 2018 has accepted the demands of the coalition “League” and has maintained a tough stance on illegal immigrants. However, the second Conte government, which came into power in September 2019, changed its approach to dealing with illegal immigrants after the “League” left and the Democratic Party (PD) joined the coalition government.

On September 14, 2019, the Italian government decided to allow the NGO rescue ship carrying 82 people rescued off the coast of Libya to enter Italy. This is because an agreement was reached between Italy, France, Germany and Malta on the quota of illegal entrants (the “Malta Agreement”). According to the agreement, Italy will only take on 10 % of those who enter the country, with France and Germany taking 25% each and the remaining 40 % to be shared by the other countries. However, negotiations with the other countries would take place on a case-by-case basis.

Justice Minister Lamorgese, who replaced Salvini, and Foreign Minister Di Maio have advocated mandatory quotas within the EU and fines for countries that reject them, and the debate over mandatory quotas is once again expected to be a major theme in the new European Parliament.

In line with this Italian policy shift, Germany and France are once again poised to push for automatic mandatory quotas for “refugees and migrants”.²⁶ Furthermore, on September 23, at Fort St. Angelo in Malta, Germany, France, Italy and Malta confirmed their earlier agreement on “refugees and migrants” arriving in Italy and Malta from the sea and agreed to discuss the issue and reach certain conclusions at the EU Justice Council on October 8.

At the October 8, 2019 Judicial Council meeting in Luxembourg, the Judicial Council discussed the “compulsory allocation of migrants rescued at sea” (the “migrants” of rescue ships entering Italy and Malta), but only 12 countries agreed to this, and moreover, they did so under condition that “acceptance is on a case-by-case basis after various technical problems have been solved”.²⁷ Countries have been cautious about

²⁶ <https://www.dw.com/en/italy-france-agree-on-automatic-distribution-of-migrants/a-50489114>).

²⁷ <https://www.dw.com/en/eu-fails-to-cement-agreement-on-migrants-rescued-at-sea/a-50743383>).

accepting automatic acceptance systems. This is not simply a domestic pose. Rather, it is a position which has been adopted because the risk of another wave of immigrants will occur if the automatic distribution mechanism is reported to be established.

Germany's Justice Minister Seehofer said that it was incomprehensible to oppose the automatic allocation of the extent to which the immediate measures relate only to the thousands of people arriving in Italy and Malta. However, for other countries, it would be acceptable if the problem could be solved finally by receiving such amount of "refugees", but considering the situation in Greece and Italy, it surely pave a way to a mandatory quota scheme, if once accepting the proposal.

Hungary, on the other hand, is willing to process quotas for the deportation of "illegal migrants" but has remained adamantly opposed to the forced underwriting of "migrants". However, the measures Hungary has been advocating to strengthen joint EU border controls are also technically difficult to implement in Greece and Italy, which include many small islands.

Meanwhile, in response to the EU's condemnation of Turkey for launching attacks on ethnic Kurds on the Syrian border in early October 2019, Turkish President Erdogan has threatened to send large numbers of refugees to Europe if the EU criticizes him. The threat is that a loosening of controls on the smuggling business could lead to a mass flow of "refugees and migrants" at any time. This has also become a means of extracting subsidies from the EU, and the "refugee/migrant" issue is being used as an international bargaining chip.

The policy choice between stricter border controls or mandatory quotas continues to sway the decisions of EU countries due to the international situation and the changing migration routes for "refugees and migrants".

The adoption was delayed by a day because of Hungary's opposition to the EU's resolution condemning Turkey. On the other hand, President Erdogan's threat to move Syrian refugees in Turkey to the border areas from which Kurds had fled was welcomed by Hungary, which thus showed an acceptance of Turkey's attack on the Kurdish people.

President Erdogan visited Budapest on October 30 and President Putin on November 7, 2019. German CDU politicians are calling for Hungary to leave the EU, as the Orbán government is going against the EU's basic diplomatic stance. Fidesz was not invited to the meeting of the European People's Party (EPP), which was held in Geneva, because the suspension has not yet been lifted. The new leader of the European People's Party is the former EU President Donald Tusk, which means that Fidesz will continue to face difficult situations.

Domestically, Fidesz politicians have been exposed for their corruption, and Fidesz has struggled in local elections. Internationally, the Fidesz government is increasingly isolated, and it has entered an era of trouble at home and abroad. As the Fidesz government attributes all problems to the "refugee and immigration" issues, the scope and the stance of government's response to every problem is very limited.

Chapter 8: A Historiography of System Transformation

Rethinking Socialism in the Twentieth Century

An analysis of the system transformation that took place in Central Europe and Hungary should not be limited to the analysis of the socioeconomic changes that began in 1989. The analysis of the process from the formation of twentieth-century socialism to its collapse is also an important part of the analysis of the transformation. What was it, exactly, that collapsed? To what extent was this collapse inevitable, and how did the economy and society which collapsed form in the first place? Only by answering these questions will the analysis of the process of system transformation be complete. However, “economics of transition”, which specializes in the study of the transformation, does not study such analytical issues. However, one simply cannot offer a complete analysis of the transformation without an analysis of the historical process of the rise and fall of twentieth-century socialism. Herein lies the absolute limitation of the so-called economics of transition.

A historical examination of the establishment and collapse of Eastern European socialism established after World War II constitutes a historical premise for the analysis of the system transformation. How were the socialist states of Central and Eastern Europe established? What kind of socialism was achieved, and why did it have to collapse? The historical analysis of the period of forty years from its establishment to its collapse forms an indispensable part of the analysis of the system transformation, which is complete only if the historical logic of the collapse of twentieth-century socialism has been clarified.

The process of the formation and collapse of individual socialist states in Central and Eastern Europe should be analyzed by experts in each country. A general proposition must be formulated on the basis of the specific analyses. It is necessary to offer a clear analysis of history that cannot be captured by an overview of history like the one provided by Anne Applebaum. In this chapter, as an attempt to do this, I analyze the historical process leading up to and following the Hungarian uprising of 1956, with a focus on Hungary, and I consider the historical process of the establishment and collapse of Hungarian socialism. This chapter is devoted primarily to a historical analysis, while the next chapter, Chapter 9, will formulate a general proposition.

8.1 The Reality of Eastern European Socialism

On April 12, 1989, János Kádár suddenly appeared at the Central Committee of the Hungarian Socialist Workers' Party while recuperating from an illness. He was not scheduled to attend the committee meeting, although he had an appointment to meet with Rezső Nyers after the Central Committee meeting. Kádár took a taxi from the

hospital to the conference hall and asked to speak at the Central Committee. Though his mind was not entirely clear and it was difficult to hear his voice as he spoke, Kádár repeatedly defended himself: “Imre Nagy’s failure to sign the resignation as prime minister resulted in his execution”.¹ General Secretary of the Party Károly Grósz did not interrupt Kádár’s statement, which lasted an entire hour. He saw this as a good opportunity to make the Central Committee members aware of Kádár’s failing health.

Shortly before his death, Kádár was said to have been haunted by the apparition not only of Imre Nagy, but also of László Rajk, who was executed in 1949. Kádár played a decisive role in both cases. However, Kádár never divulged any details of Rajk’s execution, even when making excuses for the execution of Imre Nagy. After having come to power, Kádár never talked about his role in the Rajk case, though he was deeply involved in the process from the arrest of Rajk to the obtaining of the confession, which makes him even more personally responsible for the execution of Rajk than he was for the execution of Nagy. Although he never mentioned it, Kádár could not escape his guilt over his role in Rajk’s execution.

In the spring of 1988, Kádár had been demoted from general secretary to chairman of the committee, which was a nominal position. In May, following his statement to the committee, the Central Committee dismissed him from the position as chairman as well. When an envoy arrived at Kádár’s residence to inform him of this decision, he was already packing his bags and preparing to move. He was very concerned about the dissident forces that had begun to grow in popularity in 1988, and he feared that they might turn on him. Even though he had lost the ability to think normally, his intuition was keen, and he sensed that to lose his party position meant losing everything. Of course, the Party never asked that he vacate the house, nor did he have a place to move to. But as the ceremonies surrounding the reburial of Imre Nagy and other martyrs were being prepared and the movement in support of system transformation was gaining momentum, Kádár must have sensed that he was about to be completely disqualified.

On the morning of July 6, 1989, when the Supreme Court’s verdict on the restoration of Imre Nagy was issued, Kádár passed away. As it so happened, on the morning of that day, together with the Japanese ambassador to Hungary, I met with Nyers, the leader of the Party, at the headquarters of the Socialist Workers’ Party. We were informed of Kádár’s death by Nyers in his room.

¹ Kádár’s statement on this occasion was recorded and sold as an appendix to the book (Mihály Kornis, *Kádár János utolsó beszéde* [Budapest: Kalligram, 2006]). The book contains a secret recording of Kádár and Mihály Farkas’s interrogation of László Rajk. It also contains an interview with Kádár done by a Soviet journalist about the Hungarian Revolution which is included in the documentary film *Titoktartók*, directed by Anna Geréb. Kádár’s final remarks can also be heard on YouTube (Kádár János utolsó beszéde az MSZMP Központi Bizottságának zárt ülésén).

8.1.1 The Reality of the People's Democracy

After Hungary was liberated from Nazi Germany's rule by the Soviet Red Army, many Jewish youths joined the Communist Party. They were moved and motivated by the joy of liberation from fascist rule and hatred of fascism. Márton Tardos, who was an activist in the Student Union, János Kornai, who became a reporter for the Communist Party newspaper, and Miklós Bauer, who became an interrogator for the State Security Police, were typical examples of these young people.

The so-called "troika" of Communist Party leaders (Mátyás Rákosi, Ernő Gerő and Mihály Farkas) and József Révai were all Jews who had returned from the Soviet Union. They were referred to as the Gang of Four. There was a clear disparity in rank between these Jewish leaders and János Kádár and László Rajk, who were also leaders of the Communist Party but had worked exclusively in the country during the war. The Gang of Four always conveyed the intentions of the Soviet Communist Party, which gave its orders through these leaders returning from the Soviet Union.

The Communist Party was supported by the intellectual youth, but the number of members of the party had fallen sharply, and the support for the party among the general public was not high. The Smallholders' Party and the Social Democratic Party were consistently more popular among voters.

Immediately after the liberation of Hungary by the Soviet Red Army, a provisional government was formed, and at the end of 1944, before the Allied countries had begun any talks with representatives of the Hungarian government, preliminary discussions on a ceasefire agreement between the provisional government and the Soviet Union took place in Moscow. The five Hungarian parties (the Smallholders' Party, the Social Democrats, the National Peasants' Party, the Communist Party and the Civic Democrats) were joined by the Hungarian delegation led by General Miklós Béla Dálnoki. This gave the Soviet Union the opportunity to meddle in the composition of domestic power in the occupied territories. The provisional government functioned until the first postwar general elections, and with Soviet backing, the Hungarian Communist Party obtained the post of minister of the interior and attempted to lay the foundations for the expansion of its power in the country. After the Russian Revolution, the Soviet Communist Party established a secret police organization (GPU, Gosudarstvennoe politicheskoe upravlenie), and it formed secret armed organizations which were legal. It also hastened to create similar organizations in the Eastern European countries. In Hungary, it was the Political Police (PRO, Politikai Rendészeti Osztály) which was set up at the police headquarters, and Gábor Péter² was appointed to serve as the head of

² A new book has been published on how Gábor Péter, also known as "Beria of Hungary", became Rákosi's right-hand man (Rolf Müller, *Az erőszak neve: Péter Gábor – Az ÁVH vezetőjének élete* [Budapest: Jaffa Kiadó, 2017]). Gábor Péter's real name was Benjámin Eisenberger. In 1921, at the age of fifteen, he moved to Budapest and began working as an apprentice to a garment maker. It was at this time that he joined the Social Democratic Party. This was just after the failure of the Hungarian Soviet Republic and the brief rise of a communist government under Béla Kun. The rightwing government which came to power in the wake of Kun's fall tolerated

the Political Police. From then on, until his downfall at the end of 1952, he faithfully carried out the arrest, imprisonment and massacre of his political opponents as well as of his own politicians and colleagues under the “edict” of Rákosi. Early on, the Communist Party sent its members to the State Security Police and, with the support of the Soviet Communist Party, it monitored the movements of politicians of other parties. This was facilitated by the Soviet strategy of domination of Eastern Europe using the “Allied Control Commission for Hungary” (SZEB, Szövetséges Ellenőrző Bizottság).³

very little activity among leftwing organizations of any kind. After a short time, he contracted pulmonary tuberculosis, and spent a lot of time in a sanatorium outside Budapest. When he returned to Budapest from the sanatorium in 1930, he joined the Hungarian Red Cross and the Communist Party. This led to his being sent to the International Congress of the World Red Cross (Moscow) in 1932. This was a major turning point for him. He used a number of pseudonyms thereafter, but Gábor Péter eventually became his official name. It should be noted that he left school before completing the fourth grade and received no schooling after that.

One member of the Communist Party was arrested by the political police in February 1945, shortly after the liberation of the country from the Nazi occupation. Pál Demény (1901–1991), who was falsely accused of having engaged in Communist Party splintering activities and remained in prison until his release on October 15, 1956, published a memoir (oral compilation) of his experiences (Pál Demény, *A párt foglya voltam* [Budapest: ELTE-MKKE, 1988]). In this memoir (p. 152), Demény describes how he gave Benjámin Eisenberger the name Gábor Péter. In May 1944, Demény visited Sándor Frolimovics at his home, and Eisenberger happened to be there. Frolimovics said that he needed to give Eisenberger another name. When Demény asked him what kind of name he wanted, he said “anything,” so Demény named him Gábor Péter, a combination of the names of Frolimovics’s two sons, Péter and Gábor. Thus, Benjámin Eisenberger became Gábor Péter who later was called as the “Beria of Hungary”. However, after the war, Gábor Péter led Demény to the security police and handed him over to the Soviet side, where he was forced to spend ten years in forced labor and prison.

Péter married Jolán Simon, and the couple continued their illegal activities. Jolán had been an activist in the Communist Party since before the war, and she had assisted Rákosi as a supporter of the International Red Cross when Rákosi was in prison in 1930–1940. Because of this, she not only became Rákosi’s personal secretary after the war, but her husband Péter was nominated to head the political police.

Péter had begun organizing the armed forces of the Communist Party from the beginning of the Red Army’s occupation of Budapest, and later, in a meeting with the Soviet returning leaders, he was allowed to continue his work. As someone who had returned to Hungary from the Soviet Union, Péter gained the confidence of the Communist leaders and became responsible for organizing the political (security) police. He kept the position until his ouster in early 1953.

³ The Soviet Union hosted a delegation of the Hungarian government in Moscow at the end of 1944 while Britain and the United States were proceeding with their final struggle against Germany, effectively exercising control over the country. Subsequently, Britain and the United States demanded equal rights with the Soviet Union. However, as the Soviet Union was given only an observer status in Italy and Greece, the Soviet Union asserted that the United States and Britain in turn should remain in observer status in Eastern Europe, which the Red Army had liberated. These tactics led to the division of areas of mutual control among main world powers. Soviet domination of Eastern Europe served as a pretext for the United States to exclude the Soviet Union from the occupation of Japan, but in return, the United States and Britain had

A group of young Jewish people actively participated in the creation of the Political Police. Miklós Bauer, his wife Judit Schönberg⁴ and her brother György Szendi also joined the founding group. In 1946, PRO was reorganized as ÁVO (Magyar Államrendőrség Államvédelmi Osztálya, Hungarian National Police National Defense) within the Ministry of the Interior, and in 1949, it was again reorganized as ÁVH (Államvédelmi Hatóság, the State Security Authority – hereinafter referred as Secret Police). These organizations had their headquarters in a building at 60 Andrassy Avenue. The second Fidesz government opened this building to the public as a museum, which it called the “House of Terror” (Terror Háza).

At the time of the establishment of the political police, the Communist Party was suffering from a shortage of personnel. The party had lost many members during the war, and by the end of the war, it was said to have only a few hundred members. The entry of Jewish youths into the party alone was not enough to attract sufficient personnel, and from the early stages of the establishment of the Political Police, the party was forced to register former members of the pre-war fascist party, the Arrow Cross Party (Nyilaskeresztes Párt, abbreviated as “nyilasok”). Most of the Arrow Cross Party cadres fled the country, but the young activists remained in the country. These activists were incorporated into the political police in a way that made them swear allegiance to the Communist Party. However, in terms of internal composition, care was always taken to ensure that competent young Jewish individuals were selected as cadres and that those with a background in the Arrow Cross Party were not in the majority.

At the end of 1945, the first postwar general election⁵ was held, ending the role of the provisional government. The Smallholders’ Party became the leading party with 57 % of the vote. The Communist Party received only 17 % of the vote, but following an order from the Alliance Monitoring Committee, the Smallholders’ Party was forced to form a coalition government with the Communist Party. Thus, the Communist Party, which continued to hold the post of minister of the interior, sought to disable the Smallholders’ Party by intensifying its attacks on Party leaders who were critical of the coalition government. The political police, which had been reorganized into ÁVO, installed eavesdropping equipment in the adjacent building on Csengery Street which allowed them to tap phones and mainly track the movements of political opponents. This task was carried out primarily by the wives of ÁVO cadres. In addition, a seal-opening unit was set up in the Central Post Office, and Kádár’s wife, Mária Tamáska, was among those who worked in this unit.

to abandon their interests in Eastern Europe. For a book which offers a good overview of the situation, see Sándor Szakács and Tibor Zinner, *A háború megváltozott természete – Adatok és adalékok, tények és összefüggések – 1944–1948* (Budapest: MSZH Nyomda és Kiadó Kft., 1997).

⁴ Tamás Bauer, a reformist economist, was the son of Miklós Bauer and Judit Schönberg.

⁵ The Smallholders’ Party (FKgP) had 57.03 %, the Social Democratic Party (SZDP) 17.41 %, the Hungarian Communist Party (MKP) 16.95 % and the National Peasant Party (NPP) 6.87 %. Regardless of the results of the general election, to establish a coalition government was a prior arrangement, with the Hungarian Communist Party securing the posts of minister of the interior and minister of finance.

Unable to win a majority in the general elections, the Hungarian Communist Party tried to weaken the Smallholders' Party, and it established a partnership with the Social Democrats in a bid to seize state power. The Communist Party used the political police to thoroughly attack the Smallholders' Party, many of whom opposed joint action with the Communist Party. Individual attacks against politicians (so-called salami tactics)⁶ were carried out. In this process, the barbaric behavior of the party members who earlier had been members of the Arrow Cross Party was used.

In early 2002, the Fidesz government established a decree setting February 25 as the day of mourning for Béla Kovács, general secretary of the Smallholders' Party (Országgyűlés 58/2000. (VI. 16.) sz. határozata). General Secretary Kovács was one of the victims of these salami tactics. After the establishment of the coalition, the Communist Party claimed that there was a fascist group underground in the Smallholders' Party, and it called for the resignation of 20 MPs of the Party (20 members were expelled from the party in March 1946), and in January 1947, the Communist Party again called for the resignation of General Secretary Kovács and the revocation of his immunity as a politician. The parliament did not agree, but an agreement between the parties led to Kovács appearing before the ÁVO in May, where he was arrested by the Soviet authorities and sentenced to twenty years in a Soviet labor camp.⁷ In March, Zoltán Pfeiffer and fifty other members of parliament were forced to leave the Smallholders' Party, and in May, Ferenc Nagy, who had been appointed prime minister, resigned in Switzerland where he was staying due to threats from Rákosi. In June, Béla Varga, who had been elected as speaker of parliament, defected to the West.

In the general election of August 1947, the leftwing bloc won with the introduction of a ballot paper called a *kékcédula* ('blue card').⁸ However, although the Communist Party gained the leading party status with 22.25 % of the vote, it was far from an absolute majority, winning only 100 out of 411 seats. The Social Democrats won 14.86 % with 67 seats, and the Smallholders' Party fell back significantly to just 15.34 % with 68 seats. The salami tactics had worked, and a government was formed with the Communist Party in control.

The Soviet Communist Party hastened the annexation of the Communist Party and the Social Democrats in order to establish communist-led power in the countries of

⁶ Like cutting out one piece of salami at a time, the strategy was to force individual politicians out of politics by attacking them one by one.

⁷ Kovács was handed over by the Soviet Union to Hungary in September 1955, where he was held in the ÁVH prison before being transferred to the Central Prison of the Ministry of the Interior in January 1956, but he was allowed to return home in April. At the outbreak of the Hungarian uprising in October, the Smallholders' Party was rebuilt, and Kovács joined the cabinet of Imre Nagy as minister of land development. Feeling the resurgence of the old regime after the suppression of the peoples' uprising, Kovács left the party leadership in 1957 and retired from political activity. He passed away in 1959 after an illness at 51 years of age. On May 26, 1989, the Soviet Supreme Military Prosecutor's Office rehabilitated him.

⁸ This ballot allowed people to vote outside their place of residence. It is said that many people were able to vote in two places, because a significant number of double ballots were issued.

Eastern Europe. The Hungarian Workers' Party (MDP, Magyar Dolgozók Pártja)⁹ was established on June 12, 1948 as a result of the annexation with the Social Democrats, who were willing to cooperate with the Communist Party. With the establishment of the Hungarian Workers' Party, the head of the state Zoltán Tildy of the Smallholders' Party resigned, which further weakened the Party. On the other hand, Social Democratic politicians who opposed this annexation became the target of ruthless practices to force them to withdraw. The annexation of the Communist Party and the Social Democrats that was going on in the Eastern European countries at the time was called the People's Democratic Revolution. The term was used to describe a peaceful transition of power, as distinct from the violent seizure of power in Russia, but in reality, it was not so simple.

The general election on March 15, 1949 was to be held only by allowing voters to choose from a list of a proportionally represented constituency by region. The ruling party used the name Magyar Függetlenségi Népfront (Hungarian Independence Front), and it drew up a list of candidates which included the names of politicians from the Smallholders' Party and the National Peasants' Party who could coordinate with the Hungarian Workers' Party, in addition to the candidates of the Party. If the voters were not dissatisfied with the candidates on the list, they simply put the list straight into the ballot box and the process of casting a vote was over. Candidates they did not support could be marked with an X, but most voters put the list straight into the ballot box. As a result, the Hungarian Independence Front won an overwhelming victory with 95.6 % of the vote. The distribution of seats within the Independence Front was 285 seats held by the Workers' Party, 62 seats held by the Independent Smallholders' Party and 39 seats held by the National Peasants' Party.

Thus, changes in the electoral system and purges of rival politicians established the absolute majority government of the Hungarian Workers' Party, which meant the de facto absolute rule of the former Communist Party.

⁹ The Political Bureau of the Hungarian Workers' Party consisted of 14 members, nine from the Communist Party and five from the Social Democratic Party. In addition to the troika of Rákosi, Gerő and Farkas, József Révai, Imre Nagy, László Rajk, János Kádár, István Kossa, and Antal Apró also hailed from the Communists. Apró was an unremarkable figure, although he and Kádár held positions in the Politburo until the dissolution of the Hungarian Socialist Workers' Party in 1988. Apró's residence (now the residence of Ferenc Gyurcsány and his wife Klára Dobrev) was next to Kádár's house, bordering the garden.

Those who entered the Politburo from the Social Democrats were József Harustyák (1949, chairman of the State Council of Trade Unions, SZOT), György Marosán (minister of industry 1948–1950, arrested in July 1950), Sándor Rónai (chairman of the Hungarian Presidential Council 1950–1952), Árpád Szakasits (president 1948–1949, arrested in April 1950), and Imre Vajda (director general of the Planning Agency 1947–1949, arrested in August 1950). In 1950, the purge of those politicians from the Social Democratic Party began. The relatively minor characters of the Politburo from these Social Democrats, Harustyák and Rónai, escaped arrest, since they were seen as pro-Communist, while the three leading figures were arrested and jailed. It was not until 1956 that they were released.

8.1.2 The Full Story of the Execution of László Rajk

(1) The Abduction of Noel H. Field

In 1948, the postwar honeymoon period between the U.S. and the Soviet Union ended and the world entered the Cold War era, a struggle between the U.S. and the Soviet Union for global hegemony. Yugoslavia, which advocated a self-managed socialism which differed from the Soviet model, was excommunicated from the international communist movement, and this led to an internal struggle to expose the “internal enemies of the Communist Party”.

In September 1948, Kremnyov, the deputy head of the Budapest Delegation to the Soviet Ministry of the Interior, visited Kádár who had replaced László Rajk as minister of the interior, and cautioned him that “Hungary has done less to fight its internal enemies and nationalists than the other Eastern European countries”.¹⁰ In response to this claim, Rákosi established a special task force within the ÁVH under the command of Secret Police Director Gábor Péter. This was the unit led by Deputy Director Ernő Szűcs. At the time, the Communist Party consisted of Soviet exiles, Western European exiles, and domestic illegal activists, but it was the Western European exiles that Rákosi aimed at.

At this time, Edmond Ferenczi,¹¹ who had been living in Switzerland before the war and working as an intelligence officer in the Hungarian Ministry of Defense, reported to Hungary on the movements of Hungarians in exile during and after World War

¹⁰ Record of Vladimir Farkas, who was the interpreter of this meeting (p. 159). Farkas’s oral history, which was published in 1990 (Vladimir Farkas, *Nincs mentség. Az ÁVH alezredese voltam* [Budapest: Interart Stúdió, 1990]), is a superb source of information about the Rákosi era, and it is the only record of the party’s movements at the time. All the detailed descriptions of the interrogations of the security police, the conspiracy at Rákosi’s residence and the interrogation of Rajk in this and subsequent sections are based on this record. The information from the record will be referred to as “Farkas’s oral record”, and the page numbers in question are provided.

Of course, we cannot trust “Farkas’s oral record” entirely. What seems to be clearly true is the testimony of the man himself as he followed Rákosi’s instructions to plant a wiretap microphone and attend various arrest and interrogation sites. On the other hand, his actual role as an individual should be considered suitably glorified. In fact, Péter Borenich, who negotiated with Vladimir and over the course of several years interviewed and drafted his testimony, describes the genesis of the oral record and subsequent conflicts with him on his website (<https://borenichpeter.hu/dokumentum-osszeallitasok-tenyfeltaro-riportok/irott-osszeallitasok?start=8>). For this reason, the publication does not list the name of the interviewer Borenich who prepared the dictation.

¹¹ Born in 1920, Ferenczi moved to Geneva from London when he was a toddler. He became an interpreter and translator after graduating from high school and college. His father was a university professor and later the head of department of the ILO in Geneva. Edmond was fluent in languages and is said to have spoken English, German, French and Italian freely, in addition to his native Hungarian. His father-in-law was a diplomat and served at the Hungarian Embassy in Bern and then as Italian ambassador in Rome.

II. One of his reports concerned Tibor Szőnyi, who had returned to Hungary from Switzerland and was working at party headquarters as the party's central committee member.

During the war, Allen Welsh Dulles was stationed in Europe as the commander of American diplomacy and intelligence. The Dulles family was a brilliant family, and Allen was the brother of John Foster Dulles, who had served as Secretary of State. A graduate of Princeton University, he became a diplomat and was best known as the head of diplomacy when Lenin was denied a visa to travel to the United States, and he also participated in the defeat of Hitler in 1944. He became the fifth director of the CIA, which was established after the war, but he was the first civilian director, and he was also the first person to hold the position for a long period of time, from 1953 to 1961.

Shortly before the end of the war, Dulles was also involved in providing support for the exiled Communists. He was in charge of the Office of Strategic Service (OSS), a U.S. military intelligence agency based in Bern, Switzerland. This Dulles agency was joined by a young diplomat. He was Noel H. Field, a graduate of Harvard University who had become a diplomat and then returned to his native Switzerland as a member of the Communist Party. Field was assisting Dulles in his work and assisting the exiles in Unitarian activities.

Edmond Ferenczi,¹² who heard from Noel H. Field the details of the return of Tibor Szőnyi and other Hungarians in exile in Switzerland to their home country, reported this to the Hungarian intelligence. According to him, "On January 6, 1945, Tibor Szőnyi

When Ferenczi returned to Hungary, his father-in-law's connections led him to work for the Ministry of Foreign Affairs, and then he was organized as an intelligence officer before he was dispatched to the UNESCO in March 1947. While at university in Geneva, he met the Hungarian Communist Party group in connection with organizing foreign students. He had many friends and acquaintances who were exiled Communists and immigrants from Eastern Europe. However, he himself did not belong to the Communist Party of any country.

Among the research materials uploaded to *Betekintő – Az Állambiztonsági Szolgálatok Történeti Levéltára internetes folyóirata*, which publishes research materials and studies of the State Security Police, there is one dealing with Edmond Ferenczi: Sarolta Klenjánszky, "Kémeink a Grasmarkton – Ferenczi Edmond ügynökpályafutásának második szakasza. A nyugati szociáldemokrácia megfigyelése 1953–1956", *Betekintő* 4 (2014). Also useful are materials published by the Széchényi Library 1956 Institute and the Oral History Archive (also available online); László Varga, "A Rajk-per háttérében Ferenczi Edmond és Noel Haviland Field", *Évkönyv VIII* (Budapest: 1956-os Intézet, 2000), 11–25.

¹² Ferenczi was registered as a secret agent with the code name "I.-b/2." at the Hungarian Ministry of Defense Intelligence Headquarters and "V-3001" at ÁVO/ÁVH. In September 1949, while the Rajk trial was underway, he moved from Soviet-occupied territory in Austria to U.S.-occupied territory, and then disappeared. He applied for asylum in Switzerland and was granted the status. When he learned that his own report had been used to trap László Rajk, he feared for his safety and went into exile. He then returned to Paris to seek a job from UNESCO, but was arrested by the French police in 1951 on charges of being an Eastern European spy. After eight months in detention, Ferenczi moved to Belgium using connections of the UNESCO era, because in Belgium he was less at risk of being arrested in a spy detection battle than France. Eventually, the Belgian intelligence agency recruited Ferenczi as an intelligence agent.

and four others entered Belgrade via Marseille and Naples, using fake military medical certificates obtained from the Yugoslav Communists, where they destroyed their military medical certificates at the request of Yugoslavia and entered Szeged in Hungary".¹³ From Marseille to Naples, it is said, they used an American military plane arranged by Yugoslavia. With the help of American and Yugoslavian intelligence, they had been able to return to Hungary. This old fact was taken as evidence, and the Szőnyi faction working at the party headquarters was branded "spies for American imperialism and Yugoslavian revisionism".

When the Szőnyi group was exposed, Rákosi became interested in Noel H. Field, who was assisting the Swiss exiled communists, because more names of exiled communists would come out of Field's contacts.

Born in London and raised in Switzerland, Field moved to the United States after the death of his biologist father. He studied at and graduated from Harvard University, and he then became a diplomat. It was then that he became a member of the Soviet Communist Party through exiled Germans and went back to Europe as a communist. After the war, when the case against him was about to be prepared in the U.S., he maintained relations with the Czechoslovak and East German intelligence services in search of a new place to settle. It was through the Edmond Ferenczi's notification that the Hungarian secret police ÁVH learned of Field's close ties to Czechoslovak intelligence¹⁴ and, with the help of a Czechoslovak partner, planned to abduct Field and bring him to Hungary.

Based on Edmond Ferenczi's report, the Hungarian Secret Police decided to take Field into custody and sought the cooperation of the Czechoslovak Intelligence Service. Czechoslovak Intelligence did not immediately agree to participate in Field's abduction and extradition. They took the attitude that they could not consent without Soviet permission. Rákosi and Gábor Péter obtained the approval of Belkin, the head of Central and Eastern Europe for the Soviet Ministry of the Interior,¹⁵ and he asked the Czechoslovak Intelligence Service to lead Field to Prague.

¹³ "Farkas's oral record", 175. This information was passed on from the Intelligence Headquarters of the Ministry of Defense to Gábor Péter, the leader of the state secret police. It was passed on as a report from a Swiss intelligence officer, and this intelligence officer was Edmond Ferenczi.

¹⁴ Czechoslovakian intelligence had been in frequent contact with Field since 1948, and Field and Czechoslovakian intelligence had a relationship of information exchange. Along with Alger Hiss, who was accused of being a member of the Soviet Communist Party, Field was also the subject of an investigation by the House Committee on Un-American Activities. Field had no option to return to the United States. See note 38 of this chapter.

¹⁵ Ilich Mikhail Belkin (1901–?) was the Soviet representative to the ACC (Allied Control Commission), stationed in Hungary from 1945. He subsequently headed the agency that monitored the socialist countries of Central and Eastern Europe. As the representative of MGB (Ministerstvo gosudarstvennoy bezopasnosti, Ministry of State Security) in charge of Eastern Europe, from 1949, he became an advisor to ÁVH and led the Rajk and Slánský purges behind the scenes. Following the defeat and arrest of Minister Abakumov in a power struggle in the

While waiting for German permission to emigrate, Field accepted the invitation of Czechoslovak Intelligence to go to Prague in early May 1949. At 3:30 pm on May 11, Czechoslovak Intelligence officers went to the Palace Hotel and drove him to the outskirts of the city. There he was handed over to the Hungarian abduction squad led by Deputy Director of the Hungarian secret police Ernő Szűcs, who was waiting for him.¹⁶ Szűcs used chloroform to knock him unconscious and then took Field to Hungary later that day.

Field was detained at the headquarters of the secret police at 60 Andrásy Avenue, but he was soon transferred to the secret house of the secret police ÁVH¹⁷ on Eötvös Street in Normafa. The Field abduction was top secret and a matter known only to a few senior officers. The interrogations that began in this house were first conducted by the abductor, Szűcs, and then by his subordinate interrogators, including Miklós Bauer, György Szendi, and others. Bauer and Szendi had been selected for the interrogation because they were fluent in German.

Soviet Ministry of the Interior, Belkin was also arrested in October 1951. Although he was released in 1953, he was stripped of his colonel's title, and he subsequently disappeared without explanation.

¹⁶ Field wrote a letter to the U.S. ambassador in Budapest (dated July 7, 1949). Although the details of the abduction were spelled out in the letter, it was never delivered to the embassy. After Stalin's death, when Hungary investigated the arrests and purges of this period, the Field case was also investigated: the Report of the Commission of Inquiry of the Ministry of the Interior, "Jelentés Noel Hevilland Field ügyében", dated November 5, 1954, was published in *Iratok az igazságszolgáltatás történetéhez 1* (Budapest: Közgazdasági és Jogi Könyvkiadó, 1992), 174–79.

Anne Applebaum writes that Noel H. Field was arrested in Budapest (Applebaum 2012, 287). This description seems to be based on the opening scene of a documentary film produced in 1996. As will be discussed later, the Field case was made into a documentary film, but the opening scene of the arrest was not a live action film, but a fictionalized account of the film production. Applebaum accepts the allegations made by the Hungarian secret police allegation and concludes that "Field was a notorious American spy". It is said that not only Field, but also those who traveled frequently between Western and Eastern Europe during this period were either spies or double agents of the West, but these claims cannot simply be accepted (or ruled out). At the very least, Field was a pure and naive believer in socialism, and had a good reputation among the people around him. Erika Wallach, whom Field and his wife raised, was also a member of the Communist Party who believed in socialism until she was taken to the Soviet Union.

¹⁷ The villa was built in 1905–1910 as the property of Aurél Förster, a member of the Hungarian Academy of Sciences and professor of philosophy, and it had been used as a secret house for the secret police since the late 1940s. It was long known as "the Rajk villa" because it was the house where László Rajk was detained and interrogated. It is now owned by the Budapest District XII Council, and there were plans to begin renovations in 2019 to transform it into a tourist information center. Incidentally, there is still a documentary film on the house during the Hungarian uprising in 1956. Footage of the house was inserted several times in Field's documentary film.

The state secret police maintained clandestine properties in various parts of the city and used them for secret meetings and as temporary detention sites.

The events from Field's arrest to Rajk's execution are detailed in the aforementioned extensive oral transcripts of Farkas. At the time, Farkas, as ÁVH's recording and wire-tapping technician, recorded all of Field's and Rajk's interrogations in an adjacent room. According to this.¹⁸ Field was brutally tortured, and he denied the espionage charges. In confessions forced by torture, Field wrote down the names of Communist acquaintances in Central Europe with his own pen. He also admitted that he had been in contact with an exiled Hungarian Communist in Switzerland and that he knew Tibor Szőnyi.

This was enough evidence for Rákosi. The list of names written by Field¹⁹ (a list of over 500 names) was immediately delivered to Rákosi, who further sent it to the Communist Party leaders in Czechoslovakia, Poland and other neighboring countries. This list was used in each country for the subsequent exposure of "American spies".

What followed for the Field family was a time of terrible turmoil. Truth is indeed stranger than fiction.

Before Herta disappeared, Hermann Field, Noel Field's younger brother, traveled to Czechoslovakia with Herta's news, and from there he flew to Warsaw to meet with friends. He then disappeared. On his way back to Prague, he was arrested by Polish intelligence at the Warsaw airport (August 22, 1949) and held in the Polish intelligence prison in Miedzeszyn, Warsaw.²⁰

¹⁸ "Farkas's oral record", 169–246.

¹⁹ Field's abduction was a top-secret action. Initially, Field's wife, Herta, was not worried that she had lost contact with her husband and assumed that he was headed to East Germany. However, as time passed, she became concerned that he had been involved in an accident, and she went to the Czechoslovak Intelligence Service (August 26). The intelligence service told her that her husband Noel was in a hospital in a town near the Hungarian border, and he took her to Bratislava, from where she moved further to the Hungarian border and was handed over to Hungarian intelligence (August 28, 1949). This abduction, however, led her to join with her husband. The reason for Mrs. Field's arrest was for conspiracy with her husband, who, according to the charges, was an American spy.

The content of Field's interrogation was also extremely important to Czechoslovak and Polish intelligence, and after Field's arrest, intelligence officers from both countries frequently visited Budapest to interrogate Field in person.

²⁰ Hermann Field and his wife, who were architects, had traveled to Europe often to study postwar reconstruction projects in Europe. They had done some research in Poland and had friends in Warsaw who were architects. With their help, he obtained a visa and entered Warsaw and was detained on his return trip to Prague. The arrest was carried out by Józef Światło, deputy head of the Polish Secret Police department 10 (to uncover spies inside the country's Communist Party), but the orders to arrest Field came from Bolesław Bierut, then general secretary of the Polish United Workers' Party, who was also president of Poland. The arrests and interrogations of the Fields, which served as the starting point for the Rajk case, were a matter of vital importance not only to Hungary, but also to the Czechoslovak and Polish intelligence services.

Hermann Field and his wife's memoirs (Hermann Field and Kate Field, *Trapped in the Cold War: The Ordeal of an American Family* [Stanford University Press, 2000], 5–15, 365–67) describes the circumstances of his arrest at the Warsaw Airport. At that time, the U.S. State De-

In addition, Erika Wallach, whom the Fields raised, went to Berlin with the mediation of German Communists to try to find out what happened to her parents, but she disappeared when she entered the Soviet occupied territory. She was arrested by Soviet forces.²¹ Thus, the Field family disappeared as each of them was detained by Hungarian, Polish, and Soviet security forces.²²

partment sent a diplomatic note dated September 13, 1949, to the Polish minister of foreign affairs inquiring as to the whereabouts of Hermann Field. In response, the Polish foreign minister verbally replied to the U.S. ambassador on September 28, 1949, that, with regards to Field's movements, he (the Polish foreign minister) was "really mystified" (ibid., 429).

²¹ Erika Wallach became a member of the Communist Party because of her belief in socialist ideals. She sought help from Leo Bauer, a member of the German Communist Party, to discover what had happened to Mr. and Mrs. Field, and they agreed to meet in East Berlin (August 1950). She arrived at Tempelhof Airport in West Berlin at 1:00 pm, and within an hour of entering East Berlin at 3:00 pm, she was arrested by the German secret police on suspicion of espionage and handed over to the Soviet side. After her arrest, she was held in a Berlin prison for a year and a half and sentenced to death by a Soviet military tribunal.

She was then transferred to Brest, Poland, from where she was transferred to Moscow to await her execution. About six months after her arrival in Moscow, she was notified that her sentence had been commuted from the death penalty to 15 years of forced labor, and she was transferred to the labor camp in Vorkuta (August 1953). She served in the forced labor camp in Vorkuta until December 1954, from where all foreigners were transferred to the general prison of Abez, where she was held until September 1955, after which she was transferred to a detention center in Moscow. The Moscow transfer was made "because after a reinvestigation, she was found not guilty".

When they were released in the fall of 1954, Noel H. Field and Hermann Field sent a request to the Polish and Hungarian authorities concerning Erika Wallach's disappearance, and they also sent a letter to Khrushchev. The U.S. State Department also asked the Soviets to release her. She was finally released in October 1955, and on October 27, 1955 she was flown to East Berlin, from where she took a taxi back to West Berlin.

The above details are a summary of an interview by Erica Wallach published in *U.S. News and World Report*, December 9, 1955.

²² A CIA report to the Secretary of State on Field's disappearance, now available online (subject: Noel, Herta and Hermann Field by Lyman B. Kirkpatrick, dated March 11, 1952; decision published March 18, 2010), reported the following. "1. Based on information as of November 14, 1951. 2. Noel and Hermann Field were in Moscow where they were being interrogated by the MVD in connection with the case of Władysław Gomułka, the former Secretary General of the Polish Communist Party, whose trial was being prepared. 3. Herta Field has been seriously ill. 4. Villem Novy, former Communist member of the Czechoslovak Parliament and Editor-in-Chief of 'Rude Pravo', official organ of the Czechoslovak Communist Party, who was confronted with Noel and Hermann Field at Pankrac Prison in Prague several times since 1949, is expected to be transferred to Moscow. 5. Dr. Evzen Klinger, former head of the Press Department of the Czechoslovak Ministry of Foreign Affairs, who, together with Novy and Jiri Hronek-Langstein, now Chairman of the State Propaganda Committee, contacted Hermann Field in London during the war, is still in prison in Prague and it is not planned that he be confronted with Field again. 6. General Reicin, former head of Czechoslovak Military Intelligence, arrested in February, 1951 in connection with the case of Dr. Vlado Clementis, Otto Sling and Marie Svermova,

The abduction of Noel H. Field was a top-secret matter in the Rajk trial. And if the subsequent asylum case had not occurred, the Field family's abduction would never have come to light and would have remained forever unknown and shrouded in darkness. In October 1954, five and a half years after Fields' arrest, Rákosi was in Moscow for the purpose of a spa cure. Bierut, the first general secretary of the Polish United Workers' Party, came to him unexpectedly.²³ He had come to Moscow on urgent business. A request for extradition had come through diplomatic channels from the U.S. State Department because Józef Światło,²⁴ a senior official of Polish intelligence and the

has refused to admit any contacts with either of the Fields, and has denied that he took part in the formation of the anti-Stalinist underground in the Soviet orbit, organized by the Fields (from 1945 on) with American money. Soviet inquiries in Hungary concerning that matter are not yet concluded."

This report shows that the CIA at the time had very little information about the Field family's disappearance. It is reported that Noel and Hermann were acting together, but in fact they were detained in different countries, and they were never transferred for any face-to-face interrogation in Moscow or Prague. It seems that there was a mixture of fairly inaccurate information at the time.

²³ I looked at various documents, but I did not find any that give a definite date. However, it is certain that it was the end of October 1954. Rákosi was in Moscow from the beginning of October until the end of November.

²⁴ See Varga 2000. After defecting, Światło was interrogated at the CIA Defector Reception Center in Frankfurt and transferred to the U.S. for further interrogation in April 1954. Światło's first public appearance was on Radio Free Europe on September 28, 1954. The full story of Hermann Field's abduction became public, and the U.S. State Department made a formal request for extradition, which resulted in Hermann Field's release four weeks later. Of course, Światło knew that Noel H. Field was being detained in Hungary because he had traveled to Budapest several times to interrogate him in 1949. Noel H. Field and his wife were released three weeks later after Hermann's release. The report of Światło's interrogation in Hungary: Miklós Mitrovits, "A Rajk-per lengyel szemmel – Józef Światło jelentései a helyszínről", *Betekintő* 2 (2015).

Edmond Ferenczi, who reported information concerning Field to the Hungarian Ministry of Defense Intelligence in early 1949, defected to Switzerland in the fall of 1949, as previously mentioned, but contacted the ÁVH again in February 1954. Ferenczi was supposed to resume contact with Hungarian intelligence at the request of the Belgian intelligence services. At the time, the Rajk case and the arrest of Kádár were being investigated, and Vladimir Farkas, due to his involvement in this investigation, suggested that Ferenczi should be called to Budapest for questioning. However, the then minister of the interior, Gerő, immediately rejected the proposal. He replied sullenly that it was unnecessary because the matter had already been settled. It probably meant that there was no need to rehash the case which had been initiated by Rákosi. The proposed Ferenczi hearing was vitiated ("Farkas's oral record", 394–95).

After the resumption of contact in 1954, Ferenczi, using the code name Telegdy, became a member of the Hungarian Ministry of the Interior's Intelligence Division 2, where he was responsible for reporting on Social Democratic movements in Western Europe. At the time, however, Ferenczi, who was already a Belgian intelligence officer, was operating as a double agent. In March 1957, when the Hungarians began to become increasingly suspicious that he was working as a double agent, they closed Telegdy's documents and broke off the relationship with him.

man who carried out the arrest of Hermann Field, had defected on a trip to East Berlin the previous year (December 5, 1953) and had informed the West about the abduction of Hermann Field. He said that he had to release not only Hermann Field, but also Noel H. Field, who was being detained in Hungary. Rákosi replied that he needed some time, but he gave the order to release Noel H. Field later that day.

Hermann was released on October 25, 1954. He went to London, where his wife was waiting for him, and then returned to the United States. Noel was set free on November 17, 1954, but because he had no permanent residence and because he could not cross into the United States as a communist, he applied for asylum in Hungary, where he remained until his death in 1970. With the release of the Field brothers, the disappearance of their adopted daughter, Erika Wallach, who disappeared in East Germany, was investigated. As previously mentioned, a year after the Field brothers' release, Erika was released in October 1955.²⁵

Światło was involved in various purges in Poland and was in a position to receive direct instructions from Bierut, the general secretary of the Polish United Workers' Party. His trip to Berlin was to meet with Stasi (East German State Security Ministry) officials, and the day after the meeting he went by subway to West Berlin. It is said that the meeting consisted of a plot to kill Ms. Wanda Bronska, a former member of the Polish Communist Party and an active member of the REE Polish Broadcasting Corporation. Światło, a Jew, sensed that the purge would claim him as a victim too, and he went into exile, leaving his wife and children in Poland.

As in the case of Noel H. Field, some believe Światło was a Western spy from the start, but that is an all too plausible scenario. After arriving in the U.S. from a CIA defector center, he was placed in protective custody by the U.S. government and his whereabouts were never made public. The Światło Report was never made public, and for a long time his whereabouts were never confirmed, but in 2010 the US government announced that he had died on September 24, 1994. Światło's exile forced the Polish Ministry of State Security to undergo significant reorganization. See L. W. Gluchowski, *The Defection of Jozef Swiatlo and the Search for Jewish Scapegoats in the Polish United Workers' Party, 1953–1954* (archived from the original on June 22, 2010. Retrieved: September 11, 2015, <https://www.revolvy.com/page/J%C3%B3zef-%C5%9Awiat%C5%82o?cr=1&rt=1&mt=>).

²⁵ Wallach published a book about her experiences (Erica Glaser Wallach, *Light at Midnight* [Doubleday, 1967]). The title was inspired by the Hungarian writer Arthur Koestler's non-fiction novel *Darkness at Noon* (Macmillan, 1940). The protagonist of Koestler's novel is Eva Striker Zeisel (1906–2011), the daughter of Michael Polanyi's sister Laura and Sándor Striker. Eva married an Austrian physicist and immigrated to the Soviet Union, describing the hardships she encountered there.

Furthermore, a documentary film on Noel H. Field was made in 1996 (a Swiss-German co-production), *Noel Field – The Fictitious Spy* (*Noel Field – der erfundene Spion*). The film is not interesting as a fiction film, because it consists of the testimony of survivors. The German-language DVD is attached as an appendix to the upper volume of the Field documentations (*Der Fall Noel Field* [Berlin: BasisDruck Verlag, 2005]). At present, the DVD is not available for purchase, but is uploaded to YouTube.

Mr. and Mrs. Field received an official apology from the Hungarian government and were given a residence in Budapest's District XII. After his release, Noel worked as a translator for Corvina Publishing House. Noel passed away in 1970, and his wife Herta died in 1980.

(2) The Arrest of Foreign Minister László Rajk

Noel H. Field's interrogation brought the last phase of Rákosi's conspiracy. Based on Field's confessions, Central Committee member Tibor Szőnyi and his subordinate András Szalai, who worked at the Communist Party headquarters, were arrested on May 18. In fact, the arrests of the Yugoslavian Communist Party-backed exiles had been planned even before Field's confessions. Only the temporal sequence was a problem.

A "confession" by Field, who was abducted on May 11, led to the arrest of Tibor Szőnyi on May 18, and he was forced to make a definitive "confession" on May 23. "I had contact with Field, an American spy, in Switzerland," he confessed. Rákosi ordered the authorities to go further: "Don't let it end with the arrest of Szőnyi, expose the mastermind". Following Rákosi's instructions, Gábor Péter and other ÁVH officials took aim at Rajk and gave Field numerous mugshots with Rajk's picture mixed and ordered him to pick up the people he knew. Field, who had been tortured for hours, no longer had the ability to resist. He looked at a picture of Rajk, whom he had never met, and confessed that he'd seen him before.

Thus, the scheme of conspiracy was completed. It was based simply on the notion of the following claim: "the mastermind of Szőnyi and Field, Rajk, is one of America's key spies and Yugoslavian agent, who has slipped into the Communist Party in Central and Eastern Europe". By obtaining the evidence of the Rajk purge, Rákosi invited János Kádár and Gábor Péter, together with Ernő Gerő and Mihály Farkas, to the villa for Communist Party officials in Balatonliga on the evening of 29 May, and he informed them of his intention to arrest Rajk and asked their opinion on the procedure for his detention.²⁶

At this meeting, Rákosi informed them of his decision to arrest Rajk. Kádár seemed hesitant, but it was not possible to change a scenario to which Stalin had agreed. Persuaded, in response to Rákosi's question concerning the procedure for the arrest, Kádár actively proposed the idea of inviting Rajk to a chess game and arresting him there. "I will invite him for a meeting at the party headquarters on the morning of the 30th and make him promise to play chess in the afternoon at the party sanatorium in Szabadsághegy. After that, he will go home and we can arrest him on his way home."

In addition, a compilation of Wallach and Noel Field's memoirs in Hungarian was published: György Majtényi, Zsuzsanna Mikó, and Csaba Szabó eds., *Kémek, korok, életek – Erica Glaser Wallach és Noel H. Field története* (Budapest: Libri Kiadó and Magyar Nemzeti Levéltár, 2017).

²⁶ "Farkas's oral record", 193–95. Vladimir Farkas himself was not present at this meeting, but he was told by his father Mihály Farkas. When Mihály Farkas and Gábor Péter arrived at the villa in Balatonliga that afternoon, they had to wait outside for a while as Mr. and Mrs. Rajk, who had been visiting Rákosi, were preparing to return to Budapest. Rákosi had promised them that he would see their baby the following week. József Révai, who was recuperating in a Soviet sanatorium, did not take part in the talks. When Révai was later shown Rajk's confession, he said that "I can't believe it".

This is known as a boastful story²⁷ which Kádár later proudly shared many times in his party school lectures. In addition, Rákosi also decided to arrest Rajk's wife, Júlia, who had a child less than six months old. Everything was carried out according to this plot, and Rajk was taken to a secret house on Eötvös Street in Normafa.

Rajk did not know Field, and he never believed that Szőnyi was a "spy for the United States and Yugoslavia". No confession was elicited from Rajk's interrogation. So Gábor Péter gave orders that he be subjected to torture. According to Vladimir Farkas, Péter appointed his own torture officer. It was common for interrogators to slap a prisoner on his or her face, but there was a separate specialized group which dealt with any further torture. This was the group led by Gyula Princz, who would later torture senior ÁVH officers to death, and it was their job to torture people without actually killing them. Despite the intense torture, however, Rajk refused to make the forced "confession".

Here the torture was stopped once and then the interrogation procedure was carried out for forty-eight hours in a row. All the interrogators from the ÁVH were mobilized, and every two or three hours the interrogators were changed, and a "confession" was forced on Rajk without giving him any time to sleep. And as the last interrogator, Kádár took the role of persuading Rajk to give in.²⁸

Unlike the other interrogators who raised their voices, Kádár spoke in a quiet tone, "You should admit your guilt and confess that you have caused real harm to the Party. I am speaking to you on behalf of Rákosi and the entire Party. By confessing frankly, you would be saved". In short, Kádár told him that the communist movement needed a victim (live sacrifice). This was a turning point, and Rajk realized his fate and "confessed" as Rákosi had planned.²⁹ During this time, other Politburo members were not informed of the truth of what had happened, and on June 25, Kádár gave a summary report at the Budapest Party Activists' Conference held in the Sports Gymnasium. The resolution "Death Sentence for Rajk!" was adopted. It was truly communist fascism itself. The only member of the Politburo present there who knew the truth was Kádár.

²⁷ "Farkas's oral record", 195. Kádár answered in a 1982 interview (László Gyurkó, *Arcképvázlat történelmi háttérrel* [Budapest: Magvető Kiadó, 1982], 184), "I don't think it's possible to know what actually happened from the arrest to the execution of László Rajk". Vladimir Farkas criticized this statement as a downright lie. So much so that, for Kádár, the fact that he was involved in Rajk's execution was a secret that he had to take to his grave.

²⁸ Details of the circumstances of the Rajk interrogation are provided in "Farkas's oral record" (199–204). During the Rajk interrogation, Farkas remained in the ÁVH building on Eötvös Street as recording engineer and was in a position to know the entire situation.

²⁹ Why was Rajk the victim of the purge? Rákosi was often seen arguing violently with Révai, and many thought that if anyone was to be purged, it would be Révai. Révai was an intellectual in charge of ideology, so it is likely that he did not get along with the crude Rákosi.

There was a time when Rákosi thought of Rajk as his successor, but as it became clear that Rákosi had the prospect of being a small Stalin himself, he probably became aware of the tall, neat-looking Rajk, whose speeches were well delivered, as a dangerous rival. Rákosi often displayed the age-old wisdom that "tall, skinny figures are often bad guys". It was necessary to purge the big-name figures and show submission to Stalin. For more information on this topic, see Pünkösti Árpád, *Rákosi, Sztálin legjobb tanítványa* (Budapest: Európa Könyvkiadó, 2004).

For Kádár, who later came to power, the arrest and execution of Rajk was an inexcusable stain on his political career, even though it was an escapable case of following Rákosi. The executions of Rajk and Nagy were political murders in which Kádár was directly involved, the very essence of the resentment or guilt that struck Kádár in his delusional state just before his death. Kádár was supposed to take the truth and his own guilt (assuming he felt any) to his grave without telling the truth about it. However, the publication of Farkas's oral record revealed the details of Rajk's arrest and execution, which Kádár had never spoken about in his life.³⁰ However, by that time, Kádár had already died.

(3) From the Rajk Trial to the Execution

The records of the interrogation of Field, Szőnyi and Rajk were translated into Russian and delivered to Belkin. Reading the contradictory "confessions", the Soviets seemed uneasy. In early July, Belkin personally visited ÁVH and severely criticized the method of using to extract confessions. According to Vladimir Farkas, he also said that violence was permissible, but only as a last resort.

During the period before and after Rajk's transfer from minister of the interior to foreign minister and Kádár's appointment as minister of the interior (July 1948), Rákosi invited Kádár to his private residence in the presence of the aforementioned Gang of Four. Rákosi mentioned the possibility that "Rajk had contacts with U.S. spies after the Spanish Civil War and that Rajk might be a spy for U.S. imperialism" ("Farkas's oral record", 173). The content of this meeting is detailed in Chapter XII, Note 1 of "Farkas's oral record" (629), which Kádár told to Vladimir Farkas in his interrogation of Kádár in 1953.

The growing disagreements between Rajk and Gábor Péter (Rákosi) over the secret police were the direct cause of his ouster from the Ministry of the Interior. Moreover, during this period, Rákosi was directly requested by Stalin to "flush out those who had close ties to Yugoslavia" and "expose the Trotskyists", which was a strong motivation for the Rajk purge. The purge pushed him Rajk of the succession race and gave Rákosi the reputation of being Stalin's favorite disciple.

³⁰ "Farkas's oral record", 208. Kádár knew Vladimir Farkas well from his ÁVO days, because Vladimir was the son of Mihály Farkas. It is clear that Vladimir had gotten a high-ranked position in the ÁVH thanks to his father, and therefore Kádár looked down on Vladimir, as he felt he had gotten the position simply because of his father's connections. Many officers of the ÁVH also seemed to look down on him as nothing more than a Russian interpreter and eavesdropping technician. To be sure, Vladimir was in charge of eavesdropping techniques and did not take part in interrogations outwardly, and he was not the type of man who was brilliant, but his position in the secret police was high. After Stalin's death and the peoples' uprising 1956, the Farkas family, who were forced to take all responsibility for the purges under the Rákosi dictatorship, had a miserable time. For Vladimir, who had nothing to lose, the counterattack against Kádár was a matter of revealing historical facts to the public. Many researchers have relied on Farkas's oral history (record) as a primary source of information, but the book became unavailable after the first edition was published. Besides the conflict with the planner of the book, many of the people involved were still alive at the time, and the detailed description of extremely inconvenient facts was probably the reason for the suspension of the publication of the book. However, Farkas's oral history is still available on the second-hand book market.

In order to obtain consistency in the confessions, Belkin and his subordinates were paired with senior ÁVH officers for reinterrogation. Some of the interrogations took place at the headquarters on Andrásy Avenue, but the main interrogations took place in a secret house on Eötvös Street. No signatures of the Russians were left on the records of this interrogation, in which Belkin and other MGB (Ministerstvo gosudarstvennoy bezopasnosti, Ministry of State Security) interrogators participated.³¹ In order to avoid leaving evidence of direct Russian involvement, Belkin did not leave the signatures of the interrogators.

Belkin visited Rákosi two or three times a week during his stay in Budapest. Rákosi would confirm Stalin's intentions while discussing the details with Belkin. This is how Belkin was involved in the purges of leading politicians in the Czech Republic, Poland, Bulgaria and Romania.

Once the decision was made to execute Rajk, Rákosi began to direct the entire procedure. At the end of August (or early September) 1949, just before the Rajk trial began, Rákosi visited Stalin with the Rajk accusation document (translated into Russian) and sought a final understanding. A few days before this, Vladimir Farkas³² was given the task of handing this Russian-language document to the Soviet Communist Party side via the Soviet embassy in Romania. A scheduled MALÉV (Hungarian Airlines) flight, which had been suspended due to a storm, was forced to fly at the party's instructions, and the document, addressed to Alexander Poskrebyshv, a Central Committee member of the Communist Party of the Soviet Union and Stalin's secretary, was handed to one secretary of the Soviet embassy at Bucharest airport.

Before the Rajk trial began, Rákosi had two direct lines put in his office, one to Belkin and Gábor Péter and the other to the prosecutor and presiding judge.³³ The lines

³¹ The circumstances of this interrogation are detailed in "Farkas's oral record", 217–18.

³² "Farkas's oral record", 234–35. Farkas writes that he could not understand why the document had to be given through the Soviet embassy in Romania, rather than through Belkin. But already the conflicts within the Soviet State Security Ministry were raging, and Rákosi had to bypass the Belkin-Abakumov line and give it directly to Stalin. He clearly sought to monopolize the feat and to solidify Stalin's confidence in him.

In fact, there was a heated exchange between Belkin and Rákosi over the entirety of the Rajk accusation. The letter of complaint prepared by Rákosi contained a radical statement according to which "Rajk plotted to kill Rákosi", and Belkin believed that an overly extreme scenario would cast doubt on the credibility of the case. This confrontation between Belkin and Rákosi was the backdrop for the report of Ernő Szűcs sent to Abakumov around the same time ("Rákosi is preparing provocative actions against Yugoslavia"). This report of criticism of Rákosi was prepared by Szűcs and signed by Gábor Péter, but it is believed that Belkin encouraged the report to be sent. Szűcs was a secret member of the Soviet State Security Ministry's Intelligence Service in the Hungarian secret police. There was a feud in the Soviet Union between forces that were hostile to Yugoslavia and those that sought to improve relations.

Rákosi told Belkin that the Rajk complaint had already been approved by Stalin and he did not hand over the initiative to conduct the Rajk trial. Therefore, it is likely that he chose to hand it directly to Stalin.

³³ Farkas was ordered to set up this telephone line ("Farkas's oral record", 236).

were set up so that he could hear the trial in his office, and Rákosi gave instructions one by one through the direct line. According to Gábor Péter's appeal, dated July 10, 1956, Rákosi prepared all the plot points that the trial judge, the prosecutor, and the defense team would discuss. He even instructed Gábor Péter as to whose defense would be handled by which lawyer.

While the trial was in progress, Vladimir Farkas received an urgent telegram from Poland addressed to Rákosi. The sender was Bolesław Bierut, general secretary of the Polish United Workers' Party. It read: "I have dispatched my proxy Rubinstein (state intelligence officer). Please accept him at once." Following Rákosi's instructions, Gábor Péter and Vladimir Farkas³⁴ received him at the airport. Gábor Péter later told Vladimir that this had been dispatched because of the need to connect the Rajk trial with the Gomulka purge. Rákosi forgot to include it in the complaint and hastily informed the prosecutor of this and told him to include it in the proceedings, but the prosecutor was unable to incorporate a plot that was not part of the original scenario. In the end, there was no way to link Gomulka and Rajk, and Gomulka escaped arrest at this point.

The content of the verdict was decided by Rákosi. A piece of paper with the content of the sentence was given to the presiding judge. The procedure at that time was that the content of the sentence for the main accused was decided by Rákosi, while the content of the sentence for the others was decided by Gábor Péter and other ÁVH officials. On September 24, 1949, László Rajk, Tibor Szőnyi, and András Szalai were sentenced to death, and on October 15, 1949, they were hanged.³⁵

After the trial was over, Rákosi asked Stalin for permission to execute Rajk. To this, Stalin sent a reply telegram stating that there was no need to execute him. However,

³⁴ "Farkas's oral record", 237. Vladimir did not testify to the content of the meeting, as Rákosi welcomed only Rubinstein into his office. Gomulka, the general secretary of the Polish United Workers' Party, who did not show reverence to Stalin, was labeled a "nationalist" and was removed from his party post in 1948 and was the target of Stalin's purges. Could it be that Bierut was not as powerful as Rákosi, and this is why he escaped the purge? However, Gomulka was expelled from the party and arrested in the summer of 1951. He was released in 1954 and came back to the center stage of politics at the request of the party, when the party was struggling to contain the 1956 Poznań riots.

³⁵ The trial of Rajk, Szőnyi and Szalai was a public trial. In parallel, the trials of the military and police line arrests were held. The scenario was that the front trial was a political coup and the back trial was a military coup. György Pálffy, deputy minister of defence, Colonel Dezső Németh, Police Colonel Béla Korondy, and Police Lieutenant Ottó Horváth, all of whom had been indicted by a military tribunal, were sentenced to death on October 10. They were executed on October 24 (Mihály Farkas, who was minister of defense at the time, and Ernő Gerő were present at the scene of the executions). The number of others arrested in connection with the Rajk case is said to be as high as 60 or 80. One of them, Béla Szász, a spokesman for the Ministry of Land Development, was released in 1954 and went into exile in Britain in 1957. He published a memoir describing the situation at the time (Béla Szász, *Volunteers for the Gallows: Anatomy of a Show Trial* [New York: Norton, 1972]).

a second telegram arrived later, and the execution was approved.³⁶ During the time between these two telegrams, it is natural to assume that Rákosi addressed the need for execution to Stalin. This is because Rákosi had nothing to gain by letting Rajk live. Kádár's logic in the case of the execution of the Imre Nagy would have been the same. It is the universal logic of those in power.

On the occasion of the execution of Rajk and two others, the ÁVH officers and all the interrogators who had participated in the interrogation of the prisoners were summoned to the ÁVH jail on Conti Street (now Tolnai Lajos Street, District VIII). Mihály Farkas and János Kádár³⁷ were also present. They were to look down from a room in the building to the gallows set up in the courtyard. Ernő Szűcs led the prisoners to the gallows.

After the execution, Szűcs returned to the room where the ÁVH officers were waiting and reported on the execution. When he announced that they would be executed, Rajk and Szőnyi did not want anything, but Szalai wanted a glass of cognac. At the execution, Rajk praised the Communist Party and the Soviet Union, but Szőnyi did not say anything. However, Szalai cried, "You tricked us!" The remains of the executed were not respectfully buried, but rather were haphazardly buried in a hole dug in the forest outside the town of Gödöllő, some 30 km from Budapest. They were left there until they were dug up in September 1956 for reinterment.

After Szűcs's report, the assembled ÁVH officials and others thanked one another for their hard work up to that point with simple drinks and sandwiches. In the evening, there was also a Danube Cruise hosted by Gábor Péter, attended by representatives of the Soviet Ministry of State Security, ÁVH officials, and interrogators, with Belkin as the guest of honor. Belkin was said to be in a particularly good mood.³⁸ The interrogators who handled the Field interrogation and Rajk interrogation, including Miklós

György Pálffy, who was one of these individuals, was an intelligence officer of the Soviet State Security Ministry (monitoring hostile actions against the Soviet Union within the military). In the case of Pálffy, Rákosi's anger may have been the reason behind his execution despite his well-known status as a member of Soviet intelligence. At the end of 1948, Rákosi learned that his movements had been reported to the Soviet Union by Hungarian agents of the Soviet State Security Ministry and the Ministry of Defense, and then Rákosi asked the Soviet ambassador to hand the report over to him. Rákosi was very nervous on this matter. It was not until a little later that he learned that Ernő Szűcs, a deputy director of the secret police, was also an intelligence officer of the Soviet State Security Ministry. This was the background to the purge of the Szűcs brothers.

³⁶ In 1956, Vladimir Farkas heard about this from his father Mihály ("Farkas's oral record", 239). Rákosi had a direct line of communication with Stalin.

³⁷ The process of preparing for the Rajk trial was under the full control of Rákosi, which meant that after the indictment, Kádár was not actively involved in the matter. Kádár was actively involved until the interrogation came to an end. Although he was not directly involved in the death penalty decision, he played an important role in leading the interrogation process from the arrest of Rajk.

³⁸ The circumstances of Rajk's execution are described in detail by Vladimir Farkas, who was present at the scene ("Farkas's oral record", 239–41). Belkin was not present at the hanging.

Bauer and György Szendi, were rewarded. At the end of the following November, as a reward for the Rajk execution, the Hungarian Workers' Party had the honor of hosting the Cominform Conference³⁹ in Galyatető in the Mátra Mountains in northeastern Hungary. The Yugoslavian question was the main theme of the conference, with the main report entitled "Murderers and Spy Power in Yugoslavia" given by Gheorghiu-Dej of Romania. In addition, the delegate of the Italian Communist Party Togliatti gave a report emphasizing the importance of the ideological, political and organizational unity of the international workers' movement. From Czechoslovakia, General Secretary Rudolf Slánský, who was later subject to the purge, also participated and spoke at the event. The Hungarian delegation consisted of Rákosi, Gerő, Révai and Kádár.

On December 21, the 70th anniversary of Stalin's birth was celebrated with great pomp and circumstance at the Opera House. At the end of 1949, the Council of Ministers issued a proclamation that, as of January 1, 1950, the State Security Service (ÁVH) was to function independently of the Ministry of the Interior. Andrassy Street, where ÁVH headquarters is located, was renamed Stalin Street, and Árpád Bridge was renamed Stalin Bridge.⁴⁰

The Rajk executions were only the beginning of the madness of Stalinist power. Having become an independent power beyond the state and party, the ÁVH would detain and murder many people over the course of the next two years. Eventually, the ÁVH cadres became suspicious of one another as well, and Hungary saw the last gasp of the power that had turned into madness.

It should be noted that Noel Field was transferred to this ÁVH prison on Conti Street without being brought to trial. Field's arrest and confinement were classified.

The Rajk trial happened to counter the trial of Alger Hiss, who had been arraigned by the U.S. House Committee on Un-American Activities (HUAC), which cracked down on hostilities against the United States. Hiss had participated in the Yalta talks as an attendant to President Roosevelt and had become the first acting secretary-general of the United Nations. He had been subpoenaed in the summer of 1948 by the HUAC, and Whittaker Chambers, an American Communist Party activist, had revealed to the Un-American Activities Committee that Hiss was a member of the Communist Party. Hiss was prosecuted. He had worked for the U.S. Department of State for many years and was a representative of the Carnegie Endowment for International Peace at the time of the prosecution. Noel Field and Alger Hiss were both acquainted with each other. Field was also the subject of a subpoena, but the summons did not materialize because he lived outside the country.

On the Rajk and Hiss trials see: Mária Schmidt, "A Rajk-per és az amerikai kapcsolat I. (Néhány új szempont az Egyesült Államok-beli Alger Hiss-ügy és a Rajk-per történetéhez)", *Magyar Szemle* (March 1994) and Ead, "A Rajk-per és az amerikai kapcsolat II", *Magyar Szemle* (April 1994).

³⁹ Detailed in "Farkas's oral record", 242–43.

⁴⁰ Stalin Street was temporarily renamed Magyar Ifjúság útja (Hungarian Youth Street) after the Hungarian uprising 1956, but was soon named Népköztársaság útja (Street of the People's Republic), although Stalin Bridge became Árpád Bridge again after the Hungarian uprising. It was not until 1990 that it became Andrassy Avenue again.

Bolstered by his confidence in the party's internal purge as exemplified by the Rajk execution, Belkin executed Bulgarian Deputy Prime Minister Kostov as an "American spy and Yugoslavian stooge" (December 1949) and led a purge targeting Slánský, the general secretary of the Czechoslovak Communist Party, from early 1951 to the end of the following year. This was the Slánský trial, which drew international attention. Of the 14 senior Communist Party and government officials stigmatized and accused as Zionist, Titoists and Trotskyists, 11 were sentenced to death and three to life in prison. After his release, Arthur London (A. London) published a long memoir of his experiences, and a film based on it was made in France (titled *The Confession*, 1970).⁴¹

The final target of the case was Slánský, and to make the plot work, a series of high-level government officials with whom Slánský had a working relationship were detained, and a scenario for Slánský's arrest was prepared in secret. From the beginning of the year to the spring of 1951, A. London and other high-level government officials were arrested and locked up. Most of them were Jewish, and they were hardcore Communists who had participated in the Spanish Civil War. Overtly anti-Semitic, those who participated in the Spanish Civil War were Trotskyists who did not follow the leadership of the Soviet Union, those associated with Noel H. Field and Dulles⁴² were agents of U.S. imperialism, and those who returned alive from the Nazi concentration camps were Gestapo spies. Those who returned from the French and British camps were determined to be agents of their respective countries.

A. London, who had worked mainly in France and had participated in the Spanish Civil War, had enlisted Field's help in treating a lung disease and therefore was charged with being a "Trotskyist and American imperialist spy". A list of acquaintances in Central and Eastern Europe, which Field had written down during his interrogation in Hungary, was entered into evidence.

However, as A. London's memoirs show, most of those arrested and detained were pure socialists and communists who had fought against totalitarianism in World War II and who had participated in the Spanish Civil War. They had to confess their "guilt" because they were being tortured by young interrogators who knew nothing of their heroic backgrounds. When all the arrestees had "confessed" except A. London, Slánský was arrested as the mastermind of the spy case (September 1951). The scenario took a year to complete, and in a public trial (November 20, 1952), the death penalty was

⁴¹ The film *The Confession* stars Yves Montand. A. London, who was undersecretary of foreign affairs at the time of the incident, was abducted and arrested for reasons that were not specified, and held in solitary confinement, handcuffed and not given enough sleep, but he refused to confess for eight months before being transferred to a medical prison. In the end, however, he signed a "confession" statement, just as the Soviet advisers had plotted. The film depicts a prolonged period of confinement lasting approximately 21 months, from his arrest to being forced to memorize the text of his trial testimony. The conditions of abuse described in the film are recreated precisely as described in A. London's memoirs. He was subjected to torture and abuse no less brutal than the torture used by the Gestapo, and he was forced to "confess". This was Stalin's method of purging, directed by the Soviet advisers.

⁴² The one shot of a live-action scene from the Slánský trial can be seen in the documentary film on Field.

handed down, and 11 people were hanged on December 3, 1952. It was indeed a huge and elaborate case.⁴³

The purges in the Central and Eastern European countries were initiated by entities beyond the power of the countries concerned (the Soviet Communist Party and the Ministry of State Security), who used Soviet followers in the countries concerned to target and purge their leaders and force the satellite countries to become subordinate to the Soviet Union. The death of Stalin (March 1953) and the Khrushchev “secret report” (February 1956) led to accusations and the arrests of those involved in these purges, while those who had been arrested and imprisoned were released and reinstated. In Hungary, this movement for restoration of rights developed into an uprising, but in Czechoslovakia, not only was there a delay in the release of those sentenced to life in prison, such as A. London, but there was also a refusal to rehabilitate those who had been executed, such as Slánský. This was because the Soviet side took complete control of the purge in Czechoslovakia, which lagged behind Hungary and Poland in the purges. Because those who had been selected for senior positions in the Communist Party leadership by Stalin’s authority had kept their positions, the Czechoslovak Communist Party could not adopt any kind of “self-purification” campaign, even after the “secret report”, and thus the rehabilitation of the victims of the Slánský affair was not achieved until the Prague Spring of 1968.

After the Prague Spring crackdown, conservative forces regained power in Czechoslovakia, and until the system transformation in 1989, the Communist Party leadership, which was closely tied to Soviet conservatives, remained in power. The newly established democratic power in 1989 led to the expulsion of the Czechoslovak Communist Party members from public office, which can be explained by the historical circumstances so far. This was different from Hungary, which had distinguished itself from the Soviet Union with its soft dictatorship in the wake of the peoples’ uprising in 1956.

8.1.3 The Elimination of Social Democratic politicians

In June 1948, the Communist Party and the Social Democratic Party joined to form the Hungarian Workers’ Party. Of the 14 members of the Politburo, five were from the Social Democratic Party and nine were from the Communist Party. Among them, Árpád Szakasits, a Social Democrat, was elected president of the Supreme Council (head of state), which was to be the face of Hungary’s foreign policy. Unlike Szakasits, who was not willing to join the Communist Party, György Marosán, also from the Social

⁴³ Not only did considerable time pass between A. London’s arrest in early 1951 and the arrest of Slánský (September 1951), but it took another year or more between the arrest of Slánský and the start of the trial (November 1952). Minister of State Security Viktor Abakumov, who had led the Slánský case after the Rajk case, was ousted before Slánský’s arrest (July 1951), and Belkin, who was in charge of Central and Eastern Europe under Abakumov, was arrested the month after Slánský’s arrest (October 1951). This power struggle within the Soviet leadership is believed to have significantly delayed the handling of the Slánský case. In addition to the power struggle, it is presumed that there was disagreement over how to handle the case.

Democratic Party, was active in the integration of the two parties, and Marosán was appointed minister of light industry. In addition, István Ries, who was not a member of the Politburo but was also from the Social Democrats, took up the post of minister of justice. These leading figures from the Social Democrats became the next targets of the purge by Rákosi.

On April 24, 1950, in addition to the Gang of Four, Kádár, Árpád Szakasits and Gábor Péter convened at Rákosi's private residence on Lóránt Street in the 12th district.⁴⁴ Vladimir Farkas, who had set up a microphone at Rákosi's residence at Rákosi's instructions two days earlier, testified in detail about the gathering.⁴⁵ At this meeting, Rákosi assumed that Szakasits was a "spy for the political police of the Horthy regime" because of his contacts with the police during his time as a construction trade union official in the 1930s. Rákosi dictated to himself and had Szakasits produce two documents in his own handwriting. One was a written confession that he had been a spy for the political police of the Horthy regime, and the other was a letter of resignation as President of the Supreme Council.

The Rákosi family had a family relationship with Szakasits's daughter, Klára, but with the arrest and confinement of Szakasits and his wife, Klára's husband, Pál Schiffer, a central committee member from the Social Democratic Party, was also arrested. Szakasits was treated politely, but Mrs. Szakasits died in prison. Schiffer, on the other hand, was subjected to torture.

Rezső Nyers, a Social Democrat who had once worked as a printer and who later served as a leader in the Kádár government's economic reforms, testified that the documents in Rákosi's hand at the time of Szakasits's arrest showing Szakasits's ties to the political police were forged.

After the arrest of Szakasits, followed by the arrest of the minor politicians, in July and August several prominent politicians from the Social Democratic Party were arrested and jailed at once. Light Industry Minister György Marosán, Minister of Justice István Ries, and Central Committee member and economist Imre Vajda were arrested, and young ÁVH interrogators were put in charge of interrogating these politicians. György Szendi was in charge of the interrogation of Minister Marosán and member of the Central Committee Schiffer, while Miklós Bauer was in charge of the interrogation of Minister Ries. Both Szendi and Bauer had a reputation as intelligent and sophisticated young men, but Szendi had a very aggressive personality and was said to have tortured Schiffer mercilessly, at Rákosi's instructions, when he denied the charges. Bauer was not as aggressive as Szendi, but in his interrogation of Minister of Justice

⁴⁴ In the summer of 1988, when I was posted to Budapest as an economic adviser at the embassy of Japan, I happened to find a flat on Lóránt Street where Rákosi's private residence used to be. It was the villa hidden in the shade of the trees on the lower left-hand side of the street. I found out much later that it had been the Rákosi residence where various intrigues had taken place. The ÁVH secret house on Eötvös Street, where the interrogation took place, is about 2 km away from the spot, at the top of Istenehyi Street.

⁴⁵ "Farkas's oral record", 263–66. On April 22, Vladimir Farkas received instructions to install a listening device in one of the rooms of the Rákosi residence.

Ries, he used the torture technique of continuously dripping water on Ries' head from a bucket suspended from the ceiling. When his boss at the time, Vladimir Farkas, questioned him about this, he reportedly shared his erudition, claiming that it was a "valid method used since ancient China". Farkas wrote that he informed Bauer's wife, Judit, of this and they together convinced Bauer to stop this kind of torture.⁴⁶

István Ries was struck in the head during his interrogation on September 15, 1950 and died. It is not clear who inflicted the blow that killed him.

However, after the 1956 uprising, when Vladimir Farkas was put on trial for crimes committed during the ÁVH era, Bauer's wife Judit, who appeared as a witness, flatly denied the charges and insisted on her husband's innocence. Thereafter, the Bauers never committed any crimes during the ÁVH era, and their son Tamás Bauer even claimed in parliament that his father had never been an interrogator. György Marosán and his colleagues were sentenced to death in late 1950, and their sentences were soon commuted to life in prison, but they continued to live in prison until March 1956. Marosán became then an important member of Kádár's inner circle, but due to a personal conflict with Kádár early in the 1960s, he was removed from the Politburo and removed from the Central Committee in October 1962. During the debate at that time, Marosán⁴⁷ gave voice to his own hypothesis: "There is a difference between the 'good' citizen who grew up in a worker's family and the 'denailing ávós' (secret policeman) who grew up in a bourgeois family." This was how Miklós Bauer, a Jewish bourgeois native who was known to be an effective interrogator for the secret police, came to be named "körmös Bauer" (Bauer the denailer). As noted in section 6.2 of this book, "The Disappearance of SZDSZ", this expression was taken up by the Hungarian parliament in September 2000 and focused on the issue of the "torture" inflicted by Miklós Bauer during his time as a secret police interrogator. Thereafter, Tamás Bauer became the target of political attacks on the internet as "son of the denailer Bauer". As a practical matter, there is no testimony that "denailing" was used as a means of torture, and Marosán seemed to have used this phrase simply to capture the cold-bloodedness of the interrogators at the time.

⁴⁶ "Farkas's oral record", 274.

⁴⁷ Throughout 1962, the Hungarian Socialist Workers' Party investigated illegal prosecutions and purges which had taken place under the Rákosi dictatorship in order to show a break with the political cult which had surrounded Rákosi. The regime found Rákosi, Gerő and (Mihály) Farkas responsible and expelled them from the Party (Central Committee, August 14–16, 1962). Kádár and Marosán were on good terms, but in the process of preparing this resolution, Marosán objected to Kádár. He did not approve of the content of the resolution, and this led to his dismissal from his position as Politburo member and Central Committee member at the autumn party congress (November 20–24, 1962). Marosán's statement is documented in a study that covers the entire period from the post-Hungarian uprising to the regime change of 1989. See Gábor Tabajdi and Krisztián Ungváry, *Elhallgatott múlt, A pártállam és a belügy – A politikai rendőrség működése Magyarországon 1956–1990* (Budapest: 1956-os Intézet and Corvina Kiadó, 2008), 99. In the course of the investigation of this period, Kádár was said to have discarded many of the ÁVH-era records in which he was involved.

Thus, the former Social Democratic Party leaders were purged in Hungary, and the dictatorship of Rákosi's individual power, i.e., the communist dictatorship was consolidated.

8.1.4 The Madness of Stalinism

In the process of establishing the personal dictatorship of Rákosi, the role played by Kádár and other close politicians, including Gábor Péter and Péter's right-hand man, Ernő Szűcs who controlled the secret police, as well as Miklós Bauer and other interrogators, was decisive. However, after the Social Democrat politicians had been purged, the target of Rákosi's quest to consolidate power became key officials within the secret police. This obscured the issue of the responsibility of individual parties in the process of establishing the Rákosi regime.

In October 1950, shortly after the torture and death of Minister of Justice István Ries, deputy director of the secret police (ÁVH) Ernő Szűcs was arrested along with his brother Miklós Szűcs. The arrest was led by Rákosi. The arrest of Szűcs, who had commanded an execution squad ranging from the Field arrests to Rajk executions, completely froze the secret police. His wife was a Russian who was working for the secret police, and now Szűcs, the man who knew everything, had been arrested for being an "American spy". If there was one concern, it was the allegation that Szűcs's younger brother Miklós had defected to Britain during the war and might have become a British intelligence agent. Based on that pretext, a plan was planned by Rákosi to bring charges according to which the Szűcs brothers had organized a network of Western European spies within the political police.

During the course of the interrogation, Szűcs denied all the allegations, and no evidence was produced to support the charges. Therefore, Rákosi instructed Gábor Péter to take a written self-criticism. Szűcs wrote a detailed report.⁴⁸ After reading this report, Rákosi gave Gábor Péter instructions to torture Szűcs. The sturdy and strong Szűcs brothers suffered cardiac arrest less than an hour after the torture session began. The torture was said to have been carried out with a leather cudgel and a cigarette. Gyula Princz, who was directing the torture, hurriedly informed Péter in the director's office of the change the prisoners' conditions, and a doctor in the office apparently administered a cardiotonic (or poisonous) drug, but the Szűcs brothers did not come back to life. The incident was immediately communicated to Rákosi and the Soviet advisory group. Rákosi seemed a little irritated, but he never mentioned the murder of

⁴⁸ Some of the reports written by Ernő Szűcs are included in Tibor Huszár's book *A pokol malmai – Szűcs Ernő ÁVH-s ezredes ügye és elágazásai 1946–1955* (Budapest: Corvina, 2009). The book also contains the autopsy findings and a list of personal assets found in the raids. A considerable quantity of precious metals and luxury watches were seized. Szűcs may have had gotten these valuables as rewards for being an intelligence officer in the Soviet State Security Ministry.

the Szűcs brothers again. The deaths of the Szűcs brothers were put away without any questions being raised.⁴⁹

Some studies have suggested that Ernő Szűcs was targeted for the purge as a direct result of the return of the Szűcs report prepared in July 1949 to Rákosi. The report was originally sent to Minister of State Security Abakumov with Belkin's approval in connection with the Rajk incident.⁵⁰ In 1950, Abakumov's influence waned and Beria was preparing to purge Abakumov. If so, it is likely that the Beria faction of the Ministry of the Interior returned the Szűcs report to Rákosi in order to expose the Abakumov-Szűcs relationship. As previously mentioned, Szűcs's report stated that "Rákosi is preparing provocative actions against Yugoslavia". Although Szűcs held the position of deputy chief of staff, assisting Secretary Gábor Péter, he had sole responsibility for carrying out the actual arrests, interrogations and torture, and the power of execution was in his hands. At the same time, Szűcs was also an intelligence officer in the Soviet Ministry of State Security, reporting on the movements of the Hungarian political leaders, and he was under the direct command of Minister of State Security Abakumov. Although Rákosi had not previously had information on Soviet State Security Ministry agents in the Hungarian secret police, it is likely that he decided to purge Szűcs once he discovered that Szűcs was an agent of the Soviet State Security Ministry.

Aiming to take advantage of the temporary return of his younger brother Miklós Szűcs, who was working in London as an engineer, to Hungary, Rákosi arrested the

⁴⁹ Szűcs's remains were thrown into a ditch along the highway. Mrs. Szűcs, a Soviet citizen and a secret police officer, followed her colleague's advice and walked down the side of the highway. She found her husband's body there and learned the consequences of the incident. Huszár 2009 compiles documents and letters related to the Szűcs murders.

⁵⁰ In July 1949, Vladimir Farkas heard directly from Szűcs that a report signed by Gábor Péter was sent to Abakumov according to which "Rákosi is preparing provocative actions against Yugoslavia" (see note 32 of this chapter). Péter, who did not understand Russian, only signed it, and it is assumed that it was initiated by Belkin and prepared by Szűcs.

However, it is not clear whether the report was indeed returned to Rákosi, whether the existence of the Szűcs report was orally communicated to Rákosi by a person in the Soviet State Security Ministry, or whether someone revealed that Szűcs was a Soviet State Security Ministry intelligence officer and Hungarian representative of the Soviet Security Ministry. A copy of the report was really returned to Rákosi (January 2, 1953) by Beria, who demanded the arrest of Gábor Péter. Therefore, it is hard to believe that the same report was returned to Rákosi on two occasions. However, Rákosi may somehow have gotten the information that Szűcs was an intelligence officer of the Soviet Ministry of State Security with direct access to Abakumov, which undoubtedly provoked Rákosi's anger. It is possible that Rákosi moved to purge Szűcs before the Soviet side moved to dispose of Rákosi based on the Szűcs report. Rákosi would have believed that purging the Szűcs would not result in a purge of Rákosi himself. He was comparatively safe because of his direct protégé relationship with Stalin. The only way for Rákosi to escape becoming a target of a purge himself was to show perfect loyalty to Stalin.

Nowhere in the voluminous *Memoir* (see note 87) written by Rákosi during his de facto imprisonment in the Soviet Union is there any mention of Ernő Szűcs. It is as if he never existed. As this case shows, the memoir is a Rákosi-centric narrative that ignores from the outset the matters that were inconvenient or embarrassing to him.

Szűcs brothers at the same time. Suspicion cast on Ernő by the contention that his young brother Miklós might be a British spy was used by Rákosi to his advantage. When Rákosi learned that Szűcs was under Abakumov's control and had reported the movements of his officers, including Rákosi, to the Soviet State Security Ministry, he ordered that the Szűcs brothers be arrested, and he had them mercilessly tortured.

After the murders of the Szűcs brothers, the target of Rákosi's purge shifted to the old domestic group of Communists. In late 1950 and early 1951, a series of arrests of old Communists (politicians who had played a role in the March Front movement, such as Ferenc Donáth and Sándor Haraszti) were made. Those who were arrested by the political police several times but who were soon released were condemned for allegedly having served as spies for the police during Horthy's regime. Those who had been forced to dissolve the Communist Party in the 1940s during the storm of Communist Party repression, those who actively agreed with the dissolution, those who led the dissolution of the party, and those who had many arrests on their record became targets of the purge. At the end of a series of arrests of the domestic group, Kádár was also arrested. The reason for his arrest was that he had been arrested several times during the war but had always been quickly released, which was alleged to be evidence that he was a spy for the political police of the Horthy regime.

On April 21, 1951, Kádár was on his way to the party headquarters after lunch at home when he was stopped by a car with Gábor Péter in it. Péter told Kádár that he was under arrest and he detained him.⁵¹ Kádár was locked up in the secret ÁVH house on Virányos Street in District XII, along with Gyula Kállai, a member of the political bureau who was arrested at the same time.

Mihály Farkas led the arrest of Kádár, but he left the interrogation to his son Vladimir, an interrogator less than twenty-six years of age, and this wounded Kádár's pride. After the Hungarian uprising, Kádár used the Soviet Communist Party's contention that "the masterminds of the frame-ups in the Rákosi era was Mihály Farkas and his son" to the maximum extent in order to prolong his own political life.

On the other hand, Gábor Péter, who provided Rákosi with crucial information for the arrest of Kádár, convinced Kádár to withdraw his retraction of a confession and to sign it again, just as Kádár had forced Rajk to confess. No one knows what conversa-

⁵¹ By this time there was a widespread fear that everyone would be subject to a purge. Twenty days before Kádár's arrest, Sándor Zöld, a member of the political bureau of the Workers' Party and minister of the interior, committed suicide after killing his two children, his wife and his mother with a hunting rifle at his residence on Benczúr Street. After Rákosi had criticized Zöld's work in the Ministry of Interior and had left his seat at the morning Politburo staff meeting, Zöld submitted his resignation and returned home to commit a family murder/suicide. A suicide note was left behind, and Gábor Péter relayed part of the suicide note to Rákosi from a phone at the scene: "There's no meaning in living in these situations anymore." When he told this to Rákosi over the phone, Rákosi reprimanded Péter for being upset and issued a gag order on the matter. Furthermore, Rákosi decided at the executive meeting that Zöld was "an enemy", but no investigation into the incident was conducted. Vladimir Farkas was present at the scene of the family's slaughter along with Gábor Péter, and he heard the phone call to Rákosi ("Farkas's oral record", 333–36).

tions took place between the two men, but after the confession was submitted, Kádár continued to receive polite treatment, including being fed meals delivered from the restaurant according to Vladimir Farkas. In the interrogations at the time, the story that “Kádár was tortured by having his fingernails torn off” used to make Kádár a hero after the 1956 uprising. Kádár was given special treatment in prison.

Later, Gábor Péter staked his survival under the Kádár regime by emphasizing his role as “the benefactor who saved the Kádár’s life from Rákosi, who had demanded the death penalty”. It was because of the guardianship of Kádár that Gábor Péter, who had faithfully carried out all kinds of schemes under the direct instructions of Rákosi, was released after the uprising and was able to live until he died of natural causes.

Of course, the reason why Kádár was not executed was not due to Gábor Péter’s help. Rather, Rákosi had been unable to get the approval of the Politburo of the Soviet Communist Party. In fact, Voroshilov, a Politburo member who visited Hungary, asked Péter whether Kádár was really an enemy or not. Rákosi could not execute a person who had been arrested simply because Rákosi himself had ordered the arrest, because the Communist Party of the Soviet Union was skeptical of the grounds for arrest. Clearly, the internal communist strife in the Soviet Union and Rákosi’s desire to eliminate anyone who knew everything was behind the purges within the political police and the arrest of Kádár.⁵²

The arrest of Kádár was not the end of the series of purges. The last Stalinist madness was still underway.

On July 14, 1951, when the Slánský affair in Czechoslovakia was not yet over, the Soviet Minister of State Security Abakumov⁵³ was arrested. He had lost the power struggle with Beria. After Abakumov’s arrest, his subordinate, Belkin, was also arrested in October. In a similar scenario to the Slánský case, which he himself led, he became a victim. The power struggle within the Soviet secret police significantly delayed the handling of the Slánský case in Czechoslovakia.⁵⁴

As 1951 was coming to an end, Hungary was preparing to celebrate Rákosi’s 60th birthday, imitating the celebrations of Stalin’s 70th birthday. This was the stage for the birth of Small-Stalin in Hungary, and the whole country was abuzz with a gift-giving competition for Rákosi in schools and workplaces. On March 8, 1952, a grand birthday

⁵² The arrest of Gomulka was contemporaneous with the arrest of Kádár.

⁵³ Abakumov (Viktor Semyonovich Abakumov) (1908–1954) was minister of state security in 1946–1951, and he led the purges in Central and Eastern Europe. He was sentenced to death and executed in December 1954. He was never rehabilitated.

⁵⁴ The dates of the incidents in “Farkas’s oral record” is incorrect. According to this source, the Abakumov-Belkin’s arrest was in December 1952, and this arrest led directly to the arrest of Gábor Péter in January 1953. However, the two arrests are related, but with a time difference of over a year.

Vladimir Farkas writes that relations with Gábor Péter deteriorated to an extreme degree from early 1952. It is supposed that Péter learned of Abakumov-Belkin’s arrest and feared that he would be the target of the next purge. At the time, Farkas was unaware of the information concerning the arrest, and he did not understand Péter’s extreme nervousness.

ceremony⁵⁵ was held at the National Opera House in Budapest. Prominent artists and scientists attended the ceremony. Among them was Zoltán Kodály. The cult of individual worship in Hungary had reached its peak. This was the reality of the transition from a people's democracy to socialism. It was only a year before Stalin's death.

1952 was the year in which Rákosi's cult reached its zenith, but it was also the year in which a new purge was prepared. The trial to expose the "Zionist, Titoist, Trotskyist" in Czechoslovakia finally began on November 20, 1952, and the trial ended after only eight days. Slánský and ten others who had been sentenced to death were hanged on December 3, 1952.

With the end of the Slánský affair and the end of the purge in Czechoslovakia, a message from Stalin (Beria) reached Rákosi (January 2, 1953). It stated that "Belkin not only confessed to being an American spy, but also to having recruited Gábor Péter into the American intelligence service".⁵⁶

Beria issued orders to Rákosi for the arrest of Gábor Péter, and Rákosi invited Péter to his private residence on Lóránt Street on January 3, 1953, allegedly for dinner. Péter was arrested on the spot.⁵⁷ Vladimir Farkas later heard from Gábor Péter that it was the same scenario as the arrest of Szakasits. Mihály Farkas, László Piros (who had been appointed as the Security Police Commissioner to replace Péter), and Boda, the head of the guard, were at Rákosi's residence.⁵⁸ Rákosi shouted, "Enough of the theatrics", and arrested Gábor Péter. Boda handcuffed and imprisoned him in the basement of Rákosi's residence. His wife Jolán Simon was already detained in the basement. They were then transferred to the ÁVH jail on Conti Street. It appears that the decision to arrest them was made not only on orders from Stalin (Beria), but also because Rákosi

⁵⁵ See János Nemes, *Rákosi Mátyás születésnapja* (Budapest: Láng Kiadó, 1988). Nemes was the organizer of the event at that time. An acquaintance of mine who was a schoolboy at the time told me that he was forced to clap in front of a picture of Rákosi in his classroom to honor him. Stalin's socialist fascism=individual worship was transplanted into the postwar Eastern European countries. A scene reminiscent of the pre-war Emperor's State was seen in the post-war socialist countries of Eastern Europe.

⁵⁶ "Farkas's oral record", 372.

⁵⁷ As we have already noted, in the course of the 1949 Rajk affair, with Belkin's approval, Ernő Szűcs sent a letter to Abakumov stating that "Rákosi is preparing for provocative actions against Yugoslavia". Ernő Szűcs, who was found to have been under Abakumov's command, was subject to Rákosi's purge, but the 1949 report was returned by Beria to Rákosi on January 2, 1953. Along with the report, a letter was attached to the communication according to which "Belkin confessed to recruiting Gábor Péter as a CIA spy" and urging "arrest Gábor Péter as soon as possible". When Abakumov had been purged and Slánský had been executed, Beria returned Szűcs's 1949 letter (signed by Gábor Péter) addressed to Abakumov to Rákosi, asking him to purge Gábor Péter. This is the true story of Gábor Péter's arrest. Rákosi was furious with Gábor Péter and ordered that he and his wife be tortured mercilessly. Gábor Péter described this situation in detail in his appeal to the committee of the Hungarian Workers' Party in 1956 (Gábor Péter, "Kérelem a Pártbizottsághoz", 1956. július 10-én). This appeal is included in Gábor Koltay and Péter Bródy eds., *El nem égetett dokumentumok* (Budapest: Szabad Tér Kiadó, 1990).

⁵⁸ "Farkas's oral record", 375.

thought that he could make Péter take responsibility for all the purges. The arrest of Gábor Péter was part of the Zionist-Titoist purge in Czechoslovakia, which targeted the Jewish Gábor Péter and the Jewish ÁVH interrogators. Although the quartet (Gang of Four), including Rákosi, were all Jewish, it is believed that Rákosi actively followed Stalin's wishes to avoid being subjected to the purge himself.

Gábor Péter, Rákosi's right-hand man, who had orchestrated a series of vicious purges, beginning with the arrest of Noel H. Field, followed by the arrest and execution of Foreign Minister László Rajk, the arrest of Szakasits, the massacre of Minister of Justice Ries, the massacre of the Szűcs brothers, and the arrest of Kádár, was finally the target of a purge himself. Along with Péter, his wife and Rákosi's personal secretary Jolán Simon⁵⁹ were also arrested. The last madness of Stalinism was enacted in Hungary by Rákosi. At the same time as Péter's arrest, many political police interrogators were also arrested and detained, including Miklós Bauer and György Szendi, who had been involved in the arrests, interrogations, executions, and murders of Noel H. Field, László Rajk and István Ries.⁶⁰ They were arrested on charges of "taking envelopes addressed to the CIA out of the country ordered by Gábor Péter". Kádár was also in prison. This was two months before Stalin's death. These arrestees, including Péter, were subjected to relentless torture. It was done with a leather club, as usual. Jolán was also beaten during the interrogation. Vladimir Farkas describes how he was present at Péter's interrogation once. At that time, Péter's memory was muddled and he was mentally unstable.⁶¹ The chain of purges, arrests, and torture had been continued endlessly.

Security police interrogators Miklós Bauer and György Szendi were given key posts in state enterprises after the uprising without being pursued for criminal acts in the process of establishing the Rákosi regime by highlighting that they were "victims of the Rákosi regime" because of their arrests by Rákosi. Kádár also tried to escape respon-

⁵⁹ After being released, Jolán sent several letters to Rákosi asking for Péter's release, but she did not receive any response. When Vladimir Farkas was summoned by Rákosi after Péter's arrest, Rákosi said that "You are too naive. Why didn't you know what Péter had done? Write a report on this matter" ("Farkas's oral record", 369–70).

⁶⁰ "Farkas's oral record", 370. Many of the secret police interrogators arrested at this time were Jews. The Soviet Communist Party moved to purge Jewish Communist Party officials and State Security officials because "many Jews joined the Communist Party because of their hatred of Nazism, not because they sympathized with socialism. Therefore, they could be spies for the enemy at any time."

These interrogators were released after Stalin's death. According to Gábor Péter's appeal cited above, he remained in handcuffs all day from January 3 to May 25, 1953. His handcuffs were removed in May 1953, but he was not released. He was sentenced to life in prison in 1954 and was in prison at the time of the uprising in 1956. After the uprising, his sentence was commuted in 1957, and he was released in 1959. In 1993, at the age of 86, he died. He had worked as a librarian. From the 1980s onwards, he gave several interviews, but although he spoke eloquently about the pre-war period, he never talked about his activities during the Rákosi era. The same was true of his wife, Jolán. Exceptionally, he spoke in detail about the circumstances of his own arrest.

⁶¹ "Farkas's oral record", 374.

sibility for the Rákosi purges by claiming that he was a victim of the Rákosi regime by virtue of his arrest. However, he never forgot his own role in the Rajk purge.

An investigation of the victims of the Rákosi era was carried out beginning in 1962.⁶² To the Politburo of the Hungarian Socialist Workers' Party (MSZMP, Magyar Szocialista Munkáspárt, successor to the Hungarian Workers' Party), the Ministry of the Interior reported on the victims (dated January 7, 1964) as follows.

"In accordance with the Politburo's decision of June 11, 1963, an investigation was launched to determine who died and where they were buried in the illegal proceedings that were carried out against the labor movement activists."⁶³

As a result, the following can be determined.

A total of 58 perished, 48 whose burial place could be accurately identified, and 10 whose burial place was unknown; of the 48, 44 were buried in the appropriate location, but 4 were not buried in the appropriate location. At least the following four individuals are proposed for rehabilitation: ... Since we have not been able to find the burial grounds of the ten unidentified persons, we propose to suspend this investigation."⁶⁴

The four men proposed for reinterment were the Szűcs brothers, Gábor Péter's brother-in-law Gyula Lustig (who was arrested and died in prison in connection with Gábor Péter's arrest in January 1953), and Hoffman Oskar Havas, head of the Yugoslavian division of the Security Police, who was arrested in December 1950 and executed after being sentenced to death in February 1951. Miklós Szűcs and Hoffman Oskar Havas were indeed rehabilitated, but no proceedings were held for Ernő Szűcs⁶⁵ or Gyula Lustig.

⁶² As part of this process, the interviews of Rákosi, who had been in exile in the Soviet Union, and Gerő were done by the Hungarian Socialist Workers' Party. Rákosi's hearing took place in the Soviet Union on July 17, 1962, and Gerő, who had returned to Hungary in 1960, was interrogated in Budapest in August 1962. In Rákosi's case, the hearing related to the purges of the 1950s was conducted as a condition for reviewing his return to Hungary. This interview record (with audio recording) was published in 2013 (*Lehallgatott kihallgatások – Rákosi és Gerő pártvizsgálatának titkos hangszalagjai 1962* [Budapest: Napvilág Kiadó, 2013]). There are some interesting factual statements, but the whole thing is a lot of self-defensive statements.

Rákosi defected to the Soviet Union immediately after his dismissal as general secretary in July 1956, but he was not allowed to return to Hungary until his death. Gerő went into exile in the Soviet Union on October 29, 1956, as the Hungarian uprising intensified, but he returned to Hungary in 1960. However, Kádár did not allow Gerő to return to politics. Gerő, on the other hand, considered Kádár a revisionist. Rákosi died in the Soviet Union in 1971, and Gerő died of a heart attack in 1980 at 82 years of age. Rákosi's ashes were secretly buried by his family in the Farkasrét cemetery in Budapest, but the markings for the grave were vandalized so many times that all the markings were removed from the box that held his ashes.

⁶³ These victims were only from the purges in the period from the end of the war to Stalin's death, and did not include the victims of the uprising in 1956.

⁶⁴ The decision was included in Huszár 2009, 285–86.

⁶⁵ Ernő Szűcs, an intelligence officer in the Soviet Ministry of State Security and a former deputy director of the Hungarian Security Police, may have been deemed unworthy of rehabilitation.

The reality of “people’s democracy” and “people’s democratic revolution”, hailed as a new “revolution” by the postwar Communist parties and used positively by historians, was in effect a transplant of Soviet-style socialism. In the process, socialist fascism, tainted by Stalinism, raged on. It was extremely cruel and tragic, as we have seen in this section. A review of the process of the formation of postwar socialism offers a more nuanced understanding. The same can be said of self-managed socialism, which was advocated as an axis of opposition to Soviet-style socialism. We must not neglect to review the collapse of “self-managed socialism” and analyze the situation in the former Yugoslav countries and the relationship between this situation and the Yugoslav concept of socialism.

8.1.5 Liberation from Stalinism

In March 1953, Stalin’s death was announced and Rákosi lost his ultimate backer. The power struggle in the Soviet Communist Party began, and Hungary was once again at the mercy of the Soviet Communist Party.

According to Vladimir Farkas, there was a sense of anxiety about what might happen to the socialist world after Stalin’s death, but there was no significant change in daily life. However, the failure of the economic policies of the Eastern European countries, which became more pronounced throughout 1952, could not be ignored by the Soviet Union. The Soviet Union had to avoid a major uprising against Soviet rule. Smaller uprisings in Germany, Poland and elsewhere and the growing sense of discontent among the peasants due to poor agricultural production in Hungary were troubling the Soviet Communist Party. Added to this was the death of the absolute leader, Stalin. A change in economic policy and the reform of the party organization became essential tasks.

Initially, the Soviet Communist Party invited Rákosi to come to Moscow in May 1953, believing that this would suffice to keep Hungary in line. After a brief consultation, Rákosi returned to Hungary, where at a meeting of the Secretariat, he acknowledged the mistakes made by the party leadership and the pile of economic problems that could not be ignored, and he discussed the need to reorganize the party. At that time, the separation of the general secretary of the Party from the prime minister was also discussed. On receiving reports of these discussions, the Soviet Communist Party, sensing that Rákosi was open to reform but hesitant to make fundamental changes, decided to invite representatives of the Hungarian party to Moscow. These were the two party talks between the Hungarian Socialist Workers’ Party and the Communist Party of the USSR on June 13–16, 1953.⁶⁶

⁶⁶ The Hungarian minutes of the two-party talks dated June 18, 1953 were prepared by the secretary general of the Council of Ministers, Béla Szalai. Later, on November 27, 1957, Kádár ordered that the document be designated as confidential. Four copies of the minutes were published in the summer of 1990 and kept in the Archives of the Institute of Political History. Then, according to the 1991 law, the copy was transferred to the Hungarian National Archives. The document is currently available online (<http://www.rev.hu/sulinet45/szerviz/dokument/jegyzokonyv.htm>).

The Hungarian participants in these two-party talks were Rákosi, Gerő, Imre Nagy, András Hegedüs, István Hidasi, Béla Szalai, Rudolf Földvári and István Dobi. Mihály Farkas and József Révai were removed from the delegation for political errors during the Rákosi regime.⁶⁷ On the Soviet Communist side were Malenkov, Beria, Khrushchev, Bulganin, Mikoyan, Kiseljev, and Boykoff.

The minutes of the two-party talks clearly show that the Soviet Communist Party side was in a position to dictate the policy and composition of the Hungarian Workers' Party. The problems pointed out by the Soviet side were as follows.

(1) Hungary's rapid agricultural collectivization had created many problems. Withdrawal from collective farms should not be forcefully prevented, and it was wrong to set excessive production quotas. Measures needed to be taken to increase the efficiency of collective farming.

(2) In promoting industrial production, the agricultural sector was overwhelmed. The regime should aim for balanced development of industry and agriculture.

(3) It was not appropriate for Hungary, which had a population of 9.5 million, to have 1.5 million people under investigation. The Security Police (ÁVH) did not appear to be functioning efficiently. The ÁVH should be integrated into the Ministry of the Interior.

(4) Rákosi must stop intervening directly with the secret police and the Ministry of the Interior. The beating and death of two people (I note, presumably the Szűcs brothers) at the hands of the ÁVH had been a serious mistake. "The mistake that Stalin made, Rákosi also made".⁶⁸ Any act that leaves one person to decide who to beat can only create fear.

(5) The roles of the head of government (prime minister) and the head of the party (general secretary) must be separated. Rákosi should hand over the prime ministerial position to Nagy. If Nagy were to become prime minister, Rákosi could remain as general secretary.⁶⁹

(6) The army needed to be modernized and reduced in size. 600,000 men (including reserves) was too many. Minister of Defense Mihály Farkas was seen as potentially lacking the knowledge and experience to lead the army. He needed to be trained at the Soviet Academy.

⁶⁷ The Communist Party of the Soviet Union continued to entrust the rule of post-Stalin Hungary to Rákosi and Gerő, who bore the most serious responsibility of the Gang of Four. Political responsibility for the Stalin era was shifted to Mihály Farkas and ideological and cultural responsibility to Révai. This ambiguous handling of responsibility was a remote cause of the Hungarian uprising in 1956.

⁶⁸ Beria's remark. There was a complication within the Soviet Party leadership at the time. Beria, who was serving to communicate Stalin's intentions to Rákosi, criticized Stalin and Rákosi at the two-party talks. These remarks by Beria froze Rákosi in his tracks.

⁶⁹ Ferenc Fejtő wrote that shortly before the central leadership meeting of June 28, 1953, Khrushchev summoned Rákosi and said that he could remain in the post of general secretary. See François Fejtő, *A History of the People's Democracies: Eastern Europe since Stalin* (Penguin Books, 1974), 39.

(7) It was seen as unsuitable that József Révai monopolized control of ideology and cultural aspects.

(8) Collective leadership did not seem to have been established in the Hungarian party. It had been a mistake to remove Nagy, who had criticized the party, from the politburo. Rákosi was not capable of working with others. This had to be changed.

(9) The Hungarian state apparatus was seen as bloated. It did not need to follow the same structure as the state apparatus of the Soviet Union.

This is a summary of the two-party talks of June 1953. The two-party talks, however, were consultations directed by the Soviet side, and the Soviet Union perception that it still had the Eastern European countries in its hands did not change. Having lost Stalin as his guardian, Rákosi had no choice but to comply with the demands of the new Soviet leadership. He was forced to make significant changes in the composition of the government and party leadership at the behest of the Soviet Union. However, Rákosi's righthand man, Gerő, who also served as minister of the interior, was appointed to the role of first deputy prime minister to follow Prime Minister Imre Nagy.

After the two-party talks, a new party leadership and government composition were decided upon by the Central Committee of the Hungarian Workers' Party on June 28. The party's politburo was reduced from 16 to 9 members, Farkas and Révai were removed, and on July 4, 1953, the Hungarian parliament elected Imre Nagy as the new prime minister. The number of ministers was reduced from 27 to 17.

On July 4, 1953, the Hungarian parliament elected Imre Nagy as prime minister. Nagy declared the beginning of a "New Era" (új szakasz), and he called for the curbing of rapid industrialization and reform of the agricultural sector, the acceptance of withdrawal from collective farms, the integration of the ÁVH into the Ministry of the Interior, the prohibition of illegal arrests and imprisonment, and the raising of living standards. The inauguration of Prime Minister Nagy helped ease social tensions. Aspects of social life were finally free, at least in part, from the reign of violent terror.

János Kornai got a job in 1947 at the young age of 19 in the editorial office of the Communist Party's newspaper *Szabad Nép* (Free People), and about two years later, he was appointed to the desk of the economic department. Being appointed to the desk at the young age of 21 was unthinkable even in the party at the time, but the decision was made by senior editorial officials. József Révai, the political officer in charge of the editorial office, criticized the appointment of Kornai, saying aloud that the editorial office

According to Fejtő's information obtained by one of the members of the central committee of the Hungarian party, Beria tried to liquidate the Rákosi group from the party, but Khrushchev stopped the movement and gave Rákosi his confidence. Thus, "from radical change to compromise, appointments was instructed". However, this personnel change had already been decided in the two-party talks, with Beria demanding the separation of the positions of prime minister and general secretary. Therefore, the explanation of the events as a consequence of "sudden compromise" does not coincide with historical fact. Certainly, there was confusion within the Soviet Party after the two-party talk because of Beria's fall from the power. It might be supposed that Khrushchev gave some false information to the Hungarian leaders to explain Beria's fall.

was not a kindergarten, but he did not reverse the decision. The situation was such that a competent young Jewish man was selected for both the party and the government.

Kornai became a party journalist at the very time when Stalinism was raging in Hungary, beginning with the Rajk purge of 1949, but he recalls that he was completely unaware of the purges of the Rákosi era, even at the time of the “New Era Manifesto” in 1953. Kornai wrote that he became aware of the Rákosi-era purge drama firsthand in the summer of 1954.⁷⁰

The Nagy government, which proclaimed the beginning of a new era, sought to break with the Rákosi era, but the old guard, led by Rákosi and Gerő, held key positions in the party and government, and the rivalry between the two groups intensified day by day. In the Rákosi era, dissenters would have been quickly arrested and locked up, but the shift in policy of the Soviet Communist Party, which sought to break from Stalinism, meant that the secret police no longer forcefully detained critics as they had done under the old regime.

The changing times led to intense rivalry within the editorial office of the party’s official newspaper, and an extraordinary general meeting of the editorial office, held over the course of two days in late October 1954, impeached the Stalinist faction within the editorial office and demanded the implementation of the New Era policy and the prevention of the restoration of the Stalinists to power. This was the so-called “Revolt of the *Szabad Nép* editorial office”.⁷¹ The journalists who were later executed in the Hungarian uprising were the main protagonists of this General Assembly.

In response to this move, the Politburo of the Workers’ Party initiated an inquiry into the leaders of the Extraordinary General Assembly and severely criticized the insurrectionary events. At the Politburo meeting of December 1, 1954, a list of persons to be expelled from the editorial office was drawn up. During this time, Rákosi was in Moscow on a spa cure until he returned to Hungary on December 1.⁷² In Moscow, he exchanged views with Soviet Communist Party officials on the state of liberalization within Hungary. The Soviet leadership considered the moves of the Nagy government to be a threat to socialism and decided to support Rákosi instead of Nagy.

In January 1955, the leadership of the Communist Party of the Soviet Union demanded that Imre Nagy exercise self-criticism, and it also condemned the New Era policy, which it was claimed was intended to tilt Hungary to the right. In March of the

⁷⁰ János Kornai, *By Force of Thought* (Cambridge, MA: The MIT Press, 2007), 59–60. Kornai is ashamed to say that he was so blind to the policies of the Communist Party. A feeling of unconditional support for the Soviet Union and the Communist Party, which had freed the country and, in particular, the Jewish citizens of Hungary from Nazism, prevailed among Jewish youths who had escaped the horrors of the pre-war slaughter of Jews. While some have been critical of Kornai’s account, arguing that he could not have been unaware of the torture and purges carried out by Rákosi, many have argued that the unconditional support of Jewish youth for the Communist Party was understandable.

⁷¹ For changes in the atmosphere within the editorial office of the party’s newspaper, see *ibid.*, 67–70.

⁷² It was during this stay in Moscow that Poland’s General Secretary Bierut visited Rákosi and hastened the release of the Field family.

same year, the Workers' Party Central Leadership Conference (Central Committee) was held in the presence of Suslov, and Rákosi criticized Imre Nagy for being responsible for tilting Hungary to the right. Nagy resigned as a member of the Politburo. The central leadership meeting on April 14 expelled Nagy from all party positions for "anti-Marxism, anti-Leninism and anti-party activities", followed by the dismissal of the prime minister at the 18 April parliamentary session and the appointment of András Hegedüs of the Rákosi group as prime minister. The separation of the posts of party general secretary and prime minister was formally maintained.

With the expulsion of Imre Nagy, final measures were taken against the *Szabad Nép* editorial office. Under the Politburo's decision of April 28, 1955, a number of the members of the editorial staff, including Kornai, were dismissed. Kornai was moved to the Institute of Economic Research of the Academy of Sciences in June 1955, which meant a step into the world of academia. As Kornai recalls, these were incidents which would have led to arrests and detention in the Rákosi era, but as expected in the post-Stalin era, coercive measures were avoided and each individual was reassigned to a lower-ranked workplace.

8.1.6 The Liquidation of Stalinism

Thus, from late 1954 to 1955, Rákosi and Gerő came back to the fore of political life in Hungary. The move was a response to the stance of the Soviet Communist Party, which had said that it would not tolerate any deviation from Soviet-style socialism. As it so happens, the fact that some groups around Prime Minister Nagy were considering the revival of multi-party parliamentary politics strengthened the sense of urgency among the Soviet leaders. However, the struggle for leadership within the Soviet Union's Communist Party had intensified since Stalin's death, and a fierce tug-of-war was being played out between those who were pushing for a break from Stalinism and those who believed that the rapid de-Stalinization of the country would endanger the future of socialism.

Following the wishes of the Soviet Communist Party, the Political Bureau of the Hungarian Workers' Party sent a letter requesting Imre Nagy to practice self-criticism, and Nagy sent a letter in which he claimed that he had already responded to this request. However, the Political Bureau rejected (May 4, 1955) Nagy's response as unsatisfactory. At the time, Nagy had suffered several heart attacks, and he indicated his readiness to respond to self-criticism and considered a temporary truce. Thus, small fights were developing between the two parties.

Although their presence in the government had been reduced, Rákosi's and Gerő's power in the party organization remained undiminished, and their ideas remained basically the same as in the Stalinist era. However, once social life began to de-Stalinize (allowing the expression of opinions different from those of the party and the regime), intellectuals, former Social Democrats, and party members critical of the leadership who had previously kept their voices to themselves began to meet actively and work in support of Imre Nagy. These social changes also allowed Kornai to begin his research life and write his doctoral candidate thesis criticizing Soviet-style economic manage-

ment. It is impossible to imagine anything even resembling this being done had it not been for the liberalizing situation of non-Stalinization.⁷³

Imre Nagy prepared a discussion document⁷⁴ that raised the issue rather than exercising self-criticism document as the party had requested. The document was prepared for the party leadership, but when it was published, the ex-*Szabad Nép* editors Géza Losonczy, Miklós Gimes and György Fazekas, who had been expelled from the *Szabad Nép* editorial office, as well as a number of writers and former Social Democratic Party politicians gathered at Nagy's residence. They eventually formed the initial nucleus of the so-called dissidents.

Thus, at the beginning of 1955, Rákosi's and Gerő's momentum increased in Hungary, but the circle of support for Nagy among the intellectuals widened and gradually began to influence domestic public opinion. Rákosi, who had lost Stalin's backing, was the "emperor without clothes" himself, and the position of the first secretary of the Hungarian Workers' Party itself was in jeopardy due to the policy of the Soviet Communist Party to de-Stalinize the party. The Soviet Communist Party was investigating the purges of the Stalin era and had begun to restore the victims' rights. That meant that the investigation of the Rákosi-era purges would eventually come up on the agenda. This became increasingly troubling to Rákosi in 1956.

The twentieth Congress of the Communist Party of the Soviet Union, the first party congress after Stalin's death, was scheduled for February 1956. Prior to this, Rákosi visited Moscow at the beginning of the year and exchanged views with the Soviet Communist Party. Rákosi asked András Hegedüs, who had accompanied him, for his opinion on whether it was time for him to retire.⁷⁵ He felt that the process of rehabilitating the victims of the purge was underway, and that he could not place all the blame for the purge on Gábor Péter, who had already been arrested and detained. Once the investigation into the Rajk case and the rehabilitation of László Rajk began, Rákosi could not be absolved of responsibility. He felt that he was at the end of his political career.

The Hungarian delegates to the twentieth Party Congress of the Communist Party of the Soviet Union (14-25 February 1956) were Rákosi, István Kovács and Béla Szalai. The various reports leading up to the Khrushchev Secret Report were all along the lines understood in the "New Era" declaration and were not problematic for the Hungarian party to accept. However, the so-called "Khrushchev Secret Report" (February 25) in a subsequent closed-door meeting left Rákosi thunderstruck. Rákosi recalls the emotions he felt when he read a copy of the report as reminiscent of the criticism

⁷³ See Kornai 2007, Chapter 5.

⁷⁴ This discussion document is included in Imre Nagy, *Vitairatok és beszédek 1955–1956*, Magyar Füzetek (Paris, 1984). The first edition was printed and published in Paris in March 1957. This was at a time when the Hungarian uprising had already been crushed and the Nagy group was being held in Romania. Árpád Göncz, who later became president of Hungary, handed the draft to a British embassy official and sent it to Paris.

⁷⁵ András Hegedüs, *A történelem és a hatalom ígázatában* (Budapest: Kossuth, 1988), 246.

he received from Beria at the two-party talk in 1953.⁷⁶ As mentioned earlier, he was severely criticized by Beria during the two-party talks in June 1953 for “making the same mistake as Stalin”. Along with the issue of the rehabilitation of the victims of the purges, it was the issue of improving relations with Yugoslavia that troubled Rákosi. Following Stalin’s wishes, Rákosi had been a fierce critic of Yugoslavia and Tito at the forefront of the Eastern European countries. Therefore, Rákosi had to be confronted by Tito with a transfer of power and an exorbitant demand for postwar reparations as a precondition for any improvement in relations between the two regimes.

With no prospect of a future, Rákosi returned to Hungary and held a Politburo meeting on March 1 to report on the Congress of the Soviet Communist Party, but he did not mention a word of Khrushchev’s criticism of Stalin. He was unable to digest the Khrushchev Secret Report. Rákosi’s righthand man Gerő led the discussions in the Politburo on March 1 and in the Central Leaders’ Committee (Central Committee) on March 12. Gerő took over Rákosi’s report and summarized the problem in three points.⁷⁷

(1) We need to change the way the party is led. It is necessary to establish a relationship in which a large number of leaders with equal authority can have discussions with one another, and it is necessary to put the younger generation in the leadership, free the Social Democrat leaders who have been put in jail by April 4, and at least reinstate György Marosán to a leadership position in the party.

(2) The Soviet Party Congress decided to raise the living standards of the people, but this is difficult to do in Hungary without increasing efficiency and labor discipline through technological modernization.

(3) The revitalization of the People’s Front should generate lively debate within the Party and with intellectuals.

According to Gerő’s summary, the Soviet party congress sought to end the post-Stalin process, and the task of the Hungarian party was also summarized as strengthening economic leadership, the early rehabilitation of purge victims, the establishment of the rule of law, an end to the cult of individual worship, and a return to collective leadership.

⁷⁶ Mátyás Rákosi, *Visszaemlékezések 1940–1956*, vols. I–II (Budapest: Napvilág Kiadó, 1997), 998. The day after the secret meeting on the 25th, which was held without foreign party representatives, the Hungarian delegation was preparing to return home. There, a member of the staff of the Moscow Committee of Soviet Communist Party in charge of Hungary brought two copies of the secret report. After taking a glance at it, Rákosi asked if he could take it back to Hungary, and when he was told that he could not, he spent two to three hours translating and dictating it to Béla Szalai, who wrote it down in shorthand.

⁷⁷ István Feitl, “Szembesülés. Az MDP vezetői és a XX. Kongresszus”, *Múltunk* 2 (2006): 207–9.

Another important point was a statement made by Kádár,⁷⁸ who had been released the year before and had returned to the central leadership. Kádár pointed out that none of the party's issues raised by Gerő had been resolved, and he held Mihály Farkas politically responsible for his actions. At the time, Farkas was in Czechoslovakia for training at the Soviet academy and a subsequent spa treatment, and he was not present at the Central Leadership Meeting. In a trial in absentia, Farkas was held accountable, and the Politburo decided to set up a committee to investigate Farkas' responsibility. However, it is impossible to shift the responsibility for the purges to Farkas without holding Rákosi accountable. The reason why Kádár insisted on condemning Farkas was because it was Mihály Farkas and his son Vladimir who spearheaded his own arrest and interrogation. Gerő and Révai took Kádár's allegation as an emotional rebuff, but for Rákosi, shifting the responsibility of the purges to Farkas was not a bad option. However, it was also clear that if Farkas were to be put on trial, Rákosi himself would not be able to escape responsibility for the Rajk case.

Rákosi and Gerő again requested the intervention of the Communist Party of the Soviet Union in the face of the difficulties in bringing the party together. They requested Yurii Andropov, the ambassador to Hungary, to send Suslov to Hungary (May 11, 1956). Suslov's visit to Budapest, which took place from June 7–14, did not stabilize the leadership of the party. At the time of this visit to Budapest, Tito was in Moscow for talks on improving relations with the Soviet Union. When Khrushchev asked for his opinion on the destabilization of the situation in Hungary, Tito suggested the removal of Rákosi. However, Khrushchev did not accept Tito's proposal, believing that the removal of Rákosi would further destabilize the political situation.

Suslov's visit to Budapest, accompanied by his wife, exposed the Soviet Communist Party's lack of awareness of the critical situation. Suslov supported Rákosi and reported to Khrushchev that there was no crisis to worry about in particular. Suslov also met with members of the Politburo and Kádár to get their views. Many members of the Workers' Party's Political Bureau complained about Rákosi, and Kádár harshly criticized Rákosi, but Suslov remained deaf to these criticisms. Suslov further advised that the Farkas issue not be brought to the Central Leadership Committee. He also told them that if they were unhappy with it, he would not oppose deciding it in court.

In June, the movement of intellectuals within the party became active. On June 7, Imre Nagy's 60th birthday, nearly a hundred intellectuals from inside and outside the party came to his house to congratulate him. This was a demonstration of sorts. On June 18, a meeting of partisans (*partizántalálkozó*) was held including Mrs. László Rajk, the old members of the party and the young intellectuals of the party in Budapest. There, Mrs. Rajk said, "Rákosi's prisons were worse than those of Horthy's regime". She

⁷⁸ Kádár was sentenced to life in prison in December 1952, but he was released in July 1954 in the process of rehabilitating those who had been purged and wrongfully arrested, a process which began after Stalin's death. He had served as party secretary in Budapest's District XIII since October 1954 and first secretary of the Pest County Committee since September 1955, before returning to the Central Leadership Committee.

asked for help punishing the murderers. Erzsébet Gergely, who had a history of being an illegal Communist Party member, “demanded the removal of Rákosi and Gerő.”⁷⁹

Amidst growing discontent within the party, Rákosi attended a secret meeting of the party’s general secretaries in Moscow on June 22-23, where he is said to have presided over a rotating chairmanship. At the banquet on the 23rd, it is said that he criticized himself to Voroshilov as “the last Mohawk of Stalin School.”⁸⁰

On June 27, the Petőfi Circle⁸¹ held its first public debate (Sajtvita)⁸² at the Tiszti Ház conference hall on Váci Street. The debate started at 7:00 pm. The hall was full as of 4:30 pm, and people were unable to get in. Rákosi issued a directive for the party to hold the venue in an attempt to cancel the meeting, but when the officials arrived on the scene at 6 pm, there were too many people even to get inside.

The success of the public debate on June 27 surprised the party leadership. It was the first time since the Communist Party had come to power that a rally without the involvement of the Party leadership had such an impressive turnout. Moreover, the riots in Poznań, Poland the following day, June 28, shook the party leadership. They felt a sense of urgency and began to fear that the spontaneous acts of the masses were shaking the system. At a hastily convened Central Leadership Committee on June 30,⁸³ Rákosi criticized the gathering for Nagy’s 60th birthday and the Petőfi Circle public debate as manifestations of a counterrevolutionary movement, and he cited the Poznań riots as further evidence of this movement. The Central leadership Committee expelled Tibor Tardos and Tibor Déry, the organizers of the public debate, from the party, but many members of the committee did not think that would solve the problem, and many reportedly questioned the expulsions.

At the time, Rákosi was said to have drawn up a list of hundreds of arrests in an effort to dispose of party intellectuals who criticized the leadership, but Rákosi, who had already closed the door to intervening in the state security police, had no power left to carry out a purge. On the contrary, the forces in support of Rákosi in the Politburo as well as in the Central Leaders’ Committee were tapering off, and Rákosi himself was increasingly isolated. It was almost impossible for him to escape his responsibility for the Rajk purge. Gerő therefore decided to obtain the consent of the Soviet Communist Party for Rákosi’s resignation, so he asked Ambassador Andropov to send a key figure of the Soviet Communist Party to Hungary.

⁷⁹ Árpád Pünkösti, *Rákosi bukása, száműzetése és halála, 1953–1971* (Budapest: Európa, 2001), 388.

⁸⁰ Ibid., 387.

⁸¹ The Petőfi Circle was founded in 1955 as a debate circle within the party’s youth organization (DISZ, Dolgozó Ifjúság Szövetsége), but its existence was not made public until March 1956. Between March and autumn of that year, 12 debates were held, but the debate on June 27 was the largest free debate of the postwar era, with thousands of people scattered around the hall and continuing to debate vigorously until the next morning. These activities gave the appearance of a spontaneous uprising of party intellectuals.

⁸² The minutes of this public debate were compiled by Iván Pető in 1986 and are now available online at <http://beszelo.c3.hu/cikkek/a-petofi-kor-sajtovitajanak-jegyzokonyve>.

⁸³ Levente Sipos, “Nagy Imre ‘pártügyéről’”, *Múltunk* 4 (2006): 140.

The party's internal affairs at this time were controlled by Ernő Gerő and István Kovács, the chairman of the Farkas Investigative Committee. The letter written by Gábor Péter in prison⁸⁴ had already been translated into Russian and given to the Soviet side.

On July 12, Khrushchev decided to send Mikoyan to Hungary, and he instructed him to stabilize the situation there. When Mikoyan arrived in Budapest on July 13 and met with Rákosi, he told him that "the Executive Committee of the Communist Party of the Soviet Union decided that Rákosi should resign as First Secretary of the Party and hand over the post to Hegedüs". However, Gerő and the other members of the Politburo thought that the inexperienced Hegedüs was not suitable as the first secretary and that either Gerő or Kádár would be the best choice. Gerő had thought he would be nominated for the position.

Mikoyan informed Rákosi of his ouster, but he did not necessarily insist on Hegedüs and took the attitude that Rákosi's succession should be left to the decision of the Politburo of the Hungarian Workers' Party. On July 14, the Politburo chose Gerő as Rákosi's successor. Mikoyan accepted the Politburo's decision, although he implied that he would prefer a new generation of politicians to take over by hinting at support for Kádár. However, there were also members of the Central Leaders' Committee who questioned the succession of Gerő, and the mood seemed to be that the Gerő's political life would eventually be short.

At a Central Leaders' Committee meeting held on July 18–21, 1956, Rákosi announced that he was "resigning as first secretary due to illness". Rákosi stuck to his illness as the grounds for his resignation. He also hoped to obtain an honorary position, such as chairman, but neither the Politburo nor the Central Leaders' Committee were willing to propose anything like this, as it was feared that it might cause trouble for the Party in the future. The news of the resignation of the Little Stalin in Eastern Europe was headline news all over the Western European media.

The report of the Farkas investigative committee was scheduled for this meeting. However, Farkas had prepared a written plea⁸⁵ for the Central Leaders' Committee. The investigative committee considered it necessary to take Farkas to trial and condemn him. However, Mikoyan instructed that if the case were to go to trial, the Farkas plea would become public and would provoke a new dissident movement, and he therefore suggested that Farkas should simply be expelled from the party. Mikoyan met with

⁸⁴ A letter sent by Gábor Péter to the party leadership, dated July 10, stated that Rákosi and the Soviet advisers had conspired to carry out the Rajk purge. Although this was almost an open fact, Gerő and Kovács delivered the document to the Communist Party of the Soviet Union (through Ambassador Andropov) in order to obtain approval for the removal of Rákosi.

⁸⁵ This written plea was kept confidential until the system transformation began. After the transformation, it was published in 1989 in the social theory journal *Századvég* (1–2 [1989]: 59–77). Originally, the Farkas Investigative Committee was set up to save Rákosi from the Rajk purge case, but it became a body with a merely nominal existence after Rákosi resigned. Farkas was not brought to trial at that time, but after the 1956 uprising and the establishment of the Kádár government, Mihály Farkas and his son Vladimir were brought to justice.

Farkas and persuaded him to withdraw his plea and to make a brief statement of self-criticism at the Central Leaders' Committee. Farkas wanted a position in the Soviet Union as a condition for his withdrawal of plea, and Mikoyan promised he would get one, but he never actually did.

Mikoyan left for Yugoslavia with a souvenir of Rákosi's resignation.⁸⁶ Rákosi and his wife flew to the Soviet Union in a government plane early in the morning of July 26. He took only a few trunks with him. He left instructions to repaint the walls of his private residence, as he was going to be in Yalta for a spa treatment. He intended to come back to Hungary, but he never stepped on Hungarian soil again.⁸⁷

⁸⁶ Mikoyan arrived on Brioni Island on July 19 and met with Tito. He informed him of Rákosi's resignation and the appointment of Gerő, but Tito vetoed the appointment of Rákosi's righthand man, Gerő. When Gerő was informed of this, he immediately sent a letter to Tito apologizing for the mistakes of the past years and proposing a meeting in the near future. Yugoslavia deliberately delayed its response to the letter and replied on September 11, suggesting a date sometime in October or November. As for the actual date of the visit, they were informed that it would be planned while Tito was resting on the Crimean Peninsula. For details, see "A jugoszláv-magyar kapcsolatok 1953–1956 között", *Klió* 3 (2007).

⁸⁷ Rákosi left behind a 1,000-page long memoir (Rákosi 1997). This was published by Rákosi's brother, Ferenc Biró, in 1996. A draft of Rákosi was acquired at the end of the year, and the Hungarian-language publication was realized in 1997.

It is well known that Rákosi's memoirs exist, and the Hungarian party and the Soviet Communist Party provided a certain amount of support to Rákosi in the belief that having him write down his memoirs would ease his desire to come back to the political arena. On the other hand, Rákosi asked the Hungarian and Soviet parties many times to provide him with various materials to write his memoirs from the pre-war, illegal period, and he received a fair amount of support. The Soviet side gave him a flat with five rooms in Krasnodar which has mild climate and is just 150 km from the Black Sea, which Rákosi liked (1957). There, he began to write his memoirs.

In July 1962, the Hungarian Socialist Workers' Party visited Rákosi for an official interview, and the Party decided to expel Rákosi from the party in August. Accordingly, material for the writing of the memoirs were no longer provided, and Rákosi and his wife were forced to move from Krasnodar to a mountain village (Tokumak) in Kirgizstan. They were able to bring only a quarter of their collection of books with them to their cramped house in a mountain village in a harsh climate.

Rákosi's health had been failing for several years before his death in 1970, and no progress was made in writing his memoirs. He could barely write a letter pleading to be allowed to return to Hungary out of a sense of nostalgia. The memoir was never completed, and the writing of the memoir was completed in a typewritten draft of just over 2,700 pages. After Rákosi's death, L. A. Pahomov, Mrs. Rákosi's son (from her first marriage) and vice-rector of the Plekhanov University of Economics in Moscow, handed over the memoirs and Rákosi's belongings to the Central Committee of the Soviet Communist Party. The Soviet Communist Party translated them into Russian and put some of them on microfilm, and the microfilm was kept in the archive collection of the Marxist-Leninist Institute.

8.2 The Hungarian Uprising and the Kádár Regime

8.2.1 From the Reburial Ceremony of László Rajk to Upheaval

In April 1954, the Hungarian Workers' Party's Rehabilitation Committee (headed by Antal Apró) reported to the Politburo on the principles of rehabilitation and reburial, but actual rehabilitation was slow in coming. As long as Rákosi retained political power, there was no way that the rehabilitation of the victims of the purges during the Rákosi dictatorship could be achieved. The biggest case for rehabilitation involved László Rajk. Rákosi had created the whole scenario of the purge. All party leaders, including Rákosi, knew that rehabilitation in Hungary would not end until this case was dealt with.

In July 1955, a decision was finally made to rehabilitate László Rajk, but no specifics of the rehabilitation process were decided upon. Mrs. Júlia Rajk (Júlia Földi),⁸⁸ who had been released from prison the previous year after having served four full years, was forced to fight in court not only for her husband's full rehabilitation, but also for the fact that she had been deprived of her name and forced to take an alias. She chose to fight uncompromisingly against the disgrace of not only being isolated from her child during her imprisonment, but also having her son given a false name and her being forced to take an alias upon her release.

In 1995, after the system transformation, Rákosi's brother, Ferenc Biró, through the then Hungarian Foreign Minister László Kovács, requested that the Russians hand the memoirs over to him. As a result, the microfilm was handed over by the Hungarian-Russian Embassy in October 1995. Further requests were made to hand over the missing parts of the microfilm, and finally, in 1996, the remaining parts of the memoir were handed over to Biró. This process is described in the lengthy preface to the memoirs by Levente Sípos, who edited the memoirs.

⁸⁸ Mrs. Rajk, née Júlia Földi (1914–1981) was a member of the Communist Party before the war, and she joined the French Communist Party when she lived in Paris in 1936–1939. She then returned to Hungary and joined the illegal Hungarian Communist Party, but she was arrested and released after the war. She became general secretary of the Hungarian Women's Democratic Union (Magyar Nők Demokratikus Szövetsége) in 1946–1949 and the chairwoman of the Union in 1948–1949.

She was placed under house arrest from May 30, 1949, the same day her husband was arrested, and on May 20, 1950, she was sentenced to five years' imprisonment and had to spend time in prison. Her son was placed in a child protection facility under a false name. She was released in June 1954 and rehabilitated the following year. However, she was not informed where her husband's remains were buried.

Júlia Rajk was forced to take an alias (Mrs. László Györk) when she was released from prison, and her son, who had been placed in the party's children's home, was named István Kovács. Júlia had to fight not only for the rehabilitation of her husband, but also for the rehabilitation of her children and herself. The following study documents Júlia's struggle for rehabilitation: Andrea Pető, "De-Stalinisation in Hungary from a Gendered Perspective: The Case of Júlia Rajk", in *De-Stalinising Eastern Europe: The Rehabilitation of Stalin's Victims after 1953*, eds. by Kevin McDermott and Matthew Stibbe (Palgrave Macmillan, 2015), 46–66; Andrea Pető, *Árnyékban: Rajk Júlia élete* (Budapest: Jaffa, 2020).

As soon as Rákosi left Hungary, the party considered the reburial of Rajk and three others. The bodies of Szőnyi and Szalai, who had been executed along with Rajk, and Pálffy, the highest-ranking of the four executed by the military tribunal, had been haphazardly thrown into a pit dug in the forest of Gödöllő. Mrs. Rajk had not been informed where her husband was buried. The party leadership planned a small reburial and led the women to the Gödöllő forest to identify the remains.

On September 27, 1956, the party took the four widows, Rajk, Szőnyi, Szalai, and Pálffy, and asked them to identify the remains which had been excavated. There was no other way to identify their respective remains from the skeletons, but the identification of their respective remains was easier than expected. At this point, the party leadership informed them that the reinterment of these four men would be conducted in the Kerepesi cemetery in the presence of relatives only.

Shocked by the burial situation, Mrs. Rajk decided not to compromise on her husband's full rehabilitation, and she informed the party leadership that she would not participate in the small reinterment ceremony. Puzzled by this, the party leadership agreed to open the reinterment ceremony to the public on October 5, and the reinterment ceremony was scheduled to take place on October 6.

Despite the fact that there was less than a day left to notify the public of the ceremony, a large number of people, said to be between 100,000 and 200,000, gathered around the Kerepesi cemetery for the reinterment on October 6. At the reinterment ceremony,⁸⁹ Antal Apró delivered the eulogy on behalf of the party, and Ferenc Münich delivered the eulogy as a comrade who had fought in the Spanish Civil War. Finally, the reburial ceremony ended with a harsh eulogy by Béla Szász, as a fellow comrade who had also been accused in the proceedings against Rajk, criticizing Rákosi and his abuses of power. Imre Nagy was also present at the ceremony.

The party leadership had been surprised that an unexpectedly large number of people attended the burial ceremony. However, they did not draw any lessons from this.⁹⁰ The Rajk reburial ceremony was the starting point for the mass uprising that followed. After the ceremony, some of the students who had participated in it gathered at the Batthyány-örökmécses (Batthyány Eternal Flame) to protest against the regime: a prayer monument to the spirit of Lajos Batthyány, who had been defeated and executed in the War of Independence against the Habsburgs in October 1849. From this point on, the students became active en mass.

⁸⁹ Live scenes from the reburial ceremony can be seen in the previously mentioned Noel H. Field documentary film. Apró was a member of the Politburo at the time of Rajk's execution and also at the time of the reburial ceremony. Andrea Pető (mentioned in the previous note) contends that this reburial ceremony became the dress rehearsal for the 1956 Revolution (uprising).

⁹⁰ Despite the heightened tensions in the country, the party leadership of Gerő and Kádár went on a week-long visit to neighboring Yugoslavia, starting on October 15. They lacked a sense of urgency. The Hungarian delegation was led by Gerő and consisted of János Kádár, Antal Apró, and István Kovács; they finalized an agreement on 22 and returned to Hungary on 23, but by then, the capital, Budapest, was in a state of turmoil.

MEFESZ (Magyar Egyetemi és Főiskolai Egyesületek Szövetsége, Hungarian Unity Union of Universities and Colleges) was formed in the southern city of Szeged on October 16. Inspired by the example it had set, similar organizations were launched in Pécs, Sopron and Miskolcs. Then, on October 22, a gathering of these organizations was held at the Budapest University of Technology, where a list of 14 demands⁹¹ was issued.

At this time, far away from Hungary, Poland was also experiencing a conflict between the workers who were rising up and the United Workers' Party. In order to settle the situation, the Polish United Workers' Party decided to return to the party leadership in Gomułka, and it began talks to reach a compromise with the masses. Not satisfied with this, the Soviet Communist Party moved its troops to the Polish border to prepare to invade Poland.

On October 23, in solidarity with the tense situation in Poland, some of the students gathered at Bem Square,⁹² a symbol of friendship with Poland. They then joined the students gathered at the Petőfi Statue (Petőfi-szobor) and from there went to the parliament building to demand the appearance of Imre Nagy. When Nagy appeared on the parliament balcony, a whistle of disappointment rang out as he spoke by saying "Comrades!" Nagy's first appearance did not satisfy the protesters.

⁹¹ During the process of preparing the demands, an initial 25-items request was developed, followed by alternatives for points 10, 12, 16, and 17, and finally 14 demands were printed and distributed to participants. Those 14 items are listed below. The list, which was subsequently distributed in various places, was supplemented with the following items: "15. Students of the Budapest University of Technology express solidarity with the workers and youth of Poland; 16. Students of the University of Construction and Industrial Studies establish a branch of MEFESZ as soon as possible and participate in the Youth Parliament on the 27th". A version with a different order of items was also issued. The basic list of 14 demands is as follows.

1. Immediate convocation of the MDP Party Convention and election of new leadership.
2. Government establishment led by Imre Nagy.
3. Hungary-Soviet Union and Hungary-Yugoslavia friendships based on non-intervention and equal rights.
4. The withdrawal of Soviet troops and the conclusion of a peace treaty.
5. Multi-party system by ordinary secret ballot, election of a new parliament.
6. Reorganization of the Hungarian economy involving experts, use of Hungarian uranium ore in Hungary, disclosure of foreign trade treaties, reexamination of the planned economy.
7. Clarification of industrial labor standards based on determination of survival rates, introduction of the autonomy of workers in factories.
8. Reexamination of compulsory production targets, support for individual farmers.
9. Reexamination of all political and economic charges, amnesty and rehabilitation for innocent politicians.
10. Disclosure of the Mihály Farkas issue, investigation of the role of Rákosi, return of Hungarians unfairly detained in Russia.
11. Resurrection of the Kossuth emblem in place of the emblem unrelated to the Hungarian people, holidays and vacation days on March 15 and October 6, new uniforms for military personnel.
12. Freedom to express and publish, similar freedom on the radio, a new newspaper on MEFESZ in that framework.
13. Removal of the monument to Stalin, a symbol of subordination and arbitrariness.
14. Mutual solidarity (http://www.bme.hu/sites/default/files/1956_BME_esemenytortenet_rovid.pdf).

⁹² József (Józef) Bem (1794–1850), a Polish-born Hungarian general, was one of the heroes of the 1848–49 War of Independence.

A group of workers knocked down a monument of Stalin build in 1951 near Hero's Square and took it to the vicinity of Blaha Lujza Square. Another group headed to Hungarian Radio on Bródy Sándor Street, demanding the broadcast of the 16 demands. They were met with gunfire from inside the radio station. This was the first incident of bloodshed. However, they eventually took over the radio station and moved the radio headquarters to the Parliament.

In response to this tense situation, Khrushchev decided to direct the Hungarian garrison troops of the Soviet Union to the city of Budapest to appoint Imre Nagy as interim prime minister (see the next section for a description of how the dispatch of the Soviet troops was decided).

Early the next morning, on October 24, Soviet tank units entered the city of Budapest and stared down the area around the parliament building and in the main square. Firearms confiscated from the military arsenal the night before were distributed to thousands of insurgents in the streets, and barricades were erected at key points in the city to block the tanks. Fierce street battles were fought between Soviet tanks and the insurgents in the center of the city. From the studios of the party's headquarters on Académia Street, the inauguration of Prime Minister Imre Nagy was announced, but a public notice read out in Nagy's name ("At the request of the government, Soviet troops are in charge of leveling the ground") caused the masses to lose faith in him. In his broadcasts, Nagy repeatedly stated that he would develop the "New Era" policy declared in 1954, but the fighting did not stop in the city center.

Arriving from Moscow, Mikoyan and Suslov conveyed the decision of the Soviet Communist Party to replace Gerő with Kádár. The Kádár speech at 8 pm stated that "mass action is counterrevolutionary".

In the early morning of October 25, Soviet troops recaptured the radio building and reported that "the counterrevolutionary coup has been wiped out," but the unarmed masses rallied to the main points in Budapest and headed for the parliament. Soviet tanks stationed at key points did not fire on the protesters, and at times they even chatted with them. However, when the demonstrators arrived at Kossuth Square in front of the Parliament (around 11 am), a secret police sniper unit opened fire on the demonstrators from the roof of the building (then the Ministry of Agriculture) across the street from the parliament building at a mass of about 5,000 people. This transformed the 1956 uprising into a "bloodbath". At least 100 people are said to have been killed and hundreds wounded, but the exact number is not known.

In response to the bloodshed, Kádár and Nagy issued a series of radio statements, saying, "A small number of counterrevolutionary forces carried out an armed attack. Citizens, disappointed with the situation in the country, sympathized with this. The government's political and economic failures caused this to happen. The party and the government will draw lessons from the tragic events and convene the parliament as soon as possible to ensure order and stability. As Prime Minister, I will begin discussions with the Soviet Union on the withdrawal of Soviet troops, friendly relations between Hungary and the Soviet Union, proletarian internationalism, equality and independence between the Communist Party and the socialist countries."

Some armed groups were persuaded to pull up to the garrison by Pál Maléter, who was sent by the government. On the other hand, “revolutionary committees” were set up in workplaces and schools.

On October 26, the party’s military committee advocated the suppression of the uprising, but Géza Losonczy and Ferenc Donáth demanded negotiations with the group of insurgents. On the other hand, armed groups were formed in various parts of the city. The government declared the amnesty of all the uprisers and asked them to disarm, but they did not. The party leadership continued to discuss the situation to calm the situation, with Nagy taking the lead over the groups advocating military control. He hoped to resolve the situation through talks.

On October 27, Nagy declared the formation of a new government, which consisted of the party’s reformists plus Zoltán Tildy and Béla Kovács of the Smallholders’ Party. He also held lengthy consultations with Mikoyan and Suslov at the Soviet embassy and called for calm with the withdrawal of Soviet troops. Accordingly, Nagy appealed on the radio to lay down arms and call a ceasefire.

On October 28, despite a proposed truce the night before, Soviet troops attacked the insurgents in Corvin köz (Corvin Circle), and this led to renewed fighting. The Soviet tank corps was forced to retreat when the Kilián Barracks, units led by General Pál Maléter and other Hungarian troops, refused to fight against the insurgents. In response to this situation, Nagy made a noon radio broadcast announcing the acceptance of the demands of the insurgents and a ceasefire, and the first parliamentary session of the new government was held in parliament. Following the declaration of a ceasefire, a ceasefire was promised by Pál Maléter and the insurgents, and cooperation between the Hungarian army and the insurgents was created.

In an evening radio address, Nagy announced the formation of a new government and promised the withdrawal of Soviet troops from Budapest, the dissolution of the ÁVH, the reinstatement of the Kossuth coat of arms, and a public holiday on March 15, in which the new government would drop its interpretation of the historical event as “counterrevolutionary” and reassess it as an important moment in a national democratic movement.

That night, Gerő and Hegedüs fled with their families to the Soviet Union.

On October 29, despite the ceasefire agreement, fighting began in front of the Hungarian Workers’ Party Budapest Committee building in People’s Square. Despite the order to disband the ÁVH, 46 secret police personnel holed up in the building and opened fire on the insurgents, disrupting the scene. Rumors spread that this building was the headquarters of the ÁVH and the place where numerous acts of torture had been committed, and many of the insurgents converged on Republic Square. The attack on the building resulted in a number of injuries on both sides. Many of the secret police personnel were shot in the head. Seven secret police officers who were dragged out of the building were lynched by some forces and hanged from a tree along the roadside. Twenty-five secret police officers lost their lives before another group rushed to the scene to stop the lynching. Images of the lynching went around the world and the intensity of the Hungarian upheaval became known. On the other hand, the government allowed the return of banned political parties and prepared to move to a multi-party system.

On October 30, Nagy announced the end of the one-party dictatorship and a transition to a multi-party system based on free elections. In addition, he announced that the insurgents would be welcomed into the government and that Soviet troops would completely withdraw from Hungary. He invited Ambassador Andropov to a meeting of the Council of Ministers to notify him of his withdrawal from the Warsaw Pact Organization. Following the example of the coalition government of 1945, Nagy formed a Provisional National Government, bringing in Losonczy, Kádár, Tildy, and Kovács, as well as Ferenc Erdei (NPP, National Peasant Party) to the cabinet, and he also explored the entry of former Social Democratic Party members into the cabinet.

In the meantime, the groups of insurgents had decided to assemble at the Killian garrison to establish a Revolutionary Defense Committee, and the Ministry of Defense was to reorganize the military leadership and prepare for the withdrawal of Soviet troops.

On October 31, news broke that the Soviet Union had decided to withdraw its troops from Hungary. But by then Khrushchev was already preparing for a new military engagement with Hungary.

In a speech held on Kossuth Square, Nagy declared that he would begin negotiations on the withdrawal of Soviet troops and withdrawal from the Warsaw Pact Organization, and at the same time, the dissolution of the Hungarian Workers' Party and the establishment of a new Hungarian Socialist Workers' Party were declared. István Kovács and László Piros defected to the Soviet Union, following Gerő and Hegedüs.

In addition to the Socialist Workers' Party, the Social Democratic Party, the Smallholders' Party and the National Peasants Party, the Christian Democratic People's Party, the Hungarian Revolutionary Party and the Peasants' Union were formed, and the National Peasants Party was renamed the Petőfi Party. All of Hungary was drunk with the joy of liberation from Soviet rule and the dawning of a new era. However, the Soviet army was already preparing to invade again.

On November 1, the Nagy government was nervous about the Soviet military's movement to invade again and called Andropov for an explanation. However, giving up on the Soviet side's refusal to give a clear answer, Nagy declared Hungary's withdrawal from the Warsaw Pact Organization and asked the United Nations for support to declare a neutral state. Nagy made these declarations in a radio broadcast. The radio broadcast at 10 pm aired Kádár's speech. However, by that time, Kádár was no longer in Hungary.

8.2.2 Hesitation and Decisions of the Soviet Communist Party

On October 24, Soviet tanks invaded the city of Budapest. Battles with Soviet tanks broke out at key points in the city, but according to a ceasefire agreement on the 28th, the Soviet troops withdrew to their garrison. The people of Hungary thought that they had been spared the military oppression of the Soviet army, but on November 4, the Soviet army invaded again.

What kind of discussions and final conclusions were reached within the Soviet Communist Party between the initial military invasion on October 24 and the reinvansion on November 4? The release of the documents of the Soviet Communist Party⁹³ has given us a fair degree of insight into the situation. In this section, I look at the developments of the Soviet Communist Party over a period of about a week, drawing on these documents and the research based on them.

Until the last minute, Khrushchev was cautious about military intervention. However, the struggle for leadership with the conservatives within the Politburo was un-

⁹³ The first is the classified material relating to the 1956 incident, which was handed over by President Yeltsin to then President Göncz (Hungary) in November 1992. This is the so-called "Yeltsin dossier" (*A 'Jelcin-dosszié'. Szovjet dokumentumok 1956-ról* [Budapest: Századvég Kiadó and 1956-os Intézet, 1993]). It begins with Andropov's top-secret telegram of April 1956, before the uprising, addressed to the Soviet Communist Party Executive Committee, and includes reports of key Soviet officials at the time of the uprising, the treatment of the Nagy group after the uprising, and reports and decisions on relations with Yugoslavia (through July 1958).

However, President Yeltsin did not hand over all the relevant materials. Those in the president's circle who had access to the classified material drew a distinction between materials that were to be handed over and materials that were not, and they sold the copyrights to the missing materials through the publishing house they established. The copyright business of the classified material could not be a big business, but it might have produced some money for them. Another collection of material from this route was published as *Hiányzó lapok 1956 történetéből, dokumentumok a volt SZKP KB levéltárából* (Budapest: Móra Ferenc Könyvkiadó, 1993). This collection of material consists of 78 reports and minutes, beginning with Suslov's Budapest Report dated June 13, 1956 (No Crisis in Hungary) and ending with the Minutes of the Intergovernmental Consultations (abstracts) of March 21, 1957. There are about 20 duplicates between the two collections of documents. Móra Ferenc Ltd., which published it under the assertion that it was a missing piece of material handed over to it by President Yeltsin, minces no words about how the copyright was obtained. Ilona Kiss, "A 'Jelcin-dosszié'" (*Beszélő* vol. 5, no. 5) mentions the existence of this puzzling business.

The second was the publication of the so-called "Malin Notes" (a written record of the discussions of the Soviet Communist Party's executive committee). Vladimir Nikiforovich Malin, the head of the General Affairs Department of the Central Committee of the Communist Party of the USSR, took longhand notes of the discussions among the senior members of the party during Khrushchev's period in power. The portions of these voluminous notes relating to Poland and Hungary in 1956 were published in 1996. The Hungarian translation was published as *Döntés a Kremlben, 1956* (Budapest: 1956-os Intézet, 1996). At that time, no minutes of the meetings of the Soviet Communist Party cadres were taken, and the "Malin Notes" is the only source of information on the discussions among the cadres.

An English-language article reviewing these two materials can be found in "Malin Notes" [trans. Mark Kramer], *Cold War International History Project Bulletin* nos. 8–9 (1996–1997): 393–94; Mark Kramer, "The Soviet Union and the 1956 Crises in Hungary and Poland: Re-assessments and New Findings", *Journal of Contemporary History* vol. 33, no. 2 (April 1998): 163–214; Vladislav M. Zubok ("Hatalmi harc a Kremlben és a magyar válság", *1956-os Intézet Évkönyv* 5 [1996–1997]), based on the "Malin Notes", describes the developments in the last week of October 1956.

predictable, and Khrushchev was in a position to be blamed for the political unrest in Poland and Hungary after the Khrushchev Secret Report. If Khrushchev could not control the situation in Poland and Hungary, he would be blamed and the contention would be made that "Extreme de-Stalinization policies have lost control over Eastern European countries, causing Poland and Hungary to move away from the socialist sphere." The dismissal of Rákosi was realized under the leadership of Khrushchev and Mikoyan, and this decision had been made in order to restrain the conservatives as a result of Khrushchev's process of de-Stalinization. If his approach to the circumstances in Poland and Hungary were to prove a blunder, his de-Stalinization campaign would also be defeated.

Khrushchev had hinted at armed intervention in the Hungarian situation in his June meeting with Tito, and he kept the conservatives in check by hinting at the possibility of armed intervention, even within the Politburo. By showing a determination to resolve the issue with force as a last resort if necessary, he was securing the initiative in the Politburo. In fact, as early as the summer of 1956, Khrushchev had already ordered plans to be drawn up for military intervention, and he did not suggest this merely as a pose. In the wake of the Poznań riots, Soviet troops had gathered on the Polish border, and they were ready to launch military intervention. However, Khrushchev did not use military force against Poland and opted instead for a political solution. The assembly of Soviet troops on the border had been an act to demonstrate the Soviet Communist Party's determination while at the same time giving priority to political negotiations until the last minute. Khrushchev had the pragmatic view that, while it would be simple to intervene militarily, the use of force would make subsequent political stabilization difficult. Therefore, against the backdrop of military force, he did his best to find a political solution.

The Soviet Communist Party had the same perception of the situation with regard to Poland and Hungary, but the final settlement came to a different end. Why were political negotiations concluded in Poland and not in Hungary? What was the difference between the two? How was the decision made to use the Soviet armed forces in the case of Hungary?

On October 20, the Executive Committee of the Soviet Communist Party discussed the situation in Hungary and the situation in Poland and decided to send Zhukov (commander, minister of defense) to Hungary, even though military intervention was the last option. At this point, it was confirmed that the situation in Hungary was becoming more urgent than the situation in Poland. The Soviet forces in Hungary had already prepared a desk plan for the invasion of Budapest and were ready to deploy troops at any time to the city and the major cities of the country.

But who called for an invasion by the Soviet army, and when and how did the Soviet side decide to intervene militarily in response to the sudden uprising on October 23? No matter how tense the situation was, the uprising in the streets has just begun. In response to the uprising, a large Soviet army unit was suddenly deployed in Budapest and all over Hungary at once.

According to various sources, when Gerő and his party returned to Hungary from Yugoslavia on October 23, they were in a panic over the uprising that had broken out

in Budapest. Gerő immediately called for military intervention from the armed officer at the Soviet embassy, and when Ambassador Andropov received the message, he asked the commander of the Soviet forces in Hungary, Rashchenko, to move his troops. Rashchenko replied that his troops could not be moved without a decision of the Supreme Council at home, so Andropov delivered Gerő's request to Khrushchev, and Khrushchev called on Gerő to send a formal request in writing. But Gerő did not even have time to prepare a written request, and the Communist Party of the Soviet Union did not wait for a formal written request, but instead discussed the pros and cons of military intervention almost immediately.

On October 23, the majority of the Soviet Communist Party's executive committee supported military intervention, but only Mikoyan took a stance against the decision to the last. He argued that the political choice should be to wait for the Hungarian people to stabilize the political situation on their own. Mikoyan continued to take this stance even after the decision was made to intervene in the second round of military intervention. The executive council, setting aside the principle of unanimity, decided to intervene militarily, with Mikoyan opposed. At the same time, it decided to send KGB chief Serov to Hungary, in addition to Mikoyan and Suslov. Thus, in the early hours of October 24, not only the Hungarian garrison, but also troops from Romania and Ukraine joined forces to invade Budapest and the main city with tanks. A huge force of 31,500 soldiers, 1,130 tanks, 380 mobile artillery vehicles, 185 air defense rifles, etc.⁹⁴ was deployed all over Hungary.

This sudden invasion by the Soviet army caused public hostility against the Soviet and Hungarian leadership. In the street fights with the Soviet troops, many people were killed or wounded, and Mikoyan and Suslov informed Khrushchev that the Soviet invasion had not contributed to political stability. This sudden invasion by Soviet troops was an overreaction to the events on the ground in Hungary. It fueled needless hostility against the Soviet army and the socialist dictatorship. In line with Mikoyan's argument, the Soviet leaders should have bet on the Hungarian government's self-help efforts.

At the Executive Committee of the Soviet Communist Party cadres on October 26,⁹⁵ the conservatives were harshly critical of Mikoyan for not acting properly and surrendering to the enemy. In particular, Molotov, Voroshilov, and Kaganovich intensified their criticism of Mikoyan in order to oust Khrushchev.

At a meeting of the Executive Committee on October 28, Molotov and Voroshilov again criticized Mikoyan harshly, but Bulganin, who had initially reproached Mikoyan, told them not to blame their colleagues for the deterioration of the situation and urged that the discussion should be about what to do next. The options available to the Soviet Union were limited, and with Nagy and Kádár facing pushback from the insurgents, it was decided that they should be left to govern for the time being, step down from

⁹⁴ Zhukov's report of October 24 (*Döntés a Kremlben* 1996, 171).

⁹⁵ At this cadre meeting, Suslov reported the number of casualties from the first Soviet invasion (*Döntés a Kremlben* 1996, 43). He reported 350 killed and 3,000 wounded on the Hungarian side and 600 killed by Soviet troops.

the military movement and return to the line of discussion. This decision should have been taken before the military invasion.

The cautious approach to military intervention was also influenced by the strong opposition of the Chinese Communist Party (CCP) to the stationing of Soviet troops in the Eastern European countries itself. The CCP insisted on equal relations among the states and the Communist Parties, and it expressed strong dissatisfaction with the deployment of Soviet military power. It was also the backdrop for the CCP's active role in the crisis of military intervention in Poland. Liu Shaoqi and his delegation, who had stopped in Moscow to mediate on the Polish issue, were forced to stay in Moscow due to the growing tensions in Hungary. The Soviet Communist Party cadre was so intent on maintaining Sino-Russian relations that it was forced to listen to Chinese criticism. Nevertheless, on October 24, the Soviet invasion of Hungary was launched. Liu Shaoqi was in contact with Mao Zedong and criticized the Soviet Communist Party's response. At a meeting on the morning of the October 30, the CCP still pressed for a clear statement on the withdrawal of Soviet troops from the Eastern European countries and proposed to convene a meeting of the Warsaw Pact Organization to discuss the right of the Soviet Union to remain in the country. Khrushchev, as an individual, was forced to agree to this proposal.

On October 30, the Executive Committee of the Soviet Communist Party was anguished over how to deal with this Chinese demand. Bulganin "agreed to make such a statement", while he insisted that "the Chinese Communist Party has a wrong perception of the situation in Eastern Europe". The hard-liners Molotov and Voroshilov took a compromising stance in issuing a statement that was diluted in content. Commander Zhukov insisted that, if necessary, the troops should be withdrawn from all of Hungary. At this point, a general consensus was reached for Khrushchev to proceed with a peaceful line of settlement, and on October 30, the Soviet Communist Party's Executive Committee met the demands of the Chinese Communist Party and formed an agreement with a view to withdrawing troops from Hungary.

Late on the night of October 30, however, things took a sharp turn. After the executive meeting, Khrushchev held separate talks with Liu Shaoqi and his delegation. The situation in Hungary was reviewed in telephone contact with Mao Zedong, and the lynching on People's Republic Square on October 29 and the proclamation of Hungary's withdrawal from the Warsaw Pact Organization, of which Prime Minister Nagy informed Ambassador Andropov of on October 30, were supposedly discussed. The meeting marked a significant change in the views of the CCP.

Liu Shaoqi was to attend an Executive Committee of the Soviet Communist Party on the evening of October 30 to give a new view of the Chinese Communist Party. He expressed the view that "from the standpoint of proletarian internationalism, we support the stationing of Soviet troops in Budapest and all of Hungary," forcing the Soviet Communist Party leaders who were dithering about military control to reconsider their conclusions of the morning. This decided Hungary's fate. The domino theory that if Hungary left the Warsaw Organization, the impact would be felt in Poland and East Germany was the final consensus of the cadre. The British and French military invasion of the Suez Canal had loosened the political hoops that restrained the Soviet

invasion. In this international situation, the Soviet Communist Party and the Chinese Communist Party shared the view that allowing Hungary to withdraw from the Warsaw Pact Organization would invite a U.S. imperialist offensive.⁹⁶

At the Executive Committee of the Soviet Communist Party leaders on the morning of October 31, Khrushchev said, "If we withdraw our troops from Hungary, we will be subject to the imperialist offensive. There is no longer any other option." The decision was made, and Mikoyan, who returned to Moscow on November 1, insisted that "the decision of October 30 to withdraw the troops was correct" and demanded to reconvene a meeting of the cadres in order to give Hungary between 10 and 15 days. However, Khrushchev was already leaving for Poland and Yugoslavia with Malenkov in tow. Mikoyan protested vehemently and pressed Khrushchev, saying that it would only bring regret, but Khrushchev went on a "pilgrimage" to seek understanding for military control from the communist leaders of Eastern Europe.

8.2.3 Where Is Kádár?

On November 1, 1956, Kádár suddenly disappeared from Budapest. He reappeared in Budapest three days later on November 4. On that day, he arrived in Szolnok from Moscow early in the morning, and from there he boarded a Soviet tank and entered Budapest. Kádár's activities during these days were kept under wraps for a long time, and Kádár himself never mentioned them, but the full story has been revealed with the release of Soviet Communist Party Politburo documents.⁹⁷

Kádár did not go to Moscow voluntarily, but was effectively abducted by the Soviet Union and taken to Moscow. On the morning of November 1, the Soviet ambassador to Hungary, Andropov, invited János Kádár and Ferenc Münnich to the ambassador's residence. The invitation was intended from the start to bring them to Moscow. On the same day, they were taken from the Soviet military base in Mátyásföld through Ukrainian territory to Moscow, where they were to stand at a meeting of the Politburo of the Soviet Communist Party on the following day, November 2.

⁹⁶ While Mark Kramer (Kramer 1998) argues that the change in the situation on the Suez Canal led to the decision to impose military pressure on Hungary, Vladislav M. Zubok believes that the change in the views of the Chinese Communist Party had a great influence on the decision of the Communist Party leadership in the Soviet Union. In any case, there is no doubt that the two factors were decisive.

On the basis of this decision, the Soviet government issued a statement through the TASS news agency (*Döntés a Kremlben* 1996, 200–2). It stated that "the stationing of Soviet troops in Hungary and Romania is due to the Warsaw Pact Organization and the Intergovernmental Agreement, and the stationing of Soviet troops in Poland is based on the agreement reached at Potsdam. (omitted) The Soviet Union owes a duty to the Hungarian people to defend the socialist achievements of these People's Democratic countries." This statement was used as the basis for the November 4 reinvasion to Hungary.

⁹⁷ The content of this section relies on Tibor Huszár, *Kádár – A hatalom évei 1956–1989* (Budapest: Corvina, 2006), 22–25.

Khrushchev was determined to establish a provisional government around Kádár after the military conquest of Hungary. However, things did not proceed easily. When Kádár was summoned to the Kremlin on November 2, Khrushchev was still in Yugoslavia with Malenkov, and the first hearing was presided over by Bulganin, with “Mikoyan and Suslov, who are both familiar with Hungarian affairs,” and “Kaganovich, Molotov and Novosilov, (who are in conflict with Khrushchev)”⁹⁸ participating.

At this time, via a different route, Ernő Gerő, András Hegedüs (former prime minister), László Piros (former minister of the interior) and István Bata (former minister of defense) arrived in Moscow, and they were entrusted with the task of drawing up a policy program to replace the Nagy government. Rákosi, who was in exile in the Soviet Union, presented a petition to the Politburo of the Soviet Communist Party arguing that Kádár was part of the Nagy faction and not suitable to lead and calling for his own reinstatement.

The hearing examined the Hungarian situation, but the conservatives were annoyed that Kádár acted as if he were a member of the Nagy government, and Molotov became a strong advocate of the position that Münnich, and not Kádár, should be the new candidate for the position as leader.

When Khrushchev returned to Moscow on the afternoon of November 3, he immediately joined the meeting and heard Molotov’s opinion and that Molotov favored Münnich, but he was not convinced by Molotov and decided to have an audience with the two men at the same time. At the time, Khrushchev’s opponents in the Political Bureau of the Soviet Communist Party disliked Kádár and had an affinity for party members like Münnich, who had lived in exile in the Soviet Union. What was the reason for Khrushchev’s obsession with Kádár in spite of the strong opposition of the conservatives?

One is Khrushchev’s excellent political acumen. He considered the old Rákosi faction to be unreliable, and he was convinced that they would not be able to govern the country. The second was his shrewd realization that even if only a caretaker government were created, it would not be possible to persuade the people to give it some support without a certain degree of continuity. Kádár, who was a member of the Nagy government, was the right person to show continuity.

These two decisions were correct. Khrushchev, the realistic politician, had shown his ability to control the situation. But Kádár was given a role and function that was contradictory to his role in the Nagy government, and he was forced to deal with this contradiction politically for the rest of his life.

Khrushchev’s decision was unshakable. He persuaded Kádár to accept the role as head of government at the end of the meeting on November 3, which went on and on. Khrushchev persuaded him that it was necessary for the survival of socialist power, and at the end of the interminable meeting, Kádár accepted the role as head of government. Although most Politburo members did not appreciate Kádár, it is also true that there was no other face more acceptable than his, and the conservatives, who made up

⁹⁸ The “Malin Notes” describes in detail the circumstances of the executive meetings of November 1 and 2 (*Döntés a Kremlben* 1996, 69–85).

the majority of the Soviet Communist Party Politburo, seemed to have agreed to let Kádár hold office as a kind of relief player.

Khrushchev's confidence in Kádár was henceforth his only stronghold. In his argument accepting the position as head of government, Kádár criticized the actions of the Soviet Communist Party in the past, saying that the deepest cause of the 1956 uprising was the simple fact that the Soviet Communist Party had given Rákosi and Gerő the privilege of almost unquestioned rule for twelve years. He held this belief for the rest of his life.

8.2.4 Kádár Retention and Nagy Detention

Prior to the reinvasion of Hungary by Soviet troops on November 4, Prime Minister Nagy's group defected to the Yugoslavian Embassy. In the process of this attempt to flee, what went as planned and what did not? Did the Nagy group voluntarily seek asylum in the Yugoslavian Embassy? To what extent was Yugoslavia involved in this plan? If so, what were Yugoslavia's political intentions?

As we saw in the previous section, the basic scenario of military control of Hungary and the establishment of a provisional (puppet) government was drawn up by the Soviet Communist Party. Just as Hungary was about to regain its composure, Khrushchev decided to impose military control on Hungary on October 31. From that day on, Khrushchev went on a covert mission to gain the approval of the surrounding socialist countries. What prompted Khrushchev's decision was his refusal to change the boundaries of the postwar Cold War system. If he conceded to Hungary at this point, Hungary would leave the postwar socialist system and a vacuum would be created in the Soviet Union's satellite countries. For the western camp, the weight of a single country (Hungary) is small, but for the eastern camp, the loss of Hungary would be fatal. The importance of the Hungarian problem differed greatly between the West and the East. This perception of the world situation led to the indifference of the Western governments and the decision of the Soviet Union to conquer Hungary by force.

Khrushchev's actions were swift. For the Soviet Union at the time, it was China and Yugoslavia, both of which were taking their own course in the construction of socialism, that needed to be cared for by the Soviet Union. On November 1, Khrushchev and other senior members of his party politely sent Liu Shaoqi and his party back to China at the airport to fulfill their duty to the Chinese Communist Party and Mao Zedong. On their way, they met with the first secretary of the Polish Communist Party (Polish United Workers' Party), Gomułka, in the border town of Brest to seek his approval for military control. Gomułka acknowledged that the dissident forces in Hungary were growing stronger, but he made it clear that he did not support a military invasion by the Soviet Union. Khrushchev was not successful in persuading Gomułka, but his action of seeking an understanding in advance had the effect of restraining Poland's foreign criticism. Gomułka returned to Warsaw, clarified the issue at a Politburo meeting and issued a statement opposing military action, but he refrained from further public criticism of Soviet military action.

After the meeting in Brest, Khrushchev and his delegation went to Romania. After obtaining the approval of the Romanian leaders and the first secretary of Czechoslovakia, Novotný, who was staying in Bucharest, they flew to Bulgaria. No problems had arisen so far. From there, Khrushchev went to the meeting with Tito, which was the main objective of the trip.

Khrushchev arrived by plane and then a small boat to Brioni, an island in the Adriatic Sea, at 7:00 pm on November 2. Brioni was home to Tito's villa, and Khrushchev and Malenkov were welcomed by Tito, Kardelj, and Rankowitz. The Yugoslav ambassador to Moscow at the time, Mićunović, was also present, and the secret meeting lasted until 5:00 the next morning. From there, Khrushchev returned to Moscow and began to discuss his plans with Kádár on the afternoon of November 3.

Münich and Kádár, who had been selected by the Soviet Communist Party as candidates for the head of the provisional government, had been taken to the Kremlin from Hungary. The operation to control the military was set to begin at dawn on the November 4, and the only problem left was to select the head of the provisional government to coincide with the advance of the Soviet army. What would have happened if Kádár had not accepted the job? The Soviet Communist Party would have set up Münich, and Kádár would have suffered the same fate as the members of the Nagy group. Kádár had no choice if he wanted to survive.

What was discussed on Brioni? The contents of this secret meeting have not been preserved in writing, but there is a transcript of an interview with the Yugoslav ambassador to Moscow who was present at the meeting. There is also a record of an interview with Yugoslav Ambassador to Budapest, who described the process of negotiations with the Kádár government from the acceptance of the Nagy group into exile. From these records, the content of the agreement between the Soviet Union and Yugoslavia and the collapse of the agreement due to changes in the situation become clear.

Before considering these questions, however, it is necessary to know what was going on at the time between Yugoslavia and the Soviet Union and Hungary. The tensions between Stalin's Soviet Union and Tito's Yugoslavia began in 1948. In order to consolidate his power, Stalin began a campaign to expose U.S. imperialism's stooges within the Communist Party and from the socialist countries. As a nation, it was Yugoslavia, which had turned against Stalin's Soviet Union, which was the target of the campaign. Even in Hungary, which had been on good terms with Yugoslavia until then, relations between Hungary and Yugoslavia were at their worst when Rákosi took advantage of Stalin's authority to arrest and execute Foreign Minister Rajk under the guise of exposing U.S. spies and foul-mouthed "Yugoslavian revisionism". Thus, bilateral relations between Hungary and Yugoslavia were at their worst.

With Stalin's death in 1953, Khrushchev began to work on reconciliation with Yugoslavia. Khrushchev visited Belgrade in 1955, and Tito visited Moscow in June 1956. However, relations with Hungary, where Rákosi was in power, remained cold. As already mentioned, when he visited Moscow, Tito insisted that Khrushchev recognize Yugoslavia's right to an independent form of socialism and self-reliance and promote bilateral economic cooperative relations, but he also put another demand on Khrushchev. He insisted that Rákosi resign from power in Hungary. Tito's dislike of

Rákosi was fierce, and in his view, Rákosi was the last Stalinist to reign in Central Europe after Stalin's death. For this reason, he favored Imre Nagy, who had been oppressed by Rákosi, and he hoped that Nagy would replace Rákosi. During this June meeting in Moscow, Khrushchev seemed to hint at the need to deal with the Hungarian situation while keeping Yugoslavia in check by suggesting the possibility of military intervention in Hungary. As previously mentioned, the Soviet Communist Party did not accept the demand for Rákosi's resignation on the grounds that disqualifying him at that point would have given momentum to the anti-socialist camp.

In July, as the situation became even more fluid, the Soviet Communist Party tried to settle it by giving up on Rákosi and installing Gerő, another Rákosi member, at the head of the Communist Party. If power had been transferred to Nagy at this point, the situation would have been different. However, the Soviet Communist Party regarded Nagy as a revisionist and was not eager to give him its support. The Soviet Communist Party wanted to avoid the danger of collusion between Yugoslavia and Nagy's Hungary, which had been poisoned by revisionism.

Yugoslavia harshly criticized the Soviet Union's first military intervention on October 24. Khrushchev, who had hinted at the possibility of military intervention at the Moscow talks in June, needed to have an honest talk with Tito once again to get his final military control agreement. If the Yugoslav army, which had experienced the partisan struggle, were to intervene in the situation in Hungary, it would be the very thing that could bring about a third world war. In fact, the border areas with Hungary were in a state of martial law. It was unlikely that Yugoslavia would give military support to Hungary, but Khrushchev had to be very careful and obtain the approval of Yugoslavia.

On the other hand, as the situation in Hungary has become more chaotic, Yugoslav leaders' assessment of the situation has changed. Tito clearly rejected the multi-party system and the permission to use the Kossuth coat of arms that the Nagy government had announced on October 28-30. The pluralist system of government represented a repudiation of the Yugoslav system of government, while the Kossuth coat of arms was linked to the ambitions of Greater Hungary. Here, Tito gave up supporting Nagy, who lacked the ability to stabilize the situation and was making concessions after concession. This was in line with Khrushchev's assessment of the situation.

At the secret meeting with Brioni, these views were exchanged and further opinions were discussed about the establishment of a provisional government to replace Nagy. The Soviet Union proposed the idea of a provisional government headed by Münnich in place of Nagy, while Tito insisted on establishing a workers' temporary government headed by Kádár. Münnich, who had been in the Soviet Union for a long time, would be good for the Soviet Union, but he would follow in the destiny of Rákosi and Gerő. Tito pushed for Kádár, who had visited Belgrade only a few weeks earlier.

Khrushchev saved face for Yugoslavia by listening to Tito's proposal. This settled the issue of Yugoslavia on the Soviet side, but further talks supposed to have continued over the treatment of Nagy. Since the tops of state were discussing the issue, it is hard to believe that the details of procedure were agreed upon. It is natural to assume that an agreement was reached in principle that Yugoslavia would accept the asylum of Nagy

(the Nagy group). The facts of the Brioni talks were later exposed and the secret talk was criticized as “collusion between the Soviet Union and Yugoslavia,” but, as we shall see, these talks were not of a “collusive” nature.

From the Soviet point of view, the secret talks were a success because the Soviets got a consent to military intervention. Nagy’s treatment was of secondary importance. From Yugoslavia’s point of view, on the other hand, the establishment of the Kádár government and the exile of Nagy to Yugoslavia were of equal importance. As long as the politicians of Nagy government have an affinity for Yugoslav socialism, the exile question could not be ignored at all. However, it was impossible to decide on the specific procedures for Nagy’s asylum in a short meeting of the two top leaders. It could be assumed to be decided that the Yugoslavian embassy would accept the Nagy group as asylum seekers, but there was no finalizing of the procedures after that. However, this had a long lingering effect on the relationship between the Soviet Union and Yugoslavia later on.

The Soviet Union gained confidence in its ability to calm the situation after the military crackdown and turned to refusing to give Nagy asylum to Yugoslavia in order to thoroughly reduce his influence. This was a cancellation of the Brioni Agreement. Khrushchev decided to take the appearance of “exile” not to Yugoslavia, but to Romania, a state which acted entirely according to the instructions of the Soviet Union. For the Soviet Union, Khrushchev himself paid a polite visit to Tito, and accepted Tito’s proposal to retain Kádár. The military intervention was a success, therefore “the Soviet will do what it wants to do as the event was over”. On the other hand, Yugoslavia was left with the feeling that Khrushchev had cheated Tito. Of course, Yugoslavia had no power to intervene in Hungary with the country’s survival at stake, but Khrushchev had once saved face for Tito and then disgraced Tito. Soldatić, the Yugoslav ambassador to Budapest at the time, was said to tell his family repeatedly after leaving office, “We sold Nagy over to the Soviets”. All that remained for Yugoslav leaders was the feeling that the Soviets had played them for fools.

In order to examine the “Soviet-Yugoslav collusion,” it is necessary to know how the Nagy group defected to the Yugoslavian embassy in Budapest, and how it left the embassy. Who first raised the issue of defecting to Yugoslavia (the embassy)? Was it a key figure in the Nagy government or the Yugoslavian government?

According to Paul Lendvai,⁹⁹ fifteen government officials, including Nagy, had neither the intention nor the need to defect, but at the urgent request of the Yugoslav ambassador, they moved to the embassy in a car offered by the embassy in the early hours of November 4, just before the start of the Soviet military crackdown. This explanation supports the so-called “collusion” theory. Lendvai describes that although government officials asked the possibility for defecting their family members to the embassy, there was no request of the government officials themselves to defect to the embassy.

⁹⁹ Paul Lendvai, *Forradalomról tabuk nélkül – 1956* (Budapest: Napvilág Kiadó, 2006), 169–77. Lendvai fled to Vienna in 1956 and became one of the leading figures in the Austrian world of Journalists. He consistently supported the Hungarian Socialist Party after the system transformation and is known as a journalist who has been a harsh critic of the Fidesz government.

On the other hand, according to György Frankovics's review based on Yugoslav diplomatic documents (a special series that appeared in the Serbian daily *Magyar Szó* in October–November 2006),¹⁰⁰ the question of exile in Yugoslavia was proposed by a key figure in the Nagy government. Following instructions from the Yugoslavian government, Yugoslav ambassador to Hungary, Soldatić continued to meet daily with Nagy government officials, and he sent an analysis of the situation to his country. During these talks, two requests were raised by the Nagy government officials. The one was the establishment of cooperation with the Yugoslav military, and another was the arrangement of exile for key figures in the Nagy government to Yugoslavia.

The issue of asylum was not formally raised as a government request until November 2, although it appears that several key figures raised it from time to time in the days that the Nagy government was continuing. Zoltán Szántó, one of the senior party officials, visited Ambassador Soldatić on November 2 to request an official response on the merits of “the acceptance of asylum by the Yugoslav Embassy in a situation where party and government officials are threatened”. This was shortly before the start of the secret talks on Brioni. The official (acceptation) response from the Yugoslav government was communicated to Szántó the next day. If this was the case, Tito would have started negotiations with Khrushchev on the premise that a key figure in the Nagy government would have asked for asylum, and based on the results of those negotiations, he sent the Ambassador an instruction to accept asylum.

The Brioni talks resulted in an agreement to give asylum at the Yugoslav embassy and to the establishment of a temporary government under Kádár. However, the transfer of the exiles to Yugoslavia did not come easily. Negotiations between the Soviet Union and the government of Yugoslavia continued without interruption, but the Soviet Union did not approve of the transfer of the exiles to Yugoslavia. The agreement was in default. Having succeeded in stabilizing the country through armed control, the Soviet Union had to ensure that the provisional government of Kádár took control of the country and never allowed the country to end up in such a mess again. However, the presence of the Nagy group would always be a source of disturbance. There was no way he could be freed in Hungary, but if he was allowed to defect to Yugoslavia, where revisionism was prevalent, the Nagy government could reassert its legitimacy.

¹⁰⁰ The series was compiled in a journal article, György Frankovics, “Vesztégzár a jugoszláv nagykövetségen”, *Honismeret* vol. XXXIV, no. 6 (December 2006): 37–44. Forty-eight people, including government officials and their family members, defected to the Yugoslavian Embassy. Thirty-nine people actually entered the Embassy: nine dignitaries, fourteen wives, and sixteen children, besides nine military personnel and family members who sought asylum in the homes of the Embassy's military officers. Among the defectors were Mrs. Rajk and her young son.

The area around the embassy was surrounded by Soviet tanks, which prohibited traffic to and from the embassy. Tensions were high at the embassy after an incident on 5 November, when a secretary of Yugoslavian embassy was killed instantly by a bullet from a Soviet tank while trying to get a better view of the outside world from a window on the upper floor of the embassy. Frankovics's paper describes the situation inside the embassy at the time, the message from the Yugoslav government, and the tensions surrounding the issue of the exile of the Nagy group.

on his soil. This would have weakened the centripetal force of the socialist camp, led by the Soviet Union. Therefore, the transfer of the Nagy group to Yugoslavia had to be blocked. This was the policy of the Soviet Communist Party as conveyed to Kádár on November 16.

In spite of the Soviet policy, Kádár had to pretend to consult with Yugoslav Deputy Foreign Minister Vidić, who visited Budapest on November 19 in order to address the situation. Kádár said, “The people of the Nagy group who have defected to the Yugoslav Embassy will not be punished for their past actions and will be able to peacefully go home”, and the agreement was signed. Late on the evening of November 21, Ambassador Soldatić and Minister of the Interior Münnich decided that the Nagy group would leave the embassy at “6:30 pm the following evening” as implementation of the agreement.¹⁰¹

On November 22, a transport bus stopped alongside the Yugoslav Embassy and the children willingly boarded it. According to the first secretary of the embassy at the time, “Nagy spoke to the driver, but there was no answer. Therefore, he once got off the bus. The ambassador advised him to stay in the embassy and not to get on the bus, but as if Nagy realized everything, he got on the bus again”.¹⁰²

The previous UN report states that “As the group was boarding the bus, Soviet military personnel arrived and insisted on entering it. Thereupon, the Yugoslav Ambassador asked two Embassy officials also to accompany the group, to make certain that Premier Nagy and the party reached their homes as agreed. The bus was driven to the city Headquarters of the Soviet Military Command, where the two Yugoslav officials were ordered by a Soviet lieutenant colonel to leave. Escorted by Soviet armored cars, the bus then drove away to an unknown destination.” Ambassador Soldatić requested a meeting with Kádár the next morning, which was refused, and immediately sent a letter of protest to Kádár to condemn breaking the agreement, but there was no response. Thereafter, the confrontation between the Soviet Union and Yugoslavia again became more acute.

8.2.5 The Imre Nagy Trial

How was the group surrounding Prime Minister Nagy, who had defected to the Yugoslav Embassy, to be dealt with? This was the first issue Kádár addressed when he returned to Budapest. Kádár initially thought that if Nagy announced his resignation as prime minister and allowed the government to cease to exist, he would accept asylum, while accepting people from the group to cooperate with the new government. It is

¹⁰¹ Huszár 2006, 27–30. The diplomatic negotiations between the Kádár government and the Yugoslav Embassy are described in “United Nation, Report of the Special Committee on the Problem of Hungary, General Assembly Official Records: eleventh Session Supplement No. 18 (A/3592), New York, 1957”, 196.

¹⁰² The preceding György Frankovics paper (44) describes the recollections of First Secretary Georgijević to a Belgrade historian. Nagy might have thought that “it may be a Soviet intrigue, but we can’t bother the Yugoslav Embassy anymore”.

likely that the Yugoslav government also wanted a solution along these lines. In fact, through Tito's mediation, this was becoming a reality. On the other hand, this was not a matter that Kádár could decide solely by himself.

The Politburo of the Soviet Communist Party reached a decision early on November 10 that would decide the fate of the Nagy group. The decision was to "prevent the group from defecting to Yugoslavia". But Kádár was not informed of this decision until just before its implementation, and of course the Yugoslav Communist League was also not informed.

As indicated in the preceding notes, the handling of the guests who the embassy suddenly received was extremely difficult for Yugoslavia. Yugoslavia had sought a way for the Nagy group to sign off on the resignation of the prime minister and recognition of the new government and to gain asylum or return home as soon as possible. However, this approach came to a standstill when the Nagy group refused to do so. Talks between the Soviet and Yugoslavian sides continued intermittently, and discussions between Kádár and the Yugoslav ambassador to Hungary continued on the conditions for their return and assurances of personal safety.

On November 16, when Kádár went to the "occupation headquarters"¹⁰³ in Leányfalu, Malenkov informed him of the Soviet Communist Party's decision on the Nagy group. It was impossible for Kádár to object to it. In response to this decision, Kádár was given the role of luring the Nagy group out of the embassy by making false promises to the Yugoslav ambassador, though he was fully aware of the Soviet Union's plan. Thus, on the evening of November 22, a bus driven by Soviet soldiers was parked at the Yugoslavian embassy. Contrary to the original promise, the Nagy group was taken to the military school, where the KGB headquarters had been set up, and from there they were transferred to Romania.

The news quickly spread through the streets of Budapest, further damaging Kádár's reputation. Thus, the Nagy group became prisoners of the Soviet Union. From the outset, there was no room left for Kádár to intervene in this scenario. Kádár was merely an errand boy for the Soviet Union. The intentions of the Soviet Communist Party were clear from the beginning. The "counterrevolution" in Hungary had to be thoroughly suppressed by any means, and there was no room for compromise. The Soviet leaders believed that if they allowed an easy compromise, the circle of the postwar socialist system in Europe would fall down.

After the handling of the Nagy group, Malenkov returned to the Soviet Union in December, but the Soviet Communist Party strengthened its joint international front to

¹⁰³ The occupation headquarters in Leányfalu, a small town 30 km north of the center of Budapest along the Danube, is a large villa built in 1938 by the son of Antal Sorg, a businessman. The villa, located on high ground, is scenic and was used as a villa for the Hungarian Workers' Party cadres from 1945. After the Hungarian uprising, senior members of the Soviet Communist Party and the military were based here, and in addition to Malenkov, Suslov, and Serov were present at the meeting on November 16. The villa continued to be used as a Socialist Workers' Party villa, but after the system transformation it was sold to Postabank, which operated as a restaurant for a time before closing it down in 2000.

increase its surveillance of Hungary. In early January 1957, Khrushchev held a five-party Communist Party conference with Hungary, Bulgaria, Romania, and Czechoslovakia to discuss the situation in Hungary. He also invited Kádár to a Moscow meeting between Zhou Enlai and Khrushchev, and then the delegation of the Chinese Communist Party visited Hungary. The two communist parties proclaimed international solidarity with the “counterrevolution”. Thus, an international front was set up to encircle Hungary. To establish cooperation with the Nagy group would hold the spark of the “counterrevolution”. Therefore, it was an indispensable step to sever this connection thoroughly for the Soviet Communist Party and the international communist movement.

But no matter how much he was expected to play the role of puppet by the Soviet Communist Party, Kádár insisted on asserting the legitimacy of his role. In early December, just before Malenkov returned to the Soviet Union, Kádár went to the occupation headquarters in Leányfalu and gave a report to the party’s leadership meeting. It was concerned with the definition of the revolutionary and counterrevolutionary character of the uprising.¹⁰⁴

Kádár had stuck to in dividing the process of upheaval into three periods.

First, the period from October 23–30. He defined it as the period when the counter-revolutionary elements tried to use the legitimate demands of the masses of workers who were dissatisfied with the status quo for their own purposes. Next, he defined the period from October 31 to November 4 as the peak of the counterrevolution, when the counterrevolution gained momentum and the Communist Party organizations, the State Security Service and the police were attacked and many people were killed. And then, he defined the period after November 4 as the period when the counter-revolution was put down.

Kádár believed that he could justify his role by dividing the series of events into three periods. Initially uprisings were revolutionary in character, but gradually they became more and more counterrevolutionary, and it was his turn to put down the counterrevolution. Kádár consistently believed that the cause of the 1956 uprising was the misguided leadership of the Rákosi-Gerő faction. Therefore, the revolt against it was legitimate, but gradually the revisionist tendencies and counterrevolutionary character grew stronger and led to the intervention of the Soviet Union. This was Kádár’s interpretation of the events. Therefore, he considered his own *raison d’être* to lie between the left-wing deflection of Rákosi and the right-wing deflection of Nagy.

However, Malenkov and other officials of the Soviet Communist Party refused this division of time by Kádár. For the Soviet Communist Party, the detailed characterization of the series of events was unimportant. A simple scheme of “counterrevolution from the beginning to the end” was sufficient. The political (and ethical) responsibility of Kádár was also trivial. For the Soviet Communist Party, the political ethics of Kádár, who was only a temporary figure, were not worth discussing. They believed that if they could use Kádár to thoroughly wipe out the counterrevolution, his role would be over. But henceforth, Kádár tried to ride out the political climate of the moment by shifting the emphasis of the struggle on the two fronts he had set up, sometimes to anti-

¹⁰⁴ Huszár 2006, 35–37.

Stalinism and sometimes to anti-revisionism. If we consider that this gradually created the Kádár style of governance, this period was the starting point.

It took a long time for the Kádár regime to build its power base. He was not the type of politician to form a clique to take control of an organization by nature, and there was no such thing as a Kádár group even before nor after the uprising. The absence of a supportive political force delayed the formation of the Kádár's power base. The situation in the immediate aftermath of the uprising was chaotic, with various groups and currents mingling together. There were many activists and intellectuals in the country who felt close to the Nagy group. Among the executive committee members of the re-generated Communist Party (Hungarian Socialist Workers' Party), many of them considered affiliation with the Nagy group. On the other hand, the State Security Service, under the jurisdiction of the Ministry of the Interior, was controlled by former Rákosi-era intelligence officers and commanders, and with the backing of the KGB, constituted an independent power. The KGB agents were sent to the party and the government, and Kádár had to act on the assumption that his own movements were being monitored. Outside the country, a siege of the international communist movement was set up. The anti-Khrushchev faction within the Politburo of the Soviet Communist Party saw Kádár as someone who would eventually be discarded. They criticized Kádár not only for not leading an adequately passionate struggle against the revisionism represented by Nagy, but also for considering the Soviet Communist Party's having backed up the Rákosi faction as the cause of the 1956 uprising.

An opportunity to stabilize these unstable political foundations was provided by the talks with the Soviet Communist Party and government in March 1957.¹⁰⁵ Although the truth is not clear, it is said that Kádár gave a big play at these talks. During these talks, Voroshilov and Malenkov, quoting Rákosi's letter to Khrushchev, pointed out the Kádár's errors and criticized his indecision. In response, Kádár said, "None of us who come here have any personal interest in power. If you do not trust us, then you can give power to Rákosi or whoever you like". Furthermore, in a private meeting with Khrushchev, he told him that if Rákosi and Gerő were returned to Hungary, there would be chaos again.

After these discussions, Khrushchev gave Kádár renewed credibility and decided not to allow the Rákosi faction to return to Hungary. Although conservative criticism of Kádár did not cease, Kádár got the extension of his term and prevented the return of his political opponents to Hungary. Again, Kádár won with Khrushchev's support and trust, and the trust between them was strengthened. With the confidence of the Soviet Communist Party and the prevention of the revival of the Rákosi faction, Kádár could focus his efforts on stabilizing his domestic power base. The handling of the Nagy

¹⁰⁵ Huszár 2006, 52–56. Between January and February 1957, Rákosi, Gerő, and other former leaders in the Soviet Union sent letters frequently to the Executive Committee of the Soviet Communist Party, requesting their return to Hungary. This series of letters is in the "Yeltsin-dossier". The Central Committee of the Communist Party of the USSR made a decision (dated April 18, 1957) not to allow Rákosi, Gerő and others to return to Hungary, in accordance with the request of the party in Hungary, after the meeting of the two leaders in March.

group was part of this power consolidation process. The policy of punishing them Nagy group was agreed upon during this series of talks.

Thus, the fate of the Nagy group was left in the hands of Kádár, who stuck to pass judgement in court by criminal law against the Nagy group, which had been transferred from Romania in April 1957. However, information about the transfer and detention of the Nagy group was not disclosed for several months, not even to the Central Committee. In the meantime, Kádár ordered a thorough investigation of the reasons for the prosecution and background of the case. The treatment of the Nagy group was essentially decided by the Politburo of the Hungarian Communist Party (Socialist Workers' Party), but it should have to pretend taking the appearance that the courts would be autonomous in form. This was to avoid the Stalinist tyranny of executing people in the Rákosi era by arbitrary trial, but it was essentially much the same. From the transfer of the Nagy group to Hungary to the execution of Nagy, there was approximately one year and two months. The reason why it took so long was not only the time taken to prepare for it. No matter how much the Hungarian Communist Party was entrusted with the Nagy trial, it could not ignore the wishes of the Soviet Communist Party, which was concerned about international repercussions.

A coup within the Soviet Communist Party and the development of Khrushchev's peace offensive line had determined the fate of the Nagy group's trial. When Kádár left for Moscow on June 20, 1957 to report on the Nagy prosecution, he returned to Hungary without being able to discuss the case in detail.¹⁰⁶ Kádár spent this period of time with a sense of unease as he saw firsthand how unusually tense the Kremlin was. The consequences of the situation did not become clear until July 4. The Soviet Communist Party gazette announced the expulsions of Molotov, Malenkov and Kaganovich and the demotion of Voloshilov and Bulganin. The conservatives who moved to dismiss Khrushchev in the name of the excesses of non-Stalinization were defeated. The shift in power relations in the Soviet Communist Party's political bureau helped to stabilize Kádár's power. Riding this tailwind, Kádár decided on the outline of the procedure and sentencing of the Nagy group's trial at the Politburo meeting in August. Although the Politburo decided on the essential content of the trial, Kádár continued to deny this fact until his death. This is because if it were the Politburo that decided on the content of the verdict, this regime would be no different from the Rákosi regime.

According to Tibor Huszár,¹⁰⁷ the decision of the Hungarian Communist Party Politburo was communicated to the Soviet Communist Party in September and was recorded in a memo of the Soviet Communist Party Politburo. Although no specific sentence was set, a resolution of the Hungarian Communist Party Politburo was issued dated August 21 and signed by Andropov stating that "Nagy, Losonczy, Donáth, Gimes, Maléter, Szilágyi, and Király shall be given the heaviest sentences, and the others shall

¹⁰⁶ Huszár 2006, 65–67.

¹⁰⁷ Ibid., 68. The full story of the Nagy group's trial is summarized in the following book, but due to the nature of this book, I will not go into the trial itself in depth. *A per – Nagy Imre és társai 1958–1989* (Budapest: 1956-os Intézet and Nagy Imre Alapítvány, 2008).

be punished according to their crimes and penitence". Based on this decision, the final preparations for the prosecution began in September.

In November of that year, the Congress of Communist and Workers' Parties of Socialist Countries and the International Congress of the Communist Movement were held in Moscow, where representatives of the Communist and Workers' Parties of the world gathered. One of the main themes of the conference was the assessment of the Hungarian uprising and the discussion of its effects. At this conference, the line of struggle against revisionism prevailed, which provided the tail wind for the start of the Nagy trial. Thus, the Nagy group trial began at 9 am on February 5, 1958. The original plan was to deliver a verdict in a short period of time. However, the day after the trial began, the prosecution suddenly proposed a postponement of the talks on the grounds of lack of preparation for the prosecution, and the trial was cancelled.

Of course, the cancellation of the trial was not due to circumstances in Hungary. The international implications of the Nagy trial were analyzed by the Soviet Communist Party, and the conclusions of the trial for the Nagy group were discussed at a meeting of the Politburo on February 5. "This trial must not end with a death sentence". This was the Politburo's decision. Khrushchev, who had successfully launched the world's first satellite, Sputnik, after ousting the conservatives in the Politburo, was about to launch a peace offensive under the initiative of the Soviet Union. "How the fate of Imre Nagy is decided in the eyes of the world will have a major impact on this policy development". It was clear that a death sentence and an immediate pardon would further expand international support for Khrushchev and the Soviet Union.

However, it is not clear how much the Soviet Communist Party was concerned with this conclusion. Instead of choosing the path of the Nagy group pardon, Kádár chose to postpone the trial. Moreover, while postponing the trial of the Nagy group, he continued the trial of the others and proceeded with their executions. This is where Kádár's strong determination is evident. On many occasions during his long reign, Kádár showed his acceptance of the views of the Soviet Communist Party but acted contrary to them in his actual deeds. The Soviet Communist Party decided to pardon Nagy, but there is no indication that it was enforced to the Hungarian party. Even during Khrushchev's visit to Budapest in April 1958,¹⁰⁸ Khrushchev seemed to have told Kádár that the handling of the Nagy group was a matter for Hungary to decide. It was probably Khrushchev's view that since he had entrusted Kádár with the governance of Hungary, the will of Kádár would prevail. On the other hand, Kádár's determination was clear from the stage of preparation for the prosecution of the Nagy group. When the conservative faction of the Soviet Communist Party was in retreat and there was no longer a budding revival of the old Rákosi faction, Kádár's resolve hardened. The remaining problem was to deal with the Nagy group. "Once this is done, the handling of the upheaval will be complete and the power base will be solidified. For that reason, it is necessary finally to bury the Nagy group". Kádár was left with no other option.

Kádár is believed to have talked directly to Khrushchev about resuming the prosecution when he participated in an international consultation meeting in Moscow

¹⁰⁸ Huszár 2006, 80.

in May. After securing Khrushchev's consent, Kádár decided to reopen the trial at a Politburo meeting at the end of May. The verdict against Imre Nagy and others was handed down at 5:00 pm on June 15, 1958, and at 5:00 am the following morning Nagy and others were hanged. Despite the many accusations against Kádár, the execution of Nagy solidified his position of power within the party.

8.2.6 Victims of the Uprising and the Historical Assessment

The upheaval that began on October 23 resulted in more casualties when the Soviet army reentered the city on November 4. Soviet troops, backed by overwhelming military might, took control of the city of Budapest within a few days, but heavy casualties were inflicted not only on the Hungarian side, but also on the Soviet side. Sporadic clashes with Soviet troops continued in the countryside, and in October–November the number of Hungarian casualties (deaths) in clashes with Soviet troops was estimated at between 2,500 and 3,000. In the January 17, 1957 issue of *Népszabadság*, the Central Statistical Office's casualty estimates were published. According to this estimate, 1,969 civilians were killed in the fighting in the city of Budapest and 17,000 wounded were taken to various medical facilities. In addition, the number of casualties in the countryside reached 300. Furthermore, the Hungarian military and police casualties amounted to 423, of which 155 were victims of organizations under the jurisdiction of the Ministry of the interior, most of them belonging to the Security Service. On the other hand, the Soviet forces also suffered fatalities, with 669 reported dead, 51 missing, and 1,986 wounded, most of the deaths occurring in the urban warfare in Budapest's districts VIII and IX.

In the chaos of the uprising, the Austrian borders were effectively opened, and it is estimated that 200,000 people fled the country in the months following the outbreak of the fighting. Of course, in addition to those who stood on the dissident side, many of them were on the side of the old regime and young people who took advantage of the opportunity to flee the country. Furthermore, after the uprising was put down, the participants in the uprising were arrested and prosecuted one after another, and by the end of 1959, more than 200 participants in the uprising had been sentenced to death and summarily executed. In addition to this, there were also executions of those who were captured by the Soviet army and taken to Soviet labor camps, but the exact data on these executions is not known. The military invasion by the Soviet Union took an enormous human toll.

We have no clear figure concerning how many people were also imprisoned after the suppression of the uprising, but there is one reference figure. The Central Committee of the Hungarian Socialist Workers' Party (successor to the Hungarian Workers' Party) held on December 21, 1957 reported that the number of counterrevolutionary elements registered with the Ministry of the Interior amounted to 1.2 million people. Surprised by the numbers, Kádár ordered a reduction to 200,000 people, and he also ordered a separate register of about 6,000 vicious dissidents. As a practical matter, this number is also too high. There was no way the Ministry of the Interior had the capacity to handle that many.

The nine individuals indicted collectively as the Nagy group were Imre Nagy, Géza Losonczy, József Szilágyi, Pál Maléter, Ferenc Donáth, Sándor Kopácsi, Ferenc Jánosi, Miklós Vásárhelyi, Miklós Gimes, and Zoltán Tildy. The trial of József Szilágyi, who refused to cooperate in any way in the interrogation and continued to accuse and condemn Kádár, continued even after the Soviet Communist Party requested a stay of the trial, and he was sentenced to death on April 22, 1958 and executed two days later. The judge who presided over the trial was Ferenc Vida, a colleague of Szilágyi's from the pre-war illegal days.

As this case shows, Kádár made clear the internal selection of the Nagy group and imposed the death penalty on Nagy, Maléter, and Gimes and imprisonment on others who were deemed responsible for the uprising (Losonczy died in prison). In addition, among those who defected to the Yugoslav Embassy as members of the Nagy government were György Lukács, a philosopher who served as a cabinet member of the government of the Hungarian Soviet Republic established in 1919 and was appointed Minister of People's Culture in the Nagy government in 1956, and Zoltán Vas, who had served as minister of economy. They voluntarily left the Yugoslav embassy and were released after signing a pledge not to engage in political activities. Obviously, those who truly opposed Kádár politically were given the death penalty, while the rest were commuted and released on condition that they leave politics. Those who were released on bail were henceforth barred from taking an active part in the public life of Hungarian society and were forced to remain in the estate under strict supervision.

Whether a single historical event is viewed as a "revolution" or a "counterrevolution" implies a certain political judgment. There are innumerable cases in which a change in political regimes can change the views of history. In Hungary, too, until the end of 1988, the official view of the 1956 Revolt was "counterrevolution". Now, everyone in Hungary talks about the "1956 Revolution". I do not want to be influenced by changes in political decisions in Hungary. For this reason, I do not use the term "revolution" but rather the phrase "the 1956 uprising" based on the perception that it was a "peoples' uprising". What is strange, however, is that in Hungary there is little discussion about the criteria on the basis of which one can use the term "revolution", i.e., who fought in this "revolution", and against whom did they fight? There are few people who say clearly whether the "revolution" was a revolution against Rákosi-type rule, a revolution that was a more fundamental rejection of Soviet-style socialism, or a revolution that rejects socialism itself. Some people who talk about the revolution embrace interpretations that are not necessarily based on consistent logic, since some people evaluate the Kádár regime after the 1956 uprising. I cannot shake the impression that the term "revolution" has become a passionate term in Hungary, not a logical one.

If one makes unilateral political judgments of historical events, one may lose sight of the whole story. From the historical point of view, the 1956 uprising was an uprising of discontent against the Soviet-style socialist domination of Hungary by the leadership of the Soviet Communist Party, and in particular against socialist fascism, which was poisoned by Stalinism. In that sense, it was an uprising of resistance against the postwar Soviet domination system. There is no doubt about that. Of course, many different people participated in the uprising. Most of the people who took part in the

uprising did so spontaneously and out of a sense of anger, but it cannot be denied that there were groups of violent provocateurs and irresponsible armed groups. In some cases, this led to needless clashes and murders.

On the other side, on the regime's side, there were people from party organizations, in addition to the Soviet army, Hungarian army, police and security services. Apart from the fighting in the streets, many of those who lost their lives in the armed assaults on the uprising side were people who served in the party headquarters and in the police and security services. These victims were also Hungarians, and they too had family members. In the revolution, the blood of many people was shed. It is not possible to say that all of one regime is bad and all of another regime is good. Rather than simply defining the uprising as revolution or a counterrevolution, we can make an overall assessment of a historical event by clarifying the various causes and conditions that led to it and tracing the changes in society after it. Therefore, it is better to evaluate the events in the context of history than to deal with various concrete events in detail. It is important for those of us who are living in future generations to have this attitude.

The execution of Nagy put an end to the Kádár's processing of the largest issues of the uprising. However, the trial and execution of the participants in the uprising continued until the end of 1958. Changes began to take place in 1959. From this point onwards, the pursuit and prosecution of the participants in the uprising was restricted to the wanted persons who were on the run, and investigations of those who were not politically opposed to the current government ceased.

The mass release of the participants in the revolt who were sentenced to prison was based on a special amnesty decree of appeasement dated April 22, 1963. The amnesty decree resulted in the release of more than 4,000 detainees, but in practice, sporadic releases of prisoners had taken place since 1959. Of those sentenced to prison in the Nagy group, Tildy, who was sentenced to six years in prison, was released in 1959; Jánosi, who was sentenced to eight years in prison, and Donáth, who was sentenced to 12 years in prison, were released in 1960; Vársárhelyi, who was sentenced to five years in prison, was released in 1961; and Kopácsi, who was sentenced to life in prison, was released in 1963.

As seen from these cases, Kádár changed course towards national appeasement after the execution of Nagy. This was driven by the domestic economic situation and the changing international situation. The uprising had further hurt the Hungarian economy. Therefore increased energy supplies from the Soviet Union and domestic production growth had become an urgent issue. However, the development of a politically tightening policy would not be able to draw on the vitality of the people. It was thus necessary to put a stop to the pursuit of the participants in the uprising, turn around the political sentiment of the people, increase their work ethic, and steer them towards improving the national economy.

On the other hand, internationally, the policy of appeasement of the U.S. and the Soviet Union was being developed by Khrushchev's peace offensive. The Soviet Union and Hungary, which had been made very unpopular by the Nagy executions, were faced with the need to show their friendship by launching a bold policy of appeasement of the people in order to ease the hostile situation towards the socialist bloc.

For both the Soviet Union and Hungary, it was the supreme imperative to rebuild the domestic economy and increase productivity, and the strategy was set to enjoy the economic benefits of East-West reconciliation.

8.2.7 The Kádár Regime

An advisory committee to the Prime Minister's Office, commonly known as the "Kennedy Commission", compiled a report of over 400 pages¹⁰⁹ in September 2005. The purpose of this committee was to review the measures taken by successive governments regarding the handling of classified documents such as the handling of intelligence documents by the Political Security Police, in order to identify problems and encourage the development of legislation for the release of classified documents. Many of Hungary's classified documents have been classified for seventy years, and materials related to the former regime's secret police are not accessible to anyone other than researchers. Researchers also do not have access to all the documents. In many of the former socialist countries, the old system's law on the control of classified documents is still in force, and it has kept official documents out of the public eye for a long time. It is necessary to review the mistakes of the old regime through the system transformation, but it is not possible to assess history or draw lessons from it if many important documents were hidden. The inability to formulate an effective law is due to the internal circumstances of both the ruling and opposition parties. However, for a fair historical assessment to be made, these confidential documents must be properly released to the public.

Until the outbreak of the Hungarian uprising, Hungarian secret police carried out a series of legal and illegal killings. Major cases are being unraveled, but they are not fully cleared. Since the system transformation, many testimonies and books that contribute to historical assessments have been published, and most of the incidents have been outlined, but it is said that important parts of the classified material were discarded in the chaos of the 1956 uprising and the 1989 transformation. In the process of consolidating his position of power after the Hungarian uprising, Kádár is believed to have destroyed important documents and evidence, including documents from cases in which he had been involved since Rajk's execution, as well as a confession made when he was arrested in 1951. The reason why he stuck to the execution of Nagy and did not allow Rákosi to return to the Soviet Union, ignoring the opinion that Rákosi should be returned to the country and punished, might be due to his political judgment that it would be difficult for him to stay in power if his role during the Rákosi era was exposed.

Even in the system transformation of 1989, some parts of secret police material after the uprising are said to have been destroyed. This occurred during the peaceful transition of the current Socialist Party to power. Some cadres of the former Socialist Workers' Party and the newly born Socialist Party seemed to have secretly destroyed the inconvenient material from the old regime in secret. Nevertheless, it is still impos-

¹⁰⁹ It can be downloaded: <https://mek.oszk.hu/08400/08450/08450.pdf>.

sible to destroy all the material of the intelligence services, and researchers' long-term analysis has identified the code names of existing politicians, intellectuals, and cultural figures who were members of the intelligence services. Unlike in Czechoslovakia and Poland, where the system transformation has led to the scrutiny of the former Communist Party, the Hungarian phenomenon of key figures from the former regime remaining in the public arena as key figures of both the ruling party and the opposition after the transformation has made it difficult to formulate legislation to make the former regime's secret documents public. In addition, the fact that some politicians, irrespective of the ruling or opposition parties, have parents or relatives who were involved with or held leadership positions in the secret police also makes it difficult to probe into the truth of the matter.

The Hungarian Historical Council gave a series of lectures on "Persons with Different Evaluations in Hungarian History" and compiled them into a book: *A magyar történelem vitatott személyiségei* (Budapest: Kossuth Kiadó, 2008). The last part of the book is devoted to Kádár, and the book asks the question: "A savior who saved the country or a tough politician who survived the changes?"

Although it is usually assumed that Kádár's reign lasted thirty-two years, from 1956 to his retirement as general secretary in 1988, he was in fact a political leader in post-war Hungary for more than forty years, having held key positions in the party and government from the time of the reconstruction of the Communist Party after the war. However, some politicians, such as Antal Apró, Mrs. Gyurcsány's grandfather, served in the Politburo of the Communist Party for a longer period of time than Kádár, because they were not subject to the purges. While Apró had always been a politician who had had the lowest seat as a member of the Politburo, Kádár had held key positions in the party and government as a senior member of the Communist Party. While supporting the postwar Rákosi dictatorship, he was arrested in 1951 on suspicion of espionage, returned to the party leadership after the Stalin's death and once again allied himself with Gerő, and then was feted at the head of the government during the Hungarian uprising, finally purged the Nagy group that threatened his hold on power, and then came to introduce a "soft dictatorship" of public appeasement.

It is not easy to evaluate a politician with this kind of background. Kádár will only be evaluated positively for his role in events after the 1962 period, when the handling of the social unrest was over and he advocated national appeasement. For his role prior to that, Kádár will receive a negative evaluation as someone who had a direct hand in the Rajk and Nagy executions. Kádár's arrest in 1951 on charges of espionage seems to have exonerated him of his own tainted role up to that point, as he could be portrayed as a victim of the Rákosi dictatorship. However, he was complicit with Rákosi in the execution of Rajk and played no small role in the subsequent establishment of the Rákosi dictatorship; after his release in 1954, he again cooperated with Rákosi and Gerő, attributing full responsibility for the postwar frame-up to Farkas, and after Rákosi defected to the Soviet Union, he worked with Gerő until the uprising began. This historical past cannot be erased. The execution of Nagy was also a decision that Kádár made himself.

We do not know whether Kádár was aware of the movement to rehabilitate Nagy at the time of his death, and even if he had been, we do not know whether he would have understood its significance. The habilitation of Imre Nagy and the death of Kádár were symbolic events that marked Hungary's farewell to the Kádár era, which lasted more than 30 years, and the beginning of a new era. The Hungarian uprising was reevaluated as a "revolution" rather than a "counterrevolution". Stigmatized as a counterrevolutionary, Imre Nagy became a hero of the Hungarian Revolution of 1956. If Imre Nagy was the hero of the revolution, will Kádár now be the symbol of the counterrevolution?

Things are not simple. Nowadays, all Hungarians describe it as the "1956 revolution". Not long ago, it was the "1956 counterrevolution". But people's feelings are mixed. The assessment of the uprising and the assessment of individual politicians are two different things. More than 10,000 people attended Kádár's funeral, held at the headquarters of the Socialist Workers' Party, and a long line of people lined up around the party's headquarters, all the way to the road along the Danube. The Hungarian people were once again aware of Kádár's popularity. Giving Nagy legitimacy would destroy the legitimacy of the Kádár government. But we cannot say that there was no legitimacy in the thirty years of Kádár's rule. This is precisely the typical problem of justice and legitimacy in history and reality.

In 2008, Prime Minister Gyurcsány invited the president, opposition leaders and the diplomatic corps to a special parliamentary session to commemorate the 50th anniversary of Imre Nagy's execution. The Fidesz and KDNP leaders refused to attend the ceremony without explaining why. The president also indicated that he would not attend, but President Sólyom criticized the PM-hosted parliamentary session at other memorial rallies and thus showed his reasons. The media picked up on this movement, and many criticized the President's actions, but we have to listen to President Sólyom's theory.

There are a fair number of politicians in the Socialist Party, including Prime Minister Gyurcsány, who feel that the 1956 uprising cannot simply be defined as a "revolution". The former President Göncz, who was sentenced to death for the 1956 uprising, had also said that "there are as many different 1956s as there are people". Even Prime Minister Gyurcsány's speech was unclear in this point, saying something to the effect that when the uprising broke out on October 23, it was a revolution, but as it progressed, its significances became increasingly unclear.

President László Sólyom criticized this very ambiguous and ambivalent interpretation of the assessment of the upheaval. The assessment of the "Revolution of 1956" must be primary and unambiguous, not ambivalent. The president's theory is that once the term "revolution" is defined, its evaluation must be unitive, and it must be distinct from ambivalent evaluations that apply to both Nagy and Kádár. According to President Sólyom, the Nagy revaluation was fixed at the reburial ceremony on June 15, 1989 and was a key moment of the system transformation. He even went so far as to assert that the declaration of the republic made by the then interim president of the Socialist Party, Mátyás Szűrös, on October 23 of the same year was a noncommittal event by the Socialist Party, which did not constitute the essential event of the system transformation. He further insisted, as a critical point, that the implicit recognition of the

continuity (legitimacy) of Kádárism while defining the 1956 uprising as a revolution is false. Therefore, the assessment of 1956 must be clear and unambiguous.

President Sólyom points to the refusal of the former Socialist Party leader Horn to be awarded a decoration as an example of eliminating the notion of ambivalence in assessments of the revolution. He says that a politician who stood on the side of the repression of the uprising and defended the post-revolutionary regime does not deserve a national decoration for the republic established after the system transformation. This issue has already been discussed in this book and will not be revisited here, but it is clear that the Horn decoration was applied for by Prime Minister Gyurcsány in order to consolidate his position in the party on the occasion of Horn's birthday. It is his discernment that President Sólyom did not sign this application for the ordination. And it also exposed once again the ambivalence in the Socialist Party's assessment of the 1956 uprising.

Gyurcsány himself embodies the continuity of the Kádár era in his private life. The current private residence of the Gyurcsány family is the residence provided by the party during the Kádár regime for his wife's grandfather, Antal Apró, a member of the Hungarian Communist Party's politburo. Antal Apró spent most of his nearly forty years in the party as a member of the Politburo even at the time of Rajk's execution and even at the time of Nagy's execution. Antal Apró's political career is truly ambivalent in itself, and he is a strange politician who has always been in the center of power during the vicissitudes of history. Certainly, he might have been willing to serve any of the people in power at a given time.

A sensible politician would not use the legacy of a politician with such a past as his or her private residence. This might be one of the reasons why President Sólyom did not participate in the parliament ceremony organized by Prime Minister Gyurcsány. It is only natural that he should leave the Antal Apró residence if he really wants to stand up for himself and say goodbye to the Kádár era. However, this kind of fastidiousness and integrity could not be understood by most Hungarians. That in itself is also the problem with Hungary. It is very difficult for contemporaries to separate the evaluation of a single historical event from their own personal experiences.

Depending on age, workplace, place of residence, and living conditions, the experiences people had as individuals of 1956 would be as varied as President Göncz suggested. It is too rigid to condemn the political actions of individuals at that time based on the political evaluations of future generations. On the other hand, how to assess the post-1956 regime as a political system, as opposed to the diversity of individual experience, should be a clear historical assessment. Whatever one thinks, the Kádár regime had no legitimacy, at least in its rise to power. It was clearly a puppet regime constructed by the Soviet Union. Therefore, an assessment of the 1956 uprising and subsequent life as experienced by individuals must be distinguished from an assessment of the regime that was established as a result of the 1956 uprising.

Therefore, even if the experiences of 1956 are diverse, it does not follow that the evaluations of post-1956 regime should also be diverse. On the other hand, even if the post-56 regime evaluations are univocal, it cannot be said that the role of individuals during the 1956 uprising can be determined univocally. Once the evaluation of the

regime is determined as a socio-political system, that becomes the unequivocal norm of the existence of a state, irrespective of the individual experiences and evaluations. That is not to deny the diverse experiences of individuals, but it establishes the criterion of whether or not a state can praise and decorate each individual or not. In the case of the former leader of the Socialist Party, Gyula Horn, his personal circumstances as having been on the side of the suppression of the uprising could be understandable, but the norm of the republic established by rejecting the old regime cannot honor a man who does not reject the old norm and/or does not accept the new norm. As a nation, there should not be any ambivalence in evaluation of the post-1956 regime.

This point is similar to the debate on “visit of the Yasukuni Shrine” in Japan. It is an undeniable fact that those who participated in the war as individuals had diverse lives and experiences, and many people may feel that it is unacceptable if their lives as individuals are condemned by the new regime after World War II. On the other hand, it is clear that Japan started out as a parliamentary democracy in the postwar period on the basis of the rejection of the military imperialistic system with the emperor at the reins. Therefore, there is nothing reprehensible about visiting Yasukuni Shrine as an individual, but if politicians intentionally visit the shrine and express their positive intention to celebrate equally the leaders and victims of militarism, the norm of unequivocal denial of the pre-war system cannot be maintained.

As in this case, there had been many historical events which demanded huge amounts sacrifice of human life, and also there had been a wide variety of political domination with questionable legitimacy in the twentieth century. No one cannot escape completely from the contradictory relationship between the individual and the state in the modern human societies.

Nagy is seen as a hero because he is the “representative of the martyrs of the 1956 uprising” and not because he fought boldly against the Rákosi dictatorship for a long time. In this respect, Nagy lacked charisma as a politician. This was the difference between Hungary and Poland, since in Poland, a charismatic leader, Gomulka, could control the domestic political situation and prevent military invasion by the Soviet Union. Of course, one cannot underestimate the fact that, after Stalin’s death, Nagy was the only one in the politburo of the Workers’ Party to oppose the Rákosi regime. As the inevitable result, Nagy became a martyr of 1956 and a “symbol of the 1956 revolution”.

Kádár, on the other hand, while having worked with Nagy, returned to Budapest as a collaborator in the establishment of a Soviet puppet government, albeit Kádár had been abducted by the Soviet Union. In this respect, the fates of the two politicians differed. However, in a sense, it was fortunate that Kádár was present in Hungary. The conservatives in the Soviet Union were planning to have Münnich, who had a history of exile in the Soviet Union, at the head of their government, rather than Kádár. In the reality of Soviet occupation, the options available to the Hungarian nation were limited. There was no legitimacy in Kádár’s rise to power, but by endeavoring to create a “soft dictatorship” Kádár succeeded in taking distance from the Soviet Union, which secured Hungary its relative freedom and prosperity within the Soviet bloc. There was no legitimacy to his regime at the outset, but “legitimacy as a matter of fact” arose when he managed to maintain rule. That is precisely what the Kádár regime was like.

However, history's assessments are always destined to change. Kádár had been highly respected for building a "better" regime in the Soviet bloc, but ultimately he was unable to break the framework of Soviet-style socialism. And the evils of the long-term "soft dictatorship" are evident in the process of becoming a market economy long after the process of system transformation. It would take time for the people, who were accustomed to the "lukewarm" system of the isolationist era, to accept the harshness of the market economy head on. In fact, even today, the inertia of the Kádár system still reigns in Hungarian society.

Chapter 9: Summarizing Twentieth-Century Socialism and System Transformation

So far, this book has analyzed economic and social systems undergoing a historical process of the systemic transformation from multiple social perspectives. The process of the collapse of one social system and the construction of a new one is a historical process that takes a long time. Most politicians believe that transformation can be accomplished by the shift in the political system from a one-party dictatorship to a multi-party republic. Economists also believed that the privatization of state enterprises could achieve the transformation from a socialist to a capitalist economy. However, it is clear from the discussion so far that the real process is not that simple.

Changes in the legal system can be achieved in a short time. But this does not mean the completion of the economic and social transformation. The transition from one economic society to another, whether we call it a “transition” or a “transformation,” cannot be completed in a decade or so. This book is intended to be a summary of the 30 years after the system transformation, but it is clear from the discussion so far that the socioeconomic transformation has not come to completion, at least not yet.

Thus, the observation and analysis of “economic societies in transformation (transition)” are also long-term tasks. However, for many researchers who require quick results, such continuous observation and research of historical transformations are not cost-effective, and research productivity is regarded as low. However, it is also true that new insights into social change cannot be obtained without long-term social research.

The communist governments established in Central and Eastern Europe at the end of the 1940s believed that a socialist society could be accomplished through the dictatorship of the communist party. They believed that if private ownership were abolished and private business were banned, state control of business would be achieved and a socialist economy would function. However, both for the Communist Party at the time and for all modern economic societies, the planned control and development of the national economy is an almost impossible task. Moreover, an economic society that suppressed the market economy lost the driving force of economic development. It was inevitable that a society that suppressed people’s ingenuity and voluntary labor, which are the driving forces of national economic development, would fall into long-term stagnation. This ultimately led to the collapse of the economy and society.

Certainly, “the possibility of national economic control” became a fascinating theme in the world of economics immediately after World War II. Heartbroken by the history of the capitalist countries’ plunge into the tragic war, conscientious economists pursued the possibility of controlling and planning the national economy. However, economics has not yet become a science that can control the national economy. Even though economics is an “academic discipline”, it is far from being a “science”.

Under conditions in which national economic planning and control backed by economic theory was impossible, the Soviet socialism and the socialism that it transplanted into Eastern Europe could use only the political conviction that “control and management of the national economy can be achieved through the political leadership of the Communist Party” as the basis for the implementation of economic policy. Economic policies that can be manipulated at the whim of politicians raised in the political and labor movement are no different from political slogans. The economic guidelines “ordained by wise men” to lead the working class were not beyond the “casual ideas” of the Party leadership. In order to hide the incompetence of the Communist Party leadership, it was necessary to deify the party and party leaders. As a result, it did not take long for socialism, which was supposed to create a people’s republic, to turn into a “secular enlightened monarchism”. In fact, the one-party dictatorship of the Communist Party was the “secular enlightenment monarchism” that emerged in the twentieth century.

Thus, the history of the collapse and disappearance of twentieth-century socialism should be considered over a larger historical span: the twentieth century was the “century of transition” from enlightened monarchy to republicanism. Whether we advocate socialism or capitalism, the twentieth century was a century in which a grand social transformation from a feudal monarchy to a republican society was attempted, a tumultuous century that produced two world wars and totalitarian rule in the process. If Hitler’s fascism was a totalitarianism based on individual worship that emerged in the capitalist world, Stalinism was a totalitarianism based on individual worship that emerged in the socialist world. Both of these “isms” were “secular monarchies” that emerged in the first half of the twentieth century. The transition from enlightened monarchy to republicanism in Europe did not proceed in a linear fashion, but rather via fascist societies. Fascism emerged in the twentieth century as “the deification of a secular person = secular enlightened absolutism”. Socialism permeated by Stalinism was also a kind of “secular enlightened absolutism”. Eastern European socialism was from the outset a transplant of Stalinist-polluted socialism, and the storm of purges in Eastern European society that lasted until Stalin’s death can be defined as a kind of “communist fascism”.

Originally, modern socialist thought and the ideas of the workers’ revolution were carried out by the “sages leading the working class”. Rule by self-proclaimed sages is nothing but an Enlightenment (secular) monarchy, and therefore carries the historical constraints of the enlightened absolutism of the nineteenth and twentieth centuries. The communist dictatorship was the establishment of “rule by sages”, a system in which the general secretary of the Communist Party, the “wisest of the wise”, stood at the pinnacle of rule. It did not take long for the “wisest of the wise” to be deified and for the system of rule to turn into a “secular enlightened absolutism”.

In the transitional society of the first half of the twentieth century, limited by the historical constraints of the Enlightenment monarchy, the workers’ enlightenment ideology, according to which the Communist Party could lead the working class and accomplish socioeconomic control easily, made Communist power the “king of the secular”. Clearly, the ideology of the Communist Party leading the working class was a

kind of Enlightenment, and twentieth century socialism could not escape such historical limitations.

The Communist leaders who undertook the establishment of socialist society in the postwar Eastern European countries were all born at the end of the nineteenth century or the beginning of the twentieth., and they experienced World War I and the Russian Revolution, participated in the establishment of the Hungarian Soviet Republic, resisted the aggression of Nazi Germany, participated in the Spanish Civil War, and survived World War II. With the wisdom and confidence that they had acquired through the first half of the twentieth century, they pushed forward with the establishment of a socialist government (the Communist Party) in the midst of the postwar chaos. Their way of life shows us the characteristics of human society in the twentieth century. The process from the Russian Revolution to the collapse of socialism in Eastern Europe was an attempt to establish a social organization that arose in the historical transition from feudal monarchy to republicanism, and at the same time it was a historical process of failure.

The twentieth century was the century of the long historical transition from monarchy to republicanism, a historical period of trial and error in which mankind went through a series of violent wars and slaughters. Socialism in the twentieth century took on the character of wartime socialism from the outset. Both the organizing principles of the Communist Party and the system of rationing goods were nothing but the wartime system itself. The basic character of wartime socialism did not change until the collapse of Eastern European socialism.

Even after Stalin's death, Eastern European society remained under the rule of Soviet-style socialism, backed by military power, and relations with the Western world remained closed. Though freed from the spell of Stalinism, the one-party dictatorship continued to rule, and the wartime rationing system was maintained. Criticism of the Communist Party was not tolerated, and the society was kept under the surveillance of the secret police. Neither Soviet socialism nor Eastern European socialism, throughout their seventy years of history, went beyond the historical constraints of "secular monarchy" and wartime socialism.

There was no future for a society that stifled the spontaneous creativity of its people and ceased to progress and develop. There was no other fate for this society than decay. The collapse of wartime socialist society was inevitable.

9.1 War Socialism

I published a book on the history of Hungarian reforms in 1990 which traced the process of system transformation in Hungary from the field and developed a reasoning and logic of the path to the collapse of twentieth-century socialism. In the first chapter, "2. The Prototype of Twentieth-Century Socialism: Wartime Socialism," I described it as follows.

"In the wake of the two world wars, the socialist experiment that began in the early twentieth century on the outskirts of Europe spread throughout Central and Eastern Europe. In retrospect, humanity in the twentieth century was as cruel and violent as in

previous eras; the number of human lives lost to mankind throughout the twentieth century was more than the number of human beings slaughtered up to that point. In this sense, it was the cruelest century in human history. The history of the twentieth century will be written as the history of an extremely unbalanced era, because humankind enjoyed the most rapid technological progress and economic prosperity, but at the same time the most slaughters were committed in this century.

The socialist ideals of the nineteenth century moved society throughout the twentieth century. It was the escape from poverty, the abolition of the inequalities of sex and wealth, the abolition of classes, and the cessation of all inhuman behavior, including war. For humanity, still with its monarchy and its crude and immature society, this socialist philosophy was an outgrowth of human reason. And, it should be emphasized, in that barbaric period, those who espoused socialism were the prophets of peace against war. Against the backdrop of imperialism, socialist ideals and movements were a great force for national independence and colonial liberation. The modernization of many politically and economically immature countries could not have been achieved without the socialist movement. But that socialism also could not escape the cruelty and immaturity of humanity in the twentieth century.

It is not justified that we impeach Nazism or imperial fascism on one hand and on the other hand acquit Stalinism in the favor of socialism. Neither Stalinism nor fascism was a phenomenon that emanated from an individual event, even if they were linked to a single individual or symbol. Clearly, it is a thought and a system that reflects the social conditions of the times and a reflection of the level of development of human society. Human society, whether socialist or capitalist, was caught in the “totalitarian trap” in the middle of the twentieth century. The socialism of the twentieth century has been nurtured in this historical context. The quality of the postwar socialist world system was also determined by this history.

The emancipation from fascism, in turn, became the curse of Stalinism. Eastern European socialism was indeed the product of the era, and it inherited the dual lineage of anti-fascism and Stalinism. In particular, postwar reconstruction could not have been achieved without a strong central government. For that, Soviet-style socialism, or wartime socialism, as a natural extension of the wartime economy, was compatible with the desired objectives.

The socialist system in Eastern Europe was established successively in the 1947–1950 period. Because the process took on the guise of peaceful gradualism over a relatively long period of time, it was termed a “people’s democratic revolution” to distinguish it from radical proletarian revolutions such as the Russian Revolution. Uniformly characteristic of this process was the political merger of the Communist Party with the Social Democratic Party and the nationalization of industry. Almost at once in 1950, the preparations for the Five-Year Plan were made in the East European countries. The synchronization of the Five-Year Plan, which should have symbolized the inauguration of the socialist world system, came at the cost of people’s lives, which was enforced by the world political situation of the time, because the Plan was inspired by Stalin’s theory of a third world war, and therefore wartime regimes were put in place in

all the socialist countries. For the Eastern European countries, the Five-Year Plan was synonymous with the War Plan. The extreme accumulation of capital, the priority of military industry over all other concerns, the “service work” and the slashing of living standards led to a hatred of socialism and Stalin among the people.”

The twentieth century was a century of wars and revolutions that formed the long history of human society’s transition from a feudal enlightened monarchy to a modern republican society. All the communist leaders of Hungary’s postwar socialist regimes had experienced the wars and revolutions of the twentieth century.

Mátyás Rákosi (1882–1971) was born in the Austro-Hungarian Empire and was captured by Russia in World War I. He escaped from Russia and became deputy minister of commerce and minister of social production in the Hungarian Soviet Republic of 1919, and long after the fall of the Hungarian socialist regime, he became a prisoner of the Horthy regime. Then, he went into exile in the Soviet Union and returned to Hungary after World War II. He was truly a man who experienced the war and revolution of the twentieth century. For Rákosi, Soviet socialism led by Stalin, which had overthrown the Russian Empire and defeated Nazi Germany, was absolute existence. Even after his fall from the power, he never changed his convictions.

Ernő Gerő (1898–1980), Rákosi’s right-hand man, also joined the Communist Party during World War I. At the time of the establishment of the Hungarian Soviet Republic, he joined the youth movement and became a Red Army soldier. In 1924, he went to the Soviet Union in a prisoner-of-war exchange and became an intelligence officer in the Ministry of the Interior of the Soviet Union. Later, he joined the International Corps Command in the Spanish Civil War, where he was active in the elimination of the Trotskyists. Then, together with Rákosi, he returned to Hungary after the war.

József Révai (1898–1959), who formed the leadership of the Hungarian Communist Party after the war, became a member of the Communist Party in 1918, and at the time of the establishment of the Hungarian Soviet Republic, he worked on the theoretical work of the revolution, under the influence of Béla Kun and György Lukács. With the fall of the revolutionary regime, he fled to Vienna, where he worked with Lukács on magazine editing and joined the Reconstruction Conference of the Hungarian Communist Party, where he became a central committee member with Lukács. He was later arrested in Hungary, but after his release he went to the Soviet Union, where he worked in the Comintern and continued to pursue his theoretical work.

During the Hungarian uprising in October 1956, the philosopher György Lukács (1885–1971), who defected to the Yugoslav Embassy as part of the Imre Nagy group, was a well-known Marxist philosopher, and he became minister of culture in the government of the Hungarian Soviet Republic. After the fall of the regime, he fled to Vienna, where he was criticized by the Comintern for advocating a democratic dictatorship of the workers and peasants, rather than a Soviet-style dictatorship, and henceforth he devoted himself to theoretical work. In 1933, he went to the Soviet Union and took a position at the Institute of Philosophy of the Academy of Sciences, but he was exiled to Tashkent in one of Stalin’s purges. After surviving the purges and returning to Hungary after the war, Lukács, who was enrolled at the Academy of Sciences, became a harsh critic of non-Marxist ideologues and the implementer of an intellectual purge which

used the Communist Party's salami tactics. Later, he was used politically, not as a politician, but as an internationally known Marxist thinker, but during the 1956 uprising he became a member of the Nagy government and went into exile in the Yugoslavian embassy. Many of his disciples fled to the West after the uprising, but Lukács himself expressed submission to the Kádár regime. However, he was harshly critical of the Soviet Communist Party for the Soviet invasion of Prague in 1968.

All these leading Hungarian communist leaders and thinkers were born during the enlightened absolutism of the nineteenth century, and they all experienced World War I and faced the collapse of the enlightened absolutism that followed. Seeking to usher in a new social era, they joined the establishment of a Soviet-style regime in Hungary, and after the fall of the regime, they fled to Vienna and eventually found a permanent home in the Soviet Union. There, they experienced the period of Stalin's purges and World War II, and it was they who returned to Hungary. Their goal in the 1940s was to further the so-called "people's democratic revolution", which resulted in the establishment of Soviet-style socialism.

At the time of the 1956 uprising, the world was still in an era of world domination by the two great powers, the Soviet Union and the United States. Borders were not allowed to be changed, and people's fates were not decided by themselves, but by the Soviet Union and the United States. The suppression of the uprisings in the civilized countries after World War II was a tragedy with a great cost. In order to eliminate the domino phenomenon of the Eastern European countries leaving the socialist camp, the world's communist parties tolerated the sacrifice of Hungary.

On the other hand, the United States, too, fearing a domino-like fall of states to socialism in the areas of the Indochina peninsula in which it had assumed control from France, thoroughly destroyed the land of Vietnam and killed millions of Vietnamese people. This was the biggest war crime of the postwar era.

Then, as the twentieth century drew to a close, a brutal war broke out in a corner of Europe. This was the civil war in the former Yugoslavia. Yugoslavia had advocated a new type of socialism, self-managing socialism, and people had taken pride in building a society different from Soviet-style socialism. However, as soon as this society collapsed, an unbelievable scene of mutual slaughter ensued. What on earth was self-managed socialism? The question remains unanswered.

Thus, the twentieth century was an era of the highest technological development in human history, but it was also an era of incessant wars and revolutions. Clearly, the twentieth century was a transitional century in which mankind moved from the age of the Enlightenment monarchs through the turmoil of fascism to build a republican-based civil society. It was defined first and foremost by the fascism of Nazi Germany in the middle of that century and the socialist-communist fascism of the socialist bloc, under the name of Stalinism. The fascist phenomenon is a dictatorial phenomenon that arose in the process of the collapse of the enlightened absolutism and the transition to a modern democratic society. Neither the West nor the East was able to escape this fascism in the historical process of social transformation.

9.1.1 Communist Dictatorship in the Age of Enlightenment

For Europe, the nineteenth to twentieth centuries were the age of the enlightened absolutism. At the turn of the century, society gradually moved towards republicanism, but the change came at the end of World War I. With the dissolution of the Habsburg Empire, which had ruled Central and Eastern Europe, all the countries on the map began to go down the independent republican path. In Hungary, the social transformation was led by the Marxist Communist Party. The Communist Party, which was able to clearly show the social system established after the dissolution of the monarchy, advocated the rule of the workers, who constituted the majority, as the protagonist instead of the monarch.

But even if ordinary workers can be a force for social change as a political force, they cannot draw up a blueprint for the creation of a new society. Workers' power cannot be realized without political parties and intellectuals to represent the interests of the working class. From this, the Communist Party was born, which was to lead the workers at the head of the working class. It was, so to speak, an intellectual elite group that led the workers. The Communist Party, which took power, became the leader of social construction instead of the monarch, but it was nothing more than an enlightened workers' power to replace the enlightened monarchy. It was a kind of "wise man rule" ideology.

The society of the early twentieth century still had a large educational gap separating intellectuals and the general populace, which required individuals and political forces to drive the society. This gave rise to the idea of sage rule. The insistence on building a people's sovereign society from the overthrow of the monarchy reflected the times, but as the intellectual gap between the leadership class and the people could not be easily bridged, it was inevitable that the new leaders would play the role of an enlightened monarch. The Communist Party was an elite organization representing the working class, and the Communist Party cadres were seen as the leading lights of society who could envision and oversee the construction and development of society.

The socialist power established in the twentieth century, from the beginning to the end, was unable to escape the idea of the Enlightenment (civilization from above). But the civilization from above by dictatorship stifled people's intellectual capacity and creativity, forcing them to retreat from civilization. The delusions and arrogance of a handful of leaders who actually thought themselves able to develop society led to the stifling of the intellectual potentials and spontaneous vitality of the people by force. But human society in the first half of the twentieth century still needed "wise men" and "charismatic figureheads". This became the social source of fascism and Stalinism.

9.1.2 Suppression of Opponents by the Political Police

The forces of surveillance and repression used against those who defied the "secular monarchy" were an important violent apparatus on which the regime rested. In Eastern European socialist countries where the Soviet Union took over, political secret police were established under the leadership of the Soviet Union and commanded by top

Communist Party officials. In the process of the Communist Party's seizure of power in each country, the political police worked behind the scenes to arrest or eliminate politicians who were critical of the Communist Party.

Especially after 1948, when the conflict between the Soviet Union and Yugoslavia became more serious, there was a rush to establish a socialist government, and the mass extermination of alleged opponents of the Communist Party began on a large scale. This led to a purge within the Communist Party and the secret police from 1949 onwards, and the madness of Stalinism, which was in its final stages, swept through the Soviet Union and all of Central and Eastern Europe.

With the death of Stalin in 1953, the various murders spawned by this madness became public and led to national uprisings in the countries of Central and Eastern Europe soon after the establishment of socialism. The most massive uprising was the Hungarian uprising of 1956.

With the suppression of the uprisings, the Communist Party once again tightened its control over society. As the U.S.-Soviet peaceful coexistence measures of the 1960s unfolded, the violent exclusion of critics of the Communist Party was subdued, but openly and secretly the political police continued to monitor and regulate the behavior of the people. In addition, with the armed suppression of the Prague Spring of 1968, Eastern European socialism reverted back to a gloomy society. There was no longer an overt conspiracy to exterminate political enemies, but criticism of the social system was closely monitored. Although surveillance was loosened, the political police continued to operate until the collapse of the system. The change from "wartime socialism" to "peacetime socialism" was only superficial.

9.1.3 From Dictatorship to the Cult of the Individual (Totalitarianism)

In the historical transition from monarchy to secular power, secular power has been unable to escape the temptation to become a "secular monarchy". This is evident in today's China. And the "secular monarchy" has always needed a "secular king" or charismatic person; throughout the twentieth century, socialist power has been unable to surpass the "secular monarchy".

Human organizations, not just political parties, always need a leader. Even today, whether we are speaking of companies or political parties, most organizations, even if they claim to be based on collective leadership in principle, are committed to top-down decision making. It is difficult to get things done if there are differences of opinion in collective leadership. Even if one says that one follows the majority, in reality, it is difficult to discard major differences of opinion and follow the majority. Unless one is speaking of non-profit organizations, it is not easy to reach conclusions in a collective discussion. A person who has the ability to break down opponents, who has a loud voice, who can intimidate critics, who can create sympathy, who can not only be brave enough to kick down opponents, but also wise enough to trick opponents into believing that he or she is the head of the organization can be a charismatic leader.

And those who stand at the top of the organization will want their authority and perks to be as long-lasting as possible. This is also normal thinking and behavior for

the head of an organization. However, in most organizations, there is a provision for retirement, and one cannot remain the head of the organization forever. In the case of the founder, however, he can remain the head of the organization until his death. In the case of a monarchy, the king will remain the monarch until he dies, and the king of a religious state will also remain the king until he dies. It is impossible for the head of every organization to remain at the top forever, but it is certainly a dream that most would like to see fulfilled. Those who have reached the top of state power will want to remain in power for as long as possible. The more lagging a society is in civilization, the stronger the desire to be a “secular king”.

The fact that we can observe dictatorial leaders in all the communist organizations of twentieth century socialism shows precisely that the society in question was unable to break out of the time constraints of the enlightened absolutism and could not go beyond the “secular monarchy”. The phenomenon of “Stalinism” as the “secular king” was a universal social phenomenon in the socialist countries.

On the other hand, the people’s level of enlightenment and education was low, which is why, in part, the general public in the twentieth century also sought a charismatic leader, or a “superman who would solve real problems”. Therefore, there was no high hurdle for the person in power to become a “secular king” if he could overcome the competition within the Communist Party. Stalinism, in which certain individual Communist leaders were worshipped and reigned, was a feudalistic phenomenon which appeared in the transitional period of humanity’s transformation from the Enlightenment to the democratic era.

In the first half of the twentieth century, both capitalist and socialist societies had the same social basis, which inclined towards totalitarianism. However, in contrast to the Western countries’ successful escape from fascism after World War II, the newly established Eastern European socialism was forced to follow the Soviet model of Stalinism, which was permeated by totalitarianism. Soviet-style socialism, which could not overcome the notion that Stalinism was the same thing as twentieth century socialism, could not go beyond the “secular monarchy” until its collapse. Its survival was made possible by the crisis that humanity has faced in the twentieth century, a crisis of “war or peace”, and the wartime ideology that the powers-that-be used for the survival of their rule even after the crisis had passed. As a result, the gap between the world that successfully broke free of fascism and the world that suffered from Stalinism widened beyond repair, and societies that were unable to break free from the feudal enlightenment ruling system were left to collapse on themselves.

9.1.4 From National Economic Planning to Wartime Rationing

In Chapter 1 (1.1 The Curse of Ideology), I made the following observation:

“The fiction of political leadership of the national economy by the Communist Party led to the collapse of the socialist economy and, therefore, twentieth-century socialist society. Twentieth-century socialism never surpassed wartime socialism, and the stagnation of the national economy created an unbridgeable development gap between the East and the West, and the postwar wartime socialist system was on the road to collapse.”

If a socialist society cannot establish a “planned economy”, it degenerates into mere dictatorship. The museum-like example of North Korea illustrates this very well. Immediately after the establishment of Soviet socialism, the material balances were drawn up and efforts to formulate a socialist economic plan continued. However, even today, it is not possible to use input-output analysis for economic planning. Therefore, there was an absolute limit to what could be done with paper and pencil in a world without computers. The difficulty of economic planning has replaced national economic planning with the political determination of economic goals. It was the rationing system based on political directives that supported the national economy, and this insistence on political directives has meant the complete exclusion of market forces and the market economy. The rationing system and the political determination of strategic economic goals were the essence of national economic planning in the socialist economy. This was not an invention of the socialists. It was simply the system of allocating goods which had become scarce because of the scarcities that humanity in the twentieth century had developed out of the repeated war economies.

Arbitrariness, of course, enters into political decisions on economic issues. Economic problems cannot be solved by political decisions. However, in a situation in which the planning of the national economic scheme has never gone beyond the “picture”, it was necessary to demonstrate the divinity of the political leaders as if they could solve economic problems in order to maintain and enhance the significance of the Communist Party. However, the stagnation of the national economy and the rationing system not only brought about stagnation in the the consumer life of the people, but also led to their relative impoverishment compared to the countries of the West.

If production and consumption are in a steady state, it is not difficult to formulate a plan using paper and pencil. This is because it is only a routine task that takes into account some percentage increase or decrease in the previous year’s indicators. However, while the Western countries were enjoying a life of consumption with technological innovation and the development of a market economy, the level of consumption in the socialist countries, which could not break free from routine rationing, remained stagnant and the gap between the East and the West only widened. However, the state of pseudo-war between the West and the East suppressed people’s dissatisfaction with their consumer life.

9.1.5 Containment of Criticism and National Isolation

After seizing power, the Communist regime closely monitored criticism of the party and the regime. This is also because it was a “secular monarchy”. Those who defied the monarchy were accused of being unpatriotic. Nevertheless, the rapid socialization of Central and Eastern Europe (the establishment of communist one-party rule and the nationalization of private assets) sparked social uprisings.

Periodically, national discontent became a phenomenon of social uprisings, such as the Poznań riots in Poland, the Hungarian uprising in 1956 and the Prague Spring in 1968. The uprisings in Hungary and Czechoslovakia were put down by Soviet intervention, and from then on, despotic rule was strengthened. Eastern Europe under

socialism consisted of societies that never produced autogenous socioeconomic development, a system that could not be sustained without Soviet military and domestic police power.

The failure of the peoples' uprisings in the Eastern European socialist countries led to a temporary consolidation of political control, but it did not solve the problem of the planned economy. Did Hungary, which was subject to Soviet military rule, Poland, which managed to avoid Soviet military aggression, and Yugoslavia, which went its own way with "workers' self-managed socialism," create their own socialist models? Poland faced a food crisis from the end of the 1970s and gave birth to a fierce labor movement based on "solidarity" and then abandoned socialism in 1989. With Tito's death, Yugoslavia faced a national split and civil war broke out. As the division of the state began, Yugoslavia experienced astronomical inflation, and Poland also experienced severe inflation as the regime collapsed. These were the socioeconomic explosions caused by the "systemic liabilities" of the postwar socialist system.

The "planned economy" under the postwar socialist system did not nurture the national economy, and the economic gap between the West and the East grew continuously. In order to mask this unpleasant fact from the eyes of the people, travel to the West was severely restricted, while on the other hand the embargo on the Western world against the socialist bloc (the COCOM regulations) kept the socialist world in a state of de facto isolation and increasingly left the socialist world behind in terms of development.

But from the 1970s onwards, at least in the Eastern European socialist countries, citizens of these countries came to know, through the spread of television and observations made by travelers, that economic development in the East was largely lagging behind and that consumer life was poor. In the 1980s, Hungary and Poland, where the political system was loosely controlled, started to see an increase in the movement for systemic change. The Communist Party leadership, accustomed to a society of steady stagnation, did not have the capacity to respond appropriately to this movement.

9.1.6 War Socialism

Socialism as it existed throughout the twentieth century did not change its basic character of wartime socialism from its establishment to its collapse. The characteristics of socialism can be summarized as follows:

- (1) The one-party dictatorship of the Communist Party (absolute power of the Enlightenment = secular monarchy);
- (2) The creation of a Communist Party organization and an armed organization (political police) modelled on the military organization;
- (3) Long-term rule by a particular leader (a secular king);
- (4) The abolition of the market economy based on private ownership and business, and the nationalization and collectivization of ownership and business;
- (5) The Political determination of economic targets which, collectively, are dubbed the National Economic Plan;

- (6) Control of production and consumption through a wartime rationing (shortage and price control) system that replaces the market;
- (7) The elimination of criticism of the system and the party;
- (8) National isolation due to restrictions on travel to the west;
- (8) National unity through anti-imperialist ideology that “perpetuates” the wartime regime.

These characteristics are common to all socialist countries, and even in the inertial transition to “peacetime socialism” from the 1960s onwards, the above characteristics were not lost, to varying degrees, until the collapse of the system. A socialism that cannot survive without strict oversight by military and police organizations is “wartime socialism”. The “socialist system” that never brought about economic development led to a degeneration into a society of long-term stagnation, which led to the collapse of the system. A society like North Korea, which is unable to change its system, has degenerated into mere dictatorship.

9.2 Limits of Economic Reform

In the 1960s, when the snow began to thaw between the United States and the Soviet Union, the debate over economic reform in both the Soviet Union and the countries of Eastern Europe became more active. This was because, in everyone’s eyes, the deadlock in the national economies of the socialist countries was obvious. The easing of the tense Cold War situation made possible the search for solutions to economic problems in peacetime. The Communist leaders also began to take the stagnation of the socialist economy seriously. But the search for a solution was not easy. It is extremely difficult to change the situation in which the planning of the socialist economy is no more than a vision or diagram and the implementation of the plan has degenerated into routine price controls and rationing of goods. In a situation in which planning tools are lacking, there is no possible way to develop the economy other than to increase the autonomy and independence of economic agents. However, this would allow for a private system of ownership and freedom to operate, and this created a fear that it would revive the capitalist economy.

These fears sparked a debate on how the introduction of market elements, such as commodity production, would transform the socialist system. In particular, there was a lively debate among experts about the pros and cons of the introduction of the market categories of profit and price liberalization.

In the Soviet Union, Lieberman argued for the importance of profit indices in the evaluation of corporate performance, emphasizing the importance of commodity production in national economic planning and the use of the money economy.¹ In Poland, Brus advocated a “planned economy with embedded markets,”² and this discussion

¹ Evsei Lieberman’s article “Plans, Profits and Bonuses”, which appeared in *Pravda* (September 9, 1962), was the starting point of the discussion of economic reforms in the Soviet Union.

² Włodzimierz Brus, *Ogólne problemy funkcjonowania gospodarki socjalistycznej*, 1961 (General problems of functioning of a socialist economy). English translation: *The Market in a*

had a significant impact on the debate on economic reform in Hungary. In Japan, the meaning of commodity production in a socialist economy became more active, and there was a debate on whether or not the introduction of a market-based value index would lead to a revival of the capitalist economy

In Hungary, where the scars of the Hungarian uprising were still fresh, in an effort to gain public support for economic revitalization, János Kádár engaged many economists to promote discussions on economic reform. Even before the Hungarian uprising, Hungary had an economist, György Péter, who had seen the West and preached the importance of a market economy. He served as director of the Central Statistical Office from 1948-1968. As well as having a great theoretical influence on János Kornai and Rezső Nyers, who directed the economic reforms of 1968 as the member of the politburo of the party, also learned a great deal from György Péter.

Prior to the Soviet Union and other Eastern European countries, Hungary was the first to decide to move from the allocation of direct plan achievement targets to a system of national economic management using indirect regulatory means as of January 1, 1968. This was the reform known as Hungary's New Economic Mechanism. This was due to the reality that the direct method of allocating production targets led to an inertial steady-state economy, and national economic management, in which companies were subordinated to the upper organs, did not work.

However, in the mid-1960s, even in the midst of peaceful coexistence, the world was not in a situation ideologically or politically to promote the radical marketization of the socialist economy. At that time, the principle debate on the rate of profit and the commoditization of the economy was underway, and even in Japan, the possibility that socialist economic reforms could bring about a return to capitalism was being seriously discussed. On the other hand, industrial pollution was getting worse in the advanced capitalist world, and with the Vietnam War and the student movement, the capitalist world could not be considered more peaceful and stable than the socialist world.

Due in part to the instability of the domestic situation in Czechoslovakia (the Prague Spring), strong warnings about the implementation of economic reforms in Hungary had been delivered by the Soviet Union. At the party's Central Committee meeting in November 1967, just before January 1, 1968 (the day of the implementation of the New Economic Mechanism in Hungary), Kádár indicated his stance of restraint on reform by dividing it into two stages, stating that "immediate organization and implementation of the value based relative price setting is impossible" and that "it would

Socialist Economy, ed. A. Walker (London: Routledge & Kegan Paul, 1972). The Japanese translation was published in 1971. Mrs. Helena Brus was prosecuted in her home country of Poland after the system transformation for "charges of complicity in a purge in the military tribunal of the Ministry of Defense as prosecutor of a military tribunal in the early 1950s on". After fighting the anti-fascist battle, she joined the political police and then became a military court prosecutor around 1950. The Polish government demanded in 1998 that the British government extradite Mrs. Brus, who defected to Britain in 1971 with her husband. Włodzimierz Brus passed away in August 2008, and Mrs. Brus passed away in November of the same year in the UK, bringing an event which took place during dark times to an end.

be a reform that would take another ten years to implement". Although perhaps only in very limited way, Hungary started its economic reform in 1968. The following were the six pillars of the economic reform:

(1) The abolition of the method of direct allocation of production issues by central ministries and agencies (material balances of goods);

(2) The introduction of price indicators that reflected the value relationship and free prices; Transition to indirect control using parameter indicators such as prices, credit, wages, tax rates, exchange rates, and the rate of profit in place of the material balances;

(3) The introduction of a profit remuneration (retained profit) standard instead of siphoning off profits to the national treasury;

(4) A shift from fixed wages to wage level regulations;

(5) A shift in emphasis from investment subsidies to bank loans;

(6) The relaxation of restrictions on private business and side jobs.

Hungary's New Economic Mechanism was expected to signal the direction of development towards a socialist market economy, but it had little of the desired effect. The 1968 Prague Spring crackdown deflated the momentum for reform in the Soviet Union and increased political pressure from the Soviet Union, but it was not a decisive cause for the unexpected result of the reform. Without the change in state ownership, and thus without the introduction of market competition, the market economy will not be activated. Without the creation of market competition through changes in ownership, the various value parameters will not function effectively. If a computerized system existed for processing vast amounts of data and controlling the value parameters in matter of an instant (thus, a system that would resemble vision in which the theory of national economic planning is based), even without a change of ownership the socialist market economy might be accomplished. However, no such system has ever existed. The relaxation of private business was only to the extent of allowing small-scale operations, and there was no room for private companies to emerge to compete on the market.

For the Soviet Union, which had suppressed the Prague Spring, Hungarian economic reforms that would give rise to a second Prague were unacceptable. In fact, the Soviet Communist Party was even considering replacing Kádár, who had approved of the beginning of reforms. Nyers once told me that Kádár was waiting on a train at the border area between Hungary and the Soviet Union to act as a bridge between the Soviet Communist Party and Czechoslovakia in the summer of 1968.³ However, the possibility of Kádár's own replacement was being considered by the Soviet Communist Party behind the scenes. The Soviet Union, which had paid a heavy price for the

³ In the summer of 1968, I was accompanying the Japanese delegation to the World Friendship Festival for Youth in Sofia, Bulgaria, as an English interpreter, and I was traveling through Bulgaria, Romania, and Russia. On the way back home, our ship was anchored off the coast of Niigata when we heard the news that tanks of the Warsaw Organization, mainly Soviet troops, had invaded Prague (August 21). This took place in the summer, when I was in my junior year as a university student.

1956 uprising, could not take the risk of replacing foreign national leaders as it had in Stalin's times.

After the Prague Spring crackdown, Hungary's reform momentum was diminished, and Nyers, who had led the reforms, was dismissed from his position as secretary of the Central Committee in 1974 and appointed to serve as director of the Institute of Economic Research⁴ and was also dismissed from the Politburo in 1975. György Péter, a theoretical supporter of economic reforms,⁵ was arrested in late 1968 for charges concerning "the disposal of Napoleon's gold". He was detained in the hospital attached to the Ministry of the Interior because of a heart condition, but he allegedly "committed suicide"⁶ on January 4, 1969. His criticism of the suppression of the Prague Spring was the true reason for his arrest.

It was in December 1978 that I first set foot on Hungarian soil. I still have not forgotten the feeling of loneliness when I landed at the airport. The airport lobby, where there were almost no tourists, was like a huge deserted warehouse or a country airport. The single-story buildings on the side of the road leading from the airport to the center of Budapest looked shabby. This may have been in part because of the climate of the winter season, but I was surprised by the darkness of the city and the lack of much university life. Hungarian society was shrouded in a fog of stagnation.

⁴ Nyers was originally from the Social Democrats. He was someone with no political ambitions, and he was treated by Kádár as a longtime confidant. Nyers's demotion appointment was out of consideration for the Soviet Communist Party. Nyers was also Kádár's tennis partner for the rest of his life.

⁵ Another disciple of György Péter was Márton Tardos, who married Péter's eldest daughter in 1955. I met Tardos at the Blue Ribbon Commission, which supported the economic policies of the new Hungarian government in 1990, and we left Hungary for Japan to attend a conference in Tokyo organized by the Nomura Research Institute. During the trip, Tardos told me many stories.

Born in 1928, Tardos was born into the same Jewish family as Kornai, and he attended the German Imperial School in Budapest, which Kornai also attended. Like many Jewish youths, Tardos joined the Communist Party after the war and was the secretary of the National Union of Students, and was given the opportunity to study at the University of Leningrad (1948–1952) in a training program for the political elite. The experience of his stay there convinced him of the failure of Soviet-style socialism. After returning to Hungary, Tardos worked for the State Planning Agency, where he met György Péter. However, during the Hungarian uprising of 1956, he set up a "revolutionary committee" to support the uprising within the Planning Agency, and after the suppression of the uprising, he was fired from the Planning Agency and relegated to serve as a researcher of the Institute of Business Cycle and Market Economy. Nyers offered Tardos a position at the Institute of Economic Research in 1980, and the two men worked together to propose economic reforms in the 1980s. Tardos was elected as a MP affiliated with the SZDSZ in the 1990 general election. I was going to ask him about György Péter's death at some point, but he passed away in 2006. Nyers passed away in 2018 at the age of 95 years old.

⁶ The historian Huszár states that intellectuals who criticized suppression of the Prague Spring during this period (1969–1974) died suspiciously, and one cannot be entirely certain that Péter's death was in fact a suicide (Huszár 2006, 207–38).

I remember being troubled by the lack of options for consumer goods in daily life. However, unlike in Poland, there was no shortage of meat and vegetables. Nevertheless, there was no hope of developing a market economy in Eastern Europe under Soviet-style socialism in the 1970s. “Socialist planning” simply meant the repression of the market and the nationalization of virtually everything, which resulted in keeping the national economy in a state of stagnation, not only in times of war but also in times of peace. Hungary’s economic reform ended as little more than a slogan. Less than a decade later, two decades from the beginning of the economic reform, the social changes of systemic transformation began.

9.3 Ten Propositions for Understanding System Transformation

As seen in detail in Chapters 3 and 4, the dismantling of twentieth-century socialism, which began at the end of the 1980s, has brought about major social changes. This historical process of change has been referred to as the ‘transition from planning to the market’. However, as I have repeatedly pointed out, this grasp of “transition” does not capture the historical context and nature of the social changes. How, then, can these historical social changes be summarily captured? In the following, I offer ten propositions summarizing the system transformation after the collapse of twentieth-century socialism.

Proposition 1: Redistribution of State and Party Assets

“From an economic point of view, the system transformation in the Soviet and Eastern European countries is a process of redistribution of state and party assets.”

In economics of transition, the system transformation in the Soviet Union and Eastern Europe is seen as a transition from “planning to the market”. From this perspective, the evolution of the market economy was measured by the degree of progress in privatization, that is, the degree of privatization of state enterprises. However, this is a fallacy of economics of transition, which tries to reduce everything to a general model. The “privatization of state enterprises” is nothing more than a theory on the desk. Most of the industrial companies went bankrupt. There were no industrial companies which could be privatized. Therefore, the mass bankruptcy of the key companies created the general crisis of the system transformation. The expression “from plan to market” is elegant, but the real process in these countries was the reconstruction from the planned national economy once it had collapsed. However, the former Eastern European countries did not have the capital to support economic reconstruction. The question of how exactly to make the transition from nothing to something was the “aporia” of the system transformation.

What has occurred in all the former socialist countries is not a privatization process in which state-run enterprises are converted into private enterprises, but a bankruptcy of state-run enterprises and the emergence of a new industrial sector through foreign direct investment. As soon as the national economy was opened up to the outside world, socialist industry almost disappeared like a mist, as if the “magic box” had been

opened. The economics of transition defined the crisis as a “transformational recession” (transitional recession) by accepting the name it was given by Kornai, but this is a fallacy in socioeconomic analysis. It is not a recession in short period, but a crisis of the whole system. Any economic analysis that does not understand this fails to capture the essence of the system transformation. The error of analysis lies in the fact that it lacks an analytical perspective that regards the system transformation as the collapse and rebirth of the historical society.

Of course, resource-related companies and those that had dominance on international markets could follow the privatization process and gain new owners, but they were very exceptional cases, and the overwhelming majority of state industrial enterprises had no choice but to go bankrupt. Those who took over the real estate and some of the employees of the bankrupt companies with small sum of money were able to get the assets of the state enterprises for their own assets, and this became a source of capital for the newly emerging entrepreneurs.

The turmoil caused by the collapse of one socioeconomic system makes a struggle for the remaining assets in the country inevitable. Fierce battles developed over corporate assets and bank deposits (in domestic and foreign banks) held by the state and the Communist Party. Those who benefited from the embezzlement of bank assets, the looting of public real estate, and the acquisition of state-owned corporate assets were former Communist Party cadres and businessmen in their vicinity, leaders of Communist youth organizations, and high-level government bureaucrats who controlled state assets. As state-owned industrial enterprises went bankrupt across the board, the assets left in the banks, the remaining corporate real estate, and the real estate held by the government, the Party, and local governments were all subject to competition for looting.

Clearly, the general economic crisis caused by the system transformation gave the wise men of the old regime a chance to plunder assets. The redistribution of state and party assets was a characteristic form of social behavior in the period of transformational confusion.

The legal determination of “whether the redistribution of state and party assets has been properly carried out” has no meaning in periods of crucial social change. Familiar social norms do not apply to transitional periods in the midst of social collapse. The looting of state and party assets may be a historical crime, but it is not a subject to punishment by society. One could argue that the same is true of war and murder, and the state cannot be charged with murder.

On the other hand, through the redistribution of state and party assets, a new capital (asset) of economic activity was obtained with which to revive the collapsed national economy. In this sense, the redistribution of state and party assets during the transition period can be named the initial accumulation of capital. In countries that could not attract direct investment from outside the country, some former elites with an entrepreneurial spirit started new private ventures with redistributed assets as a source of capital. This is exactly what coupon privatization was: an insider’s Monopoly game of distributing existing public assets, which had been obtained by a former elite class (high-level party bureaucrats and high-level government bureaucrats) who knew exactly where the valuable assets were.

(2) Proposition 2: System Transformation in Itself Makes Corruption Inevitable

“The redistribution of state and party assets makes the corruption that accompanies asset looting inevitable.”

The phenomenon of social corruption in the system transformation process is not a temporary episode in history, but an inevitable phenomenon associated with the redistribution of state and party assets. In the redistribution of state and party assets, those who benefited most were senior government officials with insider information concerning their respective assets, and senior Communist Party officials who were in a position to control and dispose of the party's finances and assets. Using various personal connections, they cleverly and skillfully plundered the public assets, taking on the minimum guise of legality. There was no such thing as socioeconomic ethics in their behavior. This is because under the old regime, the concept of bribery itself did not exist, nor did the concept of misappropriation of public assets, for the Communist Party itself was an insider organization. Therefore, even if potentially large marketable assets were plundered in exchange for small amounts of money in the chaos of regime change, there was neither a suitable, effective organization nor the necessary social ethics to deal with this. In a transitional society in which the old social norms had broken down and no new norms had been established, there was no social institution or posture capable of policing and punishing historic crimes.

Asset looting was not limited to state enterprises in the industrial sector, but also extended to the looting of bank assets (fraudulent loans), which led to the insolvency of most banks in Central and Eastern Europe in the mid-1990s and the need for buy-out arrangements by foreign banks at the end of the 1990s. In the turmoil of the system transformation, bank loans were defrauded by borrowers, who declared insolvency and moved the money to another company. This led to the insolvency of many of the banks and made it impossible for them to survive except through sale to foreign banks.

As previously mentioned, in Hungary's case, the assets of not only the domestic bank but also the Vienna branch of the National Bank (CW Bank), which was opened in Vienna in 1918 and served as a link between Eastern and Western funds during the Cold War, fell prey to the red mafia associated with the communist parties of the region. From the start of the process of system transformation until the mid-1990s, the assets of the bank's \$290 million were stolen by the flow of funds to black companies linked to the leaders of the Communist parties of Eastern Europe, including Hungary, as described in detail in Chapter 3.

Economics of transition tries to understand the phenomenon of crime and corruption in the system transformation with a simple general concept of rent-seeking. Based on a simple model of market equilibrium, rent-seeking is a static analysis that classifies the conditions under which various excess profits are generated and links corruption to the acquisition of excess profits. It is far from being a dynamic analysis of social change. As long as we stick to the neoclassical model analysis, we cannot understand or analyze historical crimes against the backdrop of historical and dynamic social change.

(3) Proposition 3: System Transformation is the process of creating something out of nothing.

“The transformation of the national economy into a market economy started from nothing, where most of the state enterprises went bankrupt”

In the process of system transformation, the companies that followed the process of “ownership conversion of state-owned enterprises to private enterprises” envisioned by orthodox economics were extremely exceptional, and most state-owned enterprises went bankrupt. As a result, GDP declined substantially in all transition countries, with GDP declines ranging from 30 % to nearly 70 %. Obviously, this should be regarded as a “system transformation crisis” that threatens the existence of economic society rather than as a “recession.” Orthodox economics does not grasp the fact of the collapse of the national economy, and therefore cannot analyze the difficulties of national economic reconstruction in the transition economies.

If state enterprises go bankrupt in a socialist country where there is no capital accumulation, the impetus to develop the national economy is lost. The conversion to a market economy in the former socialist countries had the aporia of “starting from nothing” with zero accumulated capital. The only source of capital (initial accumulation of capital) was redistributed state and party assets, but in the absence of an influx of fresh money and the introduction of technology, it was difficult to develop market-competitive business activities, and the only way to do this was to continue the game of monopoly (coupon privatization), which merely changed the ownership of the companies.

Thus, the system-transforming countries were confronted with an unsolvable problem: how can they create something out of nothing? This is the aporia of the system transformation. Economics of transition fails to recognize this basic problem in system transformation. This is because it lacks a dynamic analysis of socioeconomic society.

The solution to this unsolvable problem is foreign direct investment. Fresh money, technology and management are introduced by foreign capital. Foreign investment also makes it possible to cash in the looted state and party assets and use them to establish companies that can compete on the market. Emerging entrepreneurs in each country were able to follow this process to set up capitalist enterprises. However, old-style national economic management and corruption has been going on in countries where foreign investment has not arrived.

None of the countries in Central or Eastern Europe would offer a good case study or illustration of the simple privatization model envisioned by economics of transition, and the reconstruction of the actual national economy was carried out by foreign capital (multinational corporations) and the initial accumulation of redistributed state and party assets. Economics of transition is incapable of this kind of political economy analysis, and creates only a conceptually conceived model of a non-existent process “from plan to market.” In this sense, the privatization model of system transformation is little more than a (fake) model.

(4) Proposition 4: Industrial Reconstruction Depends on Direct Investment

“Reindustrialization in the transition countries depended on foreign direct investment.”

The collapse of the old system opened up the borders and made it clear that there were no socialist state enterprises capable of competing on the world market. The industrial enterprises of the former socialist countries were almost completely destroyed. Coupon privatization could not be the driving force for corporate revival and ended up merely facilitating the transfer of ownership of existing assets. Therefore, in countries in which there was no influx of foreign capital, the industrial revival did not progress and the national economy remained stagnant.

Many countries undergoing system transformation were initially wary of foreign investment. Poland was forced to choose to defer its external debt and Hungary was also struggling with financial debt. Therefore, other East European countries were highly wary of foreign investment. Many economists and political leaders in this region were also hesitant to allow foreign investment to flow in, as they were unable to distinguish between foreign financing and direct investment. In this context, Hungary was the only country to actively attract multinational companies from the early days of the system transformation to reconstruct its national economy. This is the reason why Hungary did not have to adopt the coupon privatization method.

The reindustrialization of the countries undergoing system transformation made no progress at all until the beginning of direct multinational investment in the industrial sector. The inflows of foreign investment determined the economic growth of the countries undergoing system transformation. However, this did not imply the establishment of a market economy. Foreign investment only requires wage labor for the manufacture of products for export, and it does not develop the domestic markets of the countries undergoing transformation.

The animal spirit of stealing the technology of multinational companies to develop domestic enterprises, as in China, was lacking in Central and Eastern European countries. Therefore, although the introduction of foreign investment increases the wage labor and exports of foreign companies, it does not directly work to transform the national economy into a full-fledged market economy. Thus, direct investment by foreign companies does not contribute to the development of domestic market of the country concerned. A large influx of the direct investment has rather created a unique national economy, a “borrowed economy” in the countries undergoing system transformation.

(5) Proposition 5: The Transformation of the National Economy into a “Borrowed Economy”

“The influx of foreign capital has transformed the national economy into a borrowed economy.”

FDI in the industrial sector brings capital, technology and management to the transitioning country, but these remain the property of the foreign company. The recipient countries of FDI only provide the labor force, and in most cases the component suppliers are also foreign companies. The introduction of foreign investment can trans-

form the national economy into a new industrial country overnight, but that is only a matter of appearances. The creation of a new industrial sector by foreign-invested companies is nothing more than a “borrowed landscape” for the national economy of the country. If foreign-invested enterprises withdraw from the country, the “borrowed landscape” also disappears. In this sense, we can call it a “mirage economy”.

I describe this situation a “borrowed economy”. “Borrowed” means, quite simply, “borrowed,” and this should not be misinterpreted as a form of self-reliance for the national economy. Foreign-invested companies may contribute to the GDP, exports and investment, but they do not directly represent the economic strength of the country in question. Therefore, simple comparisons of GDP growth rates and increases in exports and investment do not reflect an analysis of the actual state of the national economy of the country in question.

The borrowed economy constitutes a kind of concessional area in the national economy. Foreign-owned firms that manufacture export goods are the concessional bases of the national economy, and their impact on the domestic market economy of the country in question is very limited. In other words, the spheres of business functioning in the domestic consumer market and the sphere of functioning of the multinational corporation do not intersect much or form a relatively independent sphere. This is because the adoption of subcontractors of the country concerned is very rare, and the MNCs either bring in reliable subcontractors from outside the country or import critical components from reliable firms outside the country. Thus, with a large number of firms with a manufacturing base for West European markets, Hungary becomes a dual-structured economy in the sense that the national economy consists of two spheres.

The presence of multinational corporations in the country does not contribute much to the national economy except wage, income tax, social insurance and corporate tax. Therefore, no matter how much exports increase as a result of the expansion of multinational corporations, FDI does not contribute to the development of the domestic market economy.

In the early days of the process of system transformation, FDI was unconditionally welcomed, but now, thirty years after the transformation, in order to develop the domestic market, multinational companies must be able to transfer technology to local firms to provide value-added components. Development partnerships with local universities and research institutions are also important. However, many of the regions where MNCs operate are poor and suffer from widespread unemployment, and they are therefore content to create mere wage labor opportunities.

(6) Proposition 6: Workers Becoming Guest Workers in the Borrowed Economy “Workers in a borrowed economy become guest workers while in the country.”

Workers in foreign companies cannot have a high level of loyalty to their companies. A foreign company is not a domestic company. Therefore, workers become like guest workers even if they are in their country of birth. In other words, they will act and work as if they were guests in their own country. Workers are interested in wages

and working conditions. If the foreign company wants cheap labor and the workers are not happy with their salaries, they will easily move to another foreign company for higher salaries and better working conditions, rather than demanding a raise through the union. This places a huge burden on foreign industrial companies to recruit and manage workers.

This behavior of workers will not rely on the old bargaining through trade unions, but will dominate the workers' actions for their personal benefit. As a result, the pressure on management to raise wages is weakened, but on the other hand, management will have labor management issues, as it will have to deal with the arbitrary departure of workers.

It is true that by working in a multinational corporation, workers learn work ethics and ways of working that they could not learn in the old socialist corporations, and this raises the standards of work ethics in society. However, if the multinational corporations move out of the country, there will be nowhere to put the work ethics that workers have learned to use. That is why it is necessary to make efforts to link the expansion of multinational corporations to the revitalization of local industries, rather than just fully dependent on the multinational corporations. This will require a conscious effort on the part of the government and local governments to develop policies for the development of local industries, but it will not be easy.

On the other hand, paying exorbitant salaries to high-level managers has become commonplace in foreign companies in the financial sector, creating a special aristocratic white-collar class. If workers are to be guest workers, the managers who acquire exorbitant salaries compared to their ability are governed by a mentality of "indulgent dependence on others". It has become common practice to hire managers at a salary level comparable to that of the West, rather than in line with the market and competence. In this book, I refer to this as the "aristocrats in the era of the system transformation".

(7) Proposition 7: Deterioration of Social Norms and Work Ethics

"In a borrowed economy, work ethics and social norms are degraded."

The "guest worker phenomenon" and the aristocratization of some elite cadres significantly lowers work morale. Hungary's current leave system follows that of the old socialist era, with annual leave increasing in proportion to natural age, not in proportion to years of service. The annual leave starts at 20 days and reaches a maximum of 30 days at age 45. In addition to this, there are 15 days of sick leave (with a certain percentage reduction in daily pay), which amounts to 45 days of paid leave per year if all the sick leave is used. That's actually nine weeks. Lower-paid factory workers use their leave to the maximum extent possible, while higher-paid executives spend their excess payment on buying vacation homes and spending on leisure activities. These work practices increase the number of workers who are absent from work, significantly reducing productivity and making them less loyal to the company.

Large economic disparities with countries in the West will never be diminished if the workers in the countries undergoing system transformation enjoy leisure time as

much as the workers in the West. Income convergence will never be achieved through EU subsidies. Only by developing market economies through self-help and raising income levels will the income gap between the East and West be closed. Therefore, workers should not rest in the same way as workers in the West. It is a truth that applies to all worlds. It is self-evident that an athlete must work many times harder than other athletes if he or she wants to be a top competitor.

However, for the guest worker, developing the company is not the primary objective. Making the best use of their own rights is the primary objective. If all workers were to have full access to paid leave, sick leave and maternity leave, at any given time 25-30 % of the workforce would be absent from the workplace. If workers in the countries undergoing transformation want to use their full right to the leave, the company would have to hire 30 % more workers to maintain the production line. Managing workforces and making sure the lines do not come to a halt has become the biggest challenge for foreign companies in the countries undergoing transformation.

Thus, employment through the expansion of multinational corporations does not allow workers to develop a strict work ethic, unlike employment in local, homegrown firms. Workers who do not have the experience of supporting and developing their companies in the rigors of a market economy will not be able to adapt the strict work ethic available in foreign companies to social norms.

On the other hand, it is difficult for elite managers to be familiar with the problems in the field and proactively recommend improvement measures themselves. This is because they are doing merely subcontracting work of the foreign staff dispatched from headquarters. As long as they are not given independent responsibility, they will not be able to acquire a high work ethic as managers.

(8) Proposition 8: The “Welfare State” Supported by an Immature Market Economy
“A stagnant market economy limits the development of a welfare state.”

Kornai characterized the former socialist state as a “welfare state as a baby born prematurely” (*koraszülött jólét állam*, the premature welfare state). The supply of welfare services, unsupported by economic development, is extremely poor in both quality and quantity. It is impossible to provide quality services and benefits, whether educational services, medical services in hospitals or pension payments, without the backing of economic development. However, the former socialist states suffered from a stagnant level of technology and chronic shortages of various commodities, and slow economic development prevented them from updating the facilities of schools and hospitals and raising the incomes of civil servants. Even today, after 30 years of the system transformation, many schools and hospitals in Hungary are still operating with poor facilities. If we look only at the physical facilities aspect, there still exists 30-40 year lag compared to the developed countries. The situation in the countries east of Hungary is even worse.

The former socialist countries that were in a state of isolation from the rest of the world have suppressed social discontent arising from the lack of material goods and services by providing workers with sufficient leave. Regardless of work experience, the

number of annual leave days determined by natural age was comparable to that of the western countries, and workers supplemented the lack of everyday goods and services (dissatisfaction) by enjoying their leisure time.

As Kornai points out, the former socialist countries were not welfare states backed by a highly developed market economy. Instead, they took on the appearance of a welfare state by giving workers sufficient leisure time, giving them as much leisure time as the Scandinavian welfare states. Clearly, the underdevelopment of the market economy has hindered the rise in income levels and the development of the diversity and quality of goods and services. Therefore, the national goal of system transformation should have been the establishment of a welfare state based on the development of a high degree of market economy.

However, since the system transformation, the welfare (social security) systems of the Central European countries have inherited the systems of the old system, and they have continued to exist without any major changes. Under the old system, the “welfare state born as a premature baby” maintained a low-level social security system without being based on the development of a market economy. Even after the transformation, it has continued to be a system of “early retirement and pension welfare state” without being supported by economic development. Even after the transformation, pensions from early retirement are allowed, mainly for military personnel, firefighters and workers in hazardous occupations. However, it is not possible to live on pensions alone in Hungary, where income levels are low. Thus, even today, the system is unable to guarantee an adequate income for living, and instead by providing freedom from work, the state pretends to be a “welfare state”.

Even after the transformation, the substance of the social security system has remained largely unchanged from the old system. If the countries of Central and Eastern Europe, which are less economically developed than the western EU countries, try to maintain the same leave system as the western countries to secure their leisure time, they will not be able to bridge the gap in the level of market economic development and income between the West and the East.

(9) Proposition 9: “Treasurization” of the Economy Impedes the Development of the Market Economy

“The tresuarization of the national economy limits economic development based on a market economy.”

The biggest economic problem of the old socialist era was the degeneration of the national economy into a long stagnated economy through the political suppression of the market economy. The market economy cannot develop if it is not supported by the independent and self-reliant economic activities of businesses, and without the development of the market economy the state cannot provide a high level of social material facilities and social services. But the politicians who supported the system transformation never discussed where the core of the economic problems lay. As with the establishment of the socialist regime, politicians were most concerned with the seizure of political power and never seriously discussed the economic policies that

the government should implement. They let the matter take care of itself and just kept tax revenues and high redistribution rates in order to deal with the accumulated external debt. As a result, the transformation of Hungary into a market economy has fallen far behind.

As described in Chapter 3, Hungary's value added tax is the highest in the world at 27 %. The social insurance burden on employees and businesses is also high. As a result, the rate of income redistribution is as high as in Western European welfare states and Scandinavian countries. However, this does not mean that the level of social security in Hungary is as high as in the Nordic countries. With a low level of market economy development, Hungary has a low level of economic development, and its pension and health insurance systems have the same problems as the old system. The Hungarian economy, with its lack of economic development and large redistribution of income, has allowed the treasury to surpass the market, and the market is subordinated to the treasury, hindering the development of the market economy.

Just as the old socialist economy fell into a stagnant economy because it repressed the market economy, the national economy after the system transformation has also fallen into an ironic situation in which the national treasury is bloated like a money-eating insect, holding back the development of the market economy, and therefore failing to accomplish the high level of development of the market economy.

(10) Proposition 10: The Trap of the Treasurization of the National Economy

“The Hungarian economy has fallen into the trap of the treasurized economy and it is difficult to get out of it.”

If a Hungarian enterprises want to develop a large business in the country, it is quicker to deal with the government, which holds half of the national income. It is much more efficient to sell goods and services to national and local governments by taking public orders from the state and municipalities than to do business with consumers who have little purchasing power on the market. The relevance of this insight is not limited to Hungarian companies. Computer equipment and software from multinational companies would also be time-consuming and costly to sell through the market, but it would be as easy business if the government and municipalities would buy it in bulk. In these situations, the success or failure of a business depends on using connections with politicians and high-level bureaucrats to win public orders rather than trying to do business in the marketplace. Inevitably, therefore, corrupt relationships with bureaucrats and politicians are more likely to emerge. It is not easy to break away from the treasurized economy.

Since the state has the power to dispose of half of the people's income, dealing with this largest income holder is what makes a business successful. Even companies with no track record can scale up their operations in one night if they use their political connections to obtain subsidies or win public orders. If they can repeat this process, they can develop their private businesses with public funds alone, not relying on the market.

Because the domestic market itself is small, the easiest way to make a profit in Hungary is to take bulk public orders, rather than sweating on the market. Many of

Hungary's billionaires are people who own companies that have been expanded by public orders. It is not easy to get out of such a system. This is because there is a great advantage for both politicians and businesses to maintain a system in which the state holds and shares mutual benefits.

Once an economy has fallen into the trap of a treasurized economy, it is difficult to break out of that trap. Neither the ruling party nor the opposition parties have shown any interest in reducing the rate of redistribution, so a change of government will not result in a break from the treasurized economy. However, as long as the treasurized economy continues, the dynamic development of the market economy cannot be accomplished, as in the old regime of the welfare state can only exist on the immature foundations of the market economy. Despite the system transformation, the tasks of building a welfare state in Hungary have remained to be unchanged.

9.4 Social Norms and Ethics

The collapse of socialist society does not mean the collapse of the social norms (values and ethics) of the socialist era. Even if the existing social institutions collapse, the social norms that govern people do not easily change. Until new social norms come to govern people in the new society, the old norms will govern people, although in the chaos of social destruction, the social norms that had controlled social behavior are temporarily lost, and people's urgent wants and egoistic values dominantly control their behavior.

A great variety of looting, embezzlement, defrauding, fraud, breach of trust, lobbying, kickbacks and other injustices unfolded in the process of historical change of the social system. Obviously, these social injustices were allowed to take place because of the lack of civil society norms and ethics in the old system, the socialist era. Therefore, in considering social injustice in a system-transforming society, it is essential to examine the social norms and ethics in twentieth-century socialist society.

What were the social norms of the socialist era? Obviously, they were not based on the horizontal relationship of mutual equality found in Western civil society. The norms that dominated socialist society were the social norms in which the dictatorial party, the Communist Party, retained absolute power. The old society consisted of two layers, the Communist Party and the other layer of society, and there were norms (ethics) that governed each layer and norms (ethics) that controlled the interrelationship between the two layers.

9.4.1 Social Norms and Ethics in Twentieth-Century Socialist Society

In the socialist societies of the twentieth century, there were no civil norms and ethics to control the behavior of communist parties and politicians. This is a very interesting social phenomenon. Originally, socialist ideology was an ideology of social construction, but it did not have an effective ethical code to control the behavior of individuals, including politicians. This is the decisive difference between socialist ideology and religion.

Twentieth-century socialism was influenced by the Enlightenment monarchies of the nineteenth and twentieth centuries. The idea of an almighty party leading the construction of society instead of the Enlightenment monarchs, leading the people to a utopia, is a working-class version of the enlightened absolutism which appeared during the transitional period from the feudal era to the modern era. Like the Enlightenment monarchs, it is based on the idea that the Communist Party is omnipotent and all-knowing, and that if everything is left to the Communist Party, society will become a utopia. As the enlightened absolutism presupposed, at the top of society there is Almighty Knowledge, and underneath it are the people, who follow Almighty Knowledge. This is the relationship between the king and the people in a monarchy: the monarchy of one person (one family) was replaced by an organized group called the Communist Party, but soon the head of the organization in every Communist Party became the monarch. So much so that twentieth-century socialism was a system deeply influenced by the modern monarchy.

In a twentieth-century socialist state, the Communist Party is the organization that stands above everything and is above the laws of the state. Everything the Communist Party directs is correct and must be followed by all people in society. Even within the Communist Party, the Politburo cadres stand above all Communist Party members, and the General Secretary of the Communist Party, who ultimately leads the Politburo, is the monarch of the organization. Without exception, the Communist Party organization has somehow turned into a personal dictatorship precisely because the Communist Party organization itself has been dominated by the monarchical principle.

In 1950, shortly after the Communist Party (Hungarian Workers' Party) came to power in Hungary, four houses for Communist Party leaders (politburo) were built on a large plot of land in District XII of Budapest. There now exists a large hotel-like building that serves as a state guesthouse for foreign diplomatic guests. A total of four people, three members of the Politburo (Gerő, Farkas and Révai) and the chairman of the party's municipal committee (Zoltán Vas), moved in there. At the time, General Secretary Rákosi lived in the mansion on Lóránt Street in District XII, not far from the site, but he did not move into this house for the Politburo members. Rákosi gave the residence, which was supposed to house the top four members of the Politburo, to Vas because he planned eventually to move into the royal palace in Buda Castle. By settling in the palace, he was planning to become a monarch and gain a dictatorial position that would distinguish him from the other three in the Communist leadership, which was said to be the Gang of Four. Thus, the very beginning of the Rákosi dictatorship began with the choice of residence.

Currently, Hungarian President János Áder resides in the Presidential Palace in Buda Castle, but Prime Minister Orbán also moved from Parliament to Buda Castle in January 2019 and began using it as the Prime Minister's Office. Meals at the Prime Minister's Office are provided by the fine dining restaurant Gundel, which has been given a kitchen in the PM's office, where chefs prepare the food. Hungarian politicians consider Buda Castle a special area and a symbol of their rule. That's what every politician who has won an autocratic position wants, regardless of political ideology; in the twenty-first century, politicians with an autocratic position still want to be monarchs.

They do not want to be in the post only for a period of time that is given by elections, but like the monarch, they want to stay in that position forever.

As this example shows, every politician who has achieved a dictatorial position, whether in the Communist Party or in a party that criticizes it, tries to cling to that post forever, like a monarch. They gain all kinds of privileges and feel satisfied with the illusion that they are special people. There is no ethical code to control the behavior of a monarch.

Thus, the social norms and ethics of civil society do not work under an individual dictatorship or a one-party system.

First, because the Communist Party itself was an insider organization, there was no social norm that recognized the acquisition of profits from insider information as unfair. If one was in the Party, one could enjoy all sorts of benefits from insider information, but if one remained outside the Party, one was alienated from the benefits that insiders acquired.

Second, there was also no notion of unfair provision of conveniences. As long as the approval of the Communist Party was obtained, the conveniences provided for a specific individual were not considered a form of unfair social behavior as long as they were approved and settled by the Communist Party. Even admission to the university was a matter of convenience, and the installation of telephones and the provision of workplaces, which were valuables, were provided in return for joining the Communist Party or for recruiting for the secret police.

Third, since the Party's decisions were absolute, if the acquisition of benefits was based on the Party's decision, it would not be recognized as bribery, no matter how unreasonable it may have been. Only when a person acquired slush funds outside of the Party's decision was this regarded as accumulation of private property and denounced because, unlike civil society's conception of bribery, it was a violation of the Communist Party's decision. Basically, there was no notion of bribery associated with the company's business because there was no private enterprise delivering materials to a state-owned enterprise.

Fourth, there was also no notion of a breach of trust. With the decision of the Communist Party (leaders), the drainage of Communist Party assets, state assets, and state-owned enterprise assets to specific individuals or groups was not recognized as a "breach of trust".

In the first place, if both the company and the residence where the individual lived were public assets, the scope of private wealth was extremely narrowed. From there, the distinction between private and public assets was blurred. It was merely a tautology that public assets belonged to the people, and in fact the benefits were available to Communist Party members and, among them, senior officials, who enjoyed a wide range of privileges. Hospitals dedicated to Communist Party officials, for example, were a privilege that were found in every socialist country. In Hungary, the Kútvölgyi Hospital, next to Szent János Hospital, was a hospital for Communist Party cadres.

Thus, in a society in which one-party rule prevails, social behavior that is perceived as corrupt is extremely limited. This is because the party itself is an insider organization and its decisions are absolute. Once tolerated by the superordinate organizations,

the actions of individuals in subordinate organizations and end organizations cannot be perceived as corrupt or unjust. As long as a system of supremacy and subordination pervades the entire society, everything approved by the top is righteous, and everything not approved by the top is simply judged as wrong.

As long as there is a lack of horizontal human relations in civil society, the social norms of insider, bribery (giving and receiving of bribery) and breach of trust that civil society has created over time will not permeate or penetrate society. Moreover, importantly, the irrational social inertia of the old society will persist even after the disappearance of the one-party dictatorship, and there will be a transitional period in which many social injustices and corruptions will not be recognized as crimes for quite some time.

The case of Hungary shows that it will take a considerable amount of time before the social norms of ordinary civil society become the norms of social behavior and effective control over citizens and businesses. As far as one can observe 30 years after the beginning of the process of system transformation, it is assumed that civil society norms and ethics will not take root in society for at least another 20 years, that is, half a century after the regime change. Moreover, whether they will actually take root depends largely on the penetration of market economic principles. It will take a considerable amount of time for civil society social norms and ethics to be established through the penetration of horizontal relationships of economic players. So strong is the social and historical impact of the enlightened absolutism and the one-party dictatorship that imitated it in the nineteenth and twentieth centuries. This shows that a considerable amount of historical time is still needed before humanity can completely break away from the enlightened absolutism.

9.4.2 Changes in the Phenomenon of Corruption in System Transformation

The phenomenon of social injustice and corruption in the process of the system transformation can be observed in three periods (stages).

The first is the looting of state and Party assets, which can be observed in the period of confusion immediately before and after the beginning of the transformation. I defined this as a process of redistribution of state and party assets and analyzed it as an initial capital accumulation process for the transition to the new economic system. Looting by those who were in a position to know the whereabouts of the state and party assets with minimum form of legality was widespread in all countries undergoing system changes. This period was also a kind of legislative vacuum, during which the social injustices were able to pass through the laws and regulations of individual countries, although they were condemned as historical crimes. Therefore, most of the social injustices of this period were carried out without social or sanctions or punishment, and public assets were converted into private assets. The phenomenon of corruption in this period is analyzed in Chapter 3.

How far this period lasted depends on the economic and social development of each country. At the very least, it is reasonable to assume that the process of redistribution of state and party assets in Central and Eastern European countries continued

until the end of the twentieth century. The “illegal sale of foreign assets in Hungary,” as described in Chapter 4, can be considered the last process of state asset redistribution, even though it took place after 2000.

After the overt plundering of state and party assets had settled down, the second stage of social injustice and corruption began. The phenomenon of injustice and corruption shifted from simple looting to the embezzlement of assets aimed at the gaps in corporate management. Most of this embezzlement is or was set in public business entities that remain state-owned or publicly owned with weak managerial oversight and supervision. As many socialist enterprises were taken over by foreign capital, attempts were made in various ways to turn the assets of the remaining public enterprises providing public services into private assets. Not only in the Budapest Transport Corporation, but also in the Hungarian Electric Power Company we have observed many cases of various favors in placing orders with subcontractors (bribery), fraudulent subcontracts (false contracts), and the drainage of company assets through foreign investment (fraud and breach of trust). Moreover, these social injustices are rarely legally sanctioned. Neither the corporate entities nor the prosecutors in the countries undergoing transformation have had the capacity to check the content of hundreds of thousands of subcontracts and scrutinize the consistency of costs and outcomes. Moreover, the outflow of assets out of the country was difficult to investigate and to prove a crime. The phenomenon of corruption in this period is analyzed in Chapter 4.

As charges and scrutiny of misappropriation of corporate assets in public corporate entities strengthened and corporate compliance was established, misappropriation of corporate assets became increasingly difficult. After increased internal scrutiny of public companies, social misconduct shifted to fraud and lootings of the state budget (subsidies, public orders). This is the third stage. The phenomenon of corruption during this period was also analyzed in Chapter 4. The fraud at this stage is mainly related to state subsidies. Especially after the accession of Central and Eastern European countries to the European Union, the fraudulent use of government subsidies combined with EU subsidies became more frequent. However, even at this stage, there has been almost no social punishment for instances of fraud, much as there were no arrests of politicians or proceedings implemented by prosecutors in the respective states.

Moreover, the looting of state assets by ruling party politicians using state institutions, as in the case of Hungary’s “sale of government bonds with the right to settle”, cannot be punished as long as these acts are condoned by the heads of government, even though they are clearly crimes to which breach of statehood can be applied. This indicates a serious lack of basic conditions for the reign of law. The absence of a relatively independent and powerful prosecution, and the dominance of the judiciary by a political party make it impossible to control and monitor the various instances of fraud committed by the ruling party. Of course, it is not just a matter concerning the ruling party. The fact that the social consciousness and norms of the opposition parties and the people who are supposed to monitor them are not so different from those of the ruling power side has led to the tyranny of power.

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