

# Market and Democracy: The Dual Transition in Hungary

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## 1. Theoretical Controversies

In East Central Europe the sudden and unexpected collapse of state socialism assumed the form of a dual transition from a centrally planned economy to a market economy, and from an authoritarian political system to a democratic one. From the perspective of a liberal economic science, this transition to democratic capitalism was expected to be a coherent and relatively smooth process. Economists could argue that the replacement of the inefficient and wasteful institutions of state ownership and bureaucratic coordination with the efficient institutions of private ownership and market coordination would free economic resources that would serve as a basis for a new prosperous economy. They could also argue that democracy as a political framework for the economic transformation would reinforce the effectiveness of economic reforms, since political democracy is the optimal political institution for a functioning market economy.<sup>1</sup> However, liberal economists are also aware of the fact that radical economic reforms may be halted under democratic political circumstances if decision makers cannot be insulated from the public.

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1 ‘...democracies have the great advantage of preventing significant extraction of social surplus by their leaders. They also have the extraordinary virtue that the same emphasis on individual rights that is necessary to lasting democracy is also necessary for secure rights to both property and the enforcement of contracts. The moral appeal of democracy is now almost universally appreciated, but its economic advantages are scarcely understood’ (Olson, 1993: 574-575).

## 2. Losers Do Matter

Political economists made the possible tension between capitalism and political democracy a point of departure for the analysis of the transition. Offe (1991) argued that the economic efficiency of capitalism and the political legitimacy of democracy may ruin each other if they were introduced simultaneously. Economic reforms that produce serious economic problems, inflation, growing unemployment, high uncertainty and loss of welfare for a great number of citizens may be carried out only if voters remain patient and do not use their voting power to stop those reforms.

As macroevents have assumed an incredible speed, the painful task of patient waiting falls upon individuals. They must quickly adapt themselves to the new circumstances and then be ready to wait long for the fruits of this adaptation. They need this patience in order not to interfere with the ‘creative destruction’ which will follow the price and property reform in a perfectly intended manner, although by making use of their newly won civil rights they would be quite capable of doing so (Offe, 1991: 887).

Przeworski (1991) argued in a similar vein.<sup>2</sup> He pointed out that the neoliberal arguments in favour of radical economic reform may founder on the tension between democratization and marketization. Democracy may prove to be a threat to capitalist economic reforms and vice versa, capitalist economic reforms may threaten democracy.

In turn, under democratic conditions, where the discontent can find political expression at the polls, even the most promising reform strategies may be abandoned. Either politicians are concerned about electoral support and reverse policies that will cause them to lose elections, or they lose to competitors more attuned to the political

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2 ‘Even if the postreform system would be more efficient – more, even if the new steady state would be Pareto-superior to the status quo, that is, no one would be worse off in the new system and someone would be better off – a transient deterioration of material conditions may be sufficient to undermine either democracy or the reform process’ (Przeworski, 1991: 137).

consequences of structural transformation. And in some cases, egalitarian ideologies with strong populist and nationalistic overtones can be mobilized against both democracy and reforms (Przeworski, 1991: 138).

Due to this dichotomy one would expect either the slowdown of economic reform, because governments seeking political legitimacy will have to respond to popular demands, or the increase of democratic deficit that may finally lead to new autocratic regimes, because elites in power try to insulate themselves from popular demands in order to be able to carry out economic reforms (Przeworski, 1991: 183).

However, the empirical facts of the post-socialist transition showed that the theory about the tension between capitalism and democracy could not explain or predict what happened in Eastern Europe after the collapse of socialism. It turned out that those countries that entered the path of radical economic reform were the most successful ones and were able to put an end to the transition without endangering political democracy, while those countries that were not able to carry out radical economic reforms became the weakest democracies, faced long term and deep economic crises, and sometimes built up new authoritarian states. In the light of these events the argument about the tension between democratization and marketization was soon challenged by alternative explanations.

### 3. Winners Do Matter

Hellman (1998) pointed out that the process of capitalist transformation may be halted not by the losers, but by the winners. Losers did not use the system of democracy for discarding economic reforms. On the other hand, those winners of partial reforms, who could generate rents from the collapse of the socialist economic system and the slowness of economic transformation had a real stake in preserving those economic conditions that created rents for them. Hellman explained this seemingly paradoxical situation by the structure of the transformational costs and benefits. Benefits from the winners' rents are concentrated in the

hands of a few interest groups that have an incentive to organize collective action in defence of the new status quo. Costs have to be born by a great number of losers, but these costs are dispersed (Hellman, 1998: 204-205). In order to safeguard the economic transformation one does not have to care about the losers, but should pay attention to the winners, argued Hellman.<sup>3</sup> Winners should be constrained by the political system in their endeavours to stop economic reforms. In other words, democracy is not an obstacle but an indispensable means for the success of economic reforms, because only a competitive political system may be able to control the rent-seeking behaviour of elites.<sup>4</sup>

Greater participation of the losers can be expected to check the power of the winners to veto reform measures that do not coincide with the latter's short-term interests. More importantly, politicians who face regular, genuinely competitive elections may be constrained from pursuing policies that concentrate gains to a narrow segment of the electorate while generating high social costs (Hellman, 1998: 229).

Democracy that puts politicians under the electoral control of citizens may provide incentives for those in power to contain the rent-seeking behaviour of short-term economic winners.<sup>5</sup>

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3 'The political dilemma of economic reform is not how to sustain reform in the face of opposition from the net losers in the short term, but how to advance reform in the face of efforts by the net winners to preserve the market distortions that produced their gains in the short term' (Hellman, 1998: 223).

4 'Political systems that concentrate more power in the hands of the winners are more likely to preserve partial reforms over time. By contrast, political systems more open to the participation of the losers in the policy-making process should generate a greater dispersion of the gains of reform' (Hellman, 1998: 228).

5 'Political inclusion could alter the dynamics of the reform process in two possible ways. First, greater political inclusion could lead to a greater dissipation of the rents from partial reforms, as more groups demand their share of the short-term gains. As the private gains to specific groups decrease, the advantages of partial reforms over comprehensive reforms are also reduced. Second, the greater the degree of political inclusion in the decision making on economic reform, the less likely it is that the winners will be able to impose policies that bring them private benefits at a high social cost. Political inclusion can act as a constraint on the winners, un-

However, Hellman's theory leaves open a certain number of questions. The author says that the cost-benefit structure of collective action explains the paradox of why the winners and not the losers may stop economic reforms. This argument finds that winners will have more incentives to organize, than losers have, because benefits from partial reforms are concentrated and costs are dispersed. The theory of collective action explains satisfactorily why winners may mobilize against radical reforms, but this argument is not apt for explaining simultaneously why losers would refrain from collective action. It may be true that the rent-seeking winners are able to disperse the costs of their activities for the losers, but this only means that losers would not organize against the winners in the defence of radical reforms. However, that is not the only possible calculation for the losers. Offe and Przeworski argued that losers compare their present economic welfare with their previous situation and with the present welfare of the winners. This comparison tells them that they are much worse off both in absolute and relative terms and this may turn them against economic reforms. Consequently, Hellman's theory cannot explain why losers would not protest against economic reforms. In fact they do, and Hellman does not deny it. He acknowledges that losers also organize: losers cast a protest vote against incumbent governments. Citizens voting in the elections enter collective action. Consequently, winners and losers take part in two different kinds of collective action: winners organize for rent-seeking economic activities, losers organize for overthrowing the government by means of the protest vote. Losers are successful in protesting against governments in power, but they fail to stop economic reforms. Why? Hellman notices,<sup>6</sup> but does not explain why losers were unsuccessful in halting economic reforms.

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dermining their capacity to hold the economy in a partial reform equilibrium' (Hellman, 1998: 232).

- 6 'This paper has shown that it is precisely those countries in which governments have been most vulnerable to the losers' threat of an electoral backlash against reform that have adopted and sustained the most comprehensive reform programs. In contrast, governments insulated from electoral pressures have made, at best, only partial progress in reforming their economies. Moreover, economic reforms, once adopted, have rarely

The thesis about the tension between democracy and capitalism, that it is the losers who may halt economic reforms, is a general one which relates the working of the market to that of democracy. The inversion of this thesis, that the winners are an obstacle in the process of marketization, is less general than the statement it opposes, because it is dependant on particular assumptions. The inverted thesis assumes that economic rent-seeking groups are able to enforce their particular interests against governments. Governments may serve the interests of rent-seeking groups not only because they are insulated from electoral competition – from voters – but also because they are not insulated from the competition of interest groups, from rent-seeking economic actors. Hellman correctly states that some governments are more responsive to special interest groups than others. What explains this difference? Insulation from electoral competition, i.e., the deficiencies of the democratic political system, is only part of the answer. It is also necessary that politicians serve special interests groups. This second condition is a historical one, because different post-socialist countries may differ in the way politics is related to economics. In those countries in which a sufficient separation of civil society and the political state preceded the imposition of state socialism, after the collapse of socialism rent-seeking interest groups may find it much more difficult to exert their influence on the government than in those countries in which this separation did not take place to a similar extent. This explains why Central European countries were more successful than East European and Balkan countries in constraining the winners in their activities to hinder economic reforms. The difference between these two groups of countries is not simply a difference in the degree of insulation from electoral competition but also a difference in the degree of insulation from the competition of special interest groups. The key to success is the absence of insulation from electoral competition and the presence of insulation from the competition of special interest groups. In sum, Hellman is right in point-

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been reversed, even when the reform governments that initiated them have been ousted' (Hellman, 1998: 232).

ing out that political competition under democracy will deliver positive economic outcomes. His argument is also very useful in explaining why economic reforms were slowed down or even stopped in some East European and Balkan post-socialist countries, but he still does not explain why losers were not successful in protesting against and halting economic reforms in other post-socialist countries.

#### 4. The Legacy of Socialism Does Matter

The reason why losers abstained from political protest is rooted in the legacies of socialism, as argued by Greskovits (1998: 67):

The lack of extreme income inequality, the smaller number of marginalized poor, the relatively lower degree of urbanization of the population, and the absence of recent, violent experiences with coups and riots may all have contributed a stabilizing influence under postcommunism. It is also important to mention in this context that reformers in the East have not been in a hurry to eliminate the 'premature welfare states' (Kornai) left behind by communism ... In sum: in contrast to the South, large sectors of the population in the postcommunist region could avail themselves of relatively substantial reserves to survive hard times. This may have lessened the risk of violent and disruptive social response to economic stress in the East (Greskovits, 1998: 85).

Another legacy of socialism has been the weakness of civil society (Greskovits, 1998: 86). In accordance with the atomizing effect of socialism, citizens resorted to private action and escaped into the second economy instead of choosing collective action. The most important means that the citizens of postsocialist states used in expressing their dissatisfaction was the protest vote.<sup>7</sup> However, by using democratic institutions for protest, losers strengthen the democratic system and create favourable condi-

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7 'East Europeans' most frequent response to economic hardship is not to engage in strikes, riots, mass demonstrations, and violence, but to shift to the informal economy or use the protest vote' (Greskovits, 1998: 17).

tions for economic change by providing longer time horizons for economic reforms.

The new political institutions may in fact have acted as safety valves by channelling the expression of social discontent into democratic processes, resulting in a delaying and balancing effect. Instead of threatening economic stabilization and transformation, democratization has turned out to be their political vehicle (Greskovits, 1998: 180).

Greskovits concluded that in the post-socialist transition, democratization and marketization reinforce and hinder each other at the same time. The result is a low-level equilibrium between democracy and capitalism.<sup>8</sup> Greskovits explained why citizens in the post-socialist countries did not use extra-parliamentary forms of protest. What is still left unanswered is the question why radical parties could not mobilize the protest votes, why the successor governments carried on with those reforms against which protest votes were cast.<sup>9</sup> The answer may have to do with the way party competition is functioning in the post-socialist countries.

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8 'Low-level equilibrium briefly means that democracy and a market economy could be simultaneously introduced only because neither has been fully implemented. Democracy could only stabilize at the cost of some of its qualitative aspects due to the economic crisis and economic transformation. Economic transformation, in turn, has remained feasible only at the cost of its speed and radicalism, and its many imperfections are due not least to the democratic framework of the change. The economic and political systems reached an equilibrium, but at a lower level than in developed Western market democracies. My hypothesis is that this low-level equilibrium will remain characteristic of most East European political economies for the foreseeable future' (Greskovits, 1998: 18).

9 '...the most widely used political weapon against the crisis and the reform in the East, the democratic protest vote, may have less impact than is assumed. Citizens vote out economic policies injurious to their immediate interests, only to witness their stubborn recurrence under different party banners' (Greskovits, 1998: 91).



## 5. Party Competition Matters

Orenstein (2001) accepted Greskovits's argument as to how democracy and the market may reinforce each other, but challenged the thesis of low-level equilibrium. In other words, Orenstein emphasized the mutually positive effects between democracy and capitalism within the post-socialist context. These positive effects rest on certain features of competitive democracy. Democracy is built on party competition that allows for a flexible adjustment and learning process for political actors who carry out economic reforms: 'democratic policy alternation proved to be an important force for correcting reform errors and reaching more desirable and sustainable policies...' (Orenstein, 2001: 24).

The alternation of parties could create a cumulative learning process that helped to correct policy failures committed by the incumbent parties.<sup>10</sup> However, political democracy may enable cumulative learning processes on the part of competing parties only if these parties pursue overlapping policies leading to policy convergence (Orenstein, 2001: 140). This policy convergence is dependent on particular political conditions and constraints, as pointed out by Orenstein. The international and domestic context of Europeanization has provided those conditions and constraints that kept party competition under control and enforced policy convergence necessary for cumulative adaptation.

In those countries whose politicians and parties are choosing to be a part of Western institutions, particularly the EU, this choice creates a set of very specific international and domestic policy constraints.

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10 'In situations of rapid change and policy uncertainty, democratic institutions can help to quickly overturn mistaken policies, accelerate policy learning, and encourage policy entrepreneurship, while maintaining the best policies of past governments in the spirit of pragmatism. All of these strengths of democratic decision-making, though often unrecognized, have helped the countries of East Central Europe move out of the red and into a freer and more prosperous place in the global political-economic system. These countries have done so not by adherence to any economic orthodoxy or blueprint, but by a process of policy learning accelerated by democratic competition' (Orenstein, 2001: 144).

These constraints are international, in the sense that the EU, an international organization, has carefully defined the range of acceptable policies in its *acquis communautaire* and various documents drafted specifically to guide East Central European countries to accession. However, these constraints are also domestic, in the sense that the pro-EU aspirations of East Central European populations and leaders cause them to prefer policies that facilitate the goal of EU membership. Once in office, parties come under extreme pressure from international organizations and voters to adhere to policies that keep them on the path to Europe. Ineluctable pressures for EU membership, rooted in cultural identity, international politics, and popular aspirations, present one enormous set of constraints on the range of policies available to prospective member countries, promoting policy convergence around a broad center range. These pressures differentiate the politics of prospective EU members from those of other postcommunist countries (Orenstein, 2001: 131).

Case selection may influence theory.<sup>11</sup> Orenstein built his analysis on the Polish and Czech transition and showed how alternation of parties in office could result in policy innovations leading to successful economic reforms in these countries. Bringing other cases into the discussion may modify the theoretical argument. Looking at the Hungarian case it seems that political democracy could also provide a favourable political environment for the economic transformation in Hungary, although for different reasons. In Hungary incumbent parties always lost elections, but changes in economic policy and in the course of reforms were not directly tied to these political changes. How does the case of Hungary modify Orenstein's thesis about cumulative learning and the role of party alternation in reinforcing a strong link between democracy and capitalism? How can the successful dual transition be explained in the case of Hungary? These are the questions to which I now turn.

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11 '...cases analyzed shape the conclusions drawn' (Bunce, 2000: 724).

## 6. The Case of Hungary

An early differentiation of political parties took place in Hungary. The parties that were able to get into the Parliament in the first free elections formed three different blocs: the conservatives and/or Christian Democrats (MDF, FKGP, KDNP), the liberals (SZDSZ, FIDESZ), and the socialists (MSZP). In 1990 an oversized coalition of the conservative parties formed a government that introduced important economic reforms. The early Hungarian transition is usually characterized as a gradual process. That is true for macroeconomic stabilization, but is not true for the economic transition in general. The Antall government introduced a radical marketization program, letting market selection enforce adaptation of the firms to a changing economic environment (Table 1).

**Table 1. Hungary: a Non-constructivist Pattern of Transition, Mixing Radical and Gradual Elements, 1990-1994**

		Radical	Gradual
Economic policy	Monetary policy (stabilization)		+
	Fiscal policy (stabilization)		+
	Industrial policy	-	-
Marketization	Price liberalization (plus: abolishment of subsidies)	+	+
	Import liberalization	+	
	Bankruptcy laws	+	
Privatization			+

The effects of the creative destruction brought about by fast marketization may have contributed to the depth of the transformational recession (Kornai, 1993), but on the other hand they were also instrumental in bringing about the micro-economic adaptation of economic actors. The bank consolidation program, although it spent a very large sum of tax payers' money on the banking system, was able to create the necessary conditions for privatizing financial institutions. The Antall government tried to cushion the negative effects of the capitalist transformation by so-

cial policy measures, using the pension system to reduce the rate of unemployment, and by an incomes policy that tried to avoid a radical cut of real wages (Kornai, 1996). In international comparisons, real wages between 1990 and 1994 decreased at a slower rate than in other Central European countries (Table 2).

**Table 2. Real Wages: International Comparison, 1990-1993**

Countries	Real wages (% change over previous year)				1993 as percentage of 1989
	1990	1991	1992	1993	
Czech Republic	-5.4	-23.7	10.1	4.1	82.7
Hungary	-3.5	-6.8	-1.5	-4.0	85.0
Poland	-24.4	-0.3	-2.7	-1.8	72.0
Slovakia	-5.9	-25.6	8.9	-3.9	73.3
Slovenia	-26.5	-15.1	-2.8	16.0	70.4

Source: Kornai (1996), 13/A.

In spite of the efforts of the conservative government to mitigate the negative economic consequences of the transformation, the MDF-led coalition suffered a humiliating defeat in the next elections in 1994. Due to the protest vote of the citizens, the MDF, which had been the largest party in 1990 measured by popular votes, became a small party. In contrast, the MSZP grew from a small party to a large one and won the election (Table 4). The MSZP, although it gained more than 50 per cent of the seats in the Parliament, formed a coalition government with the SZDSZ. The socialist-liberal government, after a certain hesitation that had partly to do with local elections also taking place in 1994, was forced to introduce an unpopular radical stabilization program in 1995 since at that time the country was close to economic bankruptcy. The Bokros package restored the balance of payments, reduced the budget deficit, decreased real wages by roughly 15 per cent, and accelerated the rate of privatization (for macroeconomic data see Table 3).

**Table 3. Economic Development in Hungary (annual change in %)**

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Real GDP		88.1	88.9	96.9	99.4	102.9	101.5	101.3	104.6	104.9	104.2	105.2	
Consumer prices			135.0	123.0	122.5	118.8	128.2	123.6	118.3	114.3	110.0	109.8	
Rate of unemployment, ILO				9.8	11.9	10.7	10.2	9.9	8.7	7.8	7.0	6.4	5.8
Rate of activity				58.6	56.0	54.0	52.4	51.8	51.2	51.7	53.1	53.5	52.8
Number of employed			93.3	85.2	93.7	98.0	98.1	99.2	99.9	101.4	103.1	101.0*	
Household consumption	102.3		94.4	100.0	101.9	99.8	92.9	96.6	101.7	104.9	104.6	104.1	104.5
Real wage per wage earner			93.0	98.6	96.1	107.2	87.8	95.0	104.9	103.6	102.5	101.5	105-106
Real income per capita			98.3	96.5	95.3	102.7	94.7	99.5	101.1	103.8	101.1	101-102 <sup>a</sup>	
GDP per capita			88.3	97.2	99.7	103.2	101.8	101.7	105.0	105.3	104.7	103.6 <sup>a</sup>	
Current account deficit as percentage of GDP		0.4	0.8	0.8	-9.0	-9.4	-3.6	-2.5	-1.4	-4.7	-5.1	-6.2	-3.4
Budget deficit as percentage of GDP		0.0	-2.1	-6.0	-4.2	-8.4	-6.6	-3.1	-4.8	-6.6	-3.7	-3.7	-3.0

\*estimated

**Source:** Office of the Prime Minister, Ministry of Finance, Central Statistical Office.

The stabilization program created a sound basis for export-led economic growth and increased the competitiveness of the Hungarian economy. Also, together with the privatization that targeted foreign owners, it gave positive signals to foreign investors. Up to the end of the 1990s, Hungary attracted the largest amount of foreign direct investment per capita in Eastern Europe. The multinational companies moving into Hungary proved to be the engines of export-led growth in the second half of the decade.<sup>12</sup>

In 1998 the socialist-liberal government lost the election. Citizens again resorted to the protest vote, since the increase of wages still lagged behind the rate of economic growth, and a great number of voters did not perceive an increase in their own welfare. Another reason for the fall of the Horn government was that the main rival, the FIDESZ, promised fast economic growth of about eight per cent as opposed to the five per cent offered by the socialists. The socialist-liberal government was replaced by a conservative one. FIDESZ formed a coalition government with the FKGP and the MDF. The Orbán government changed the emphasis of economic policy using the rhetoric of economic nationalism and emphasizing the importance of domestic, Hungarian entrepreneurs in the economy. In the second half of its term, under the circumstances of an international economic recession, the conservative government experimented with a domestic demand stimulus in order to maintain a relatively high rate of economic growth. The Orbán government doubled the minimum wage, introduced a new housing program for households and a loan scheme for small- and medium-sized domestic businesses with subsidized credits. However, FIDESZ lost the 2002 elections. The conservative government was replaced by a socialist-liberal gov-

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12 ‘The experience of Hungary suggests that only the presence of TNCs can lead to a rise in manufacturing exports, which in turn helps to keep the country on an export-led growth path. It is noteworthy also that the Hungarian experience suggests an indirect link between privatisation on the one hand and export performance on the other. It seems that privatisation of existing SOEs is a pre-condition to massive FDI inflow, which, in turn, generates the export upswing with a certain time lag’ (Mihályi, 2000/2001: 126-128.)

ernment. The triumph of the MSZP-SZDSZ coalition was related to an escalated contest of economic promises made by all parties. This time the MSZP could outbid the FIDESZ in promising higher wages and social services for the voters. After a bitter election campaign that questioned the credibility of the MSZP, the Medgyessy government was forced to keep the promises the party had made in the campaign. As a result, real wages in Hungary increased by about 22 per cent in 2002 and 2003, while the balance of payments and the state budget produced large deficits. The competitiveness of the economy was reduced and foreign direct investment slowed down. Uncertainties were increased by the hectic changes in the exchange rate and the conflicts about the course of economic policy between the National Bank and the Ministry of Finance. As a consequence, the Medgyessy government has to cope with the unpopular task of adjusting economic policies to economic exigencies. The government has to reduce the budget deficit, to slow wage increases, to stabilize the exchange rate at a level favourable for exporters, to speed up privatization, to give new incentives to foreign investors, and to carry on with the reform of the social security sector.

The history of economic reforms in Hungary does not support Orenstein's thesis about a cumulative learning process tied to the alternation of parties in power. Although in Hungary no incumbent party coalition could stay in power for a second term, change in government was not identical with change in policies. The change in policies did not require a change of the party in power, and also, the alternation of parties in power did not necessarily lead to change in the course of economic reforms. Important policy corrections could also be carried out without changing the parties in power, as in the case of the Bokros package in 1995. On the other hand, in Hungary there has been a certain minimum consensus about economic reforms among the competing parties. Conservatives, liberals and socialists were all in favour of a pragmatic pattern of privatization preferring real owners and avoided the application of the constructivist pattern of mass voucher privatisation. They all insisted on attracting foreign direct investment and on enforcing microeconomic adaptation of the

firms by radical marketization.<sup>13</sup> The emergence of this minimum consensus was reinforced by the existence of international constraints. Orenstein rightly emphasizes the impact of Europeanization on policy convergence across the competing political parties. Another international constraint that was present in Hungary, which entered the post-socialist transition with a high level of foreign indebtedness, was linked to the influence of the international financial community and the international financial institutions on economic policies. The two constraints reinforced each other and were conducive to the emergence of the partly overlapping economic policies of consecutive governments. Cumulative learning and change in economic policies became possible without the alternation of political parties in office, and the continuity of economic reforms could take place under the condition of constantly changing party coalitions in power.

The relative continuity of economic policies of competing parties was also made possible by the particular characteristics of political democracy in Hungary: parties competing for power chose to differentiate themselves from their opponents not along the economic, but along the cultural dimension. Inserting the Hungarian political parties into a three dimensional space in which the three dimensions are the economic, the cultural and the systemic divide, makes clear that it is rather difficult to find clear-cut programmatic profiles for the Hungarian parties along the economic dimension, while parties differentiate themselves very clearly along the cultural divide.<sup>14</sup> The systemic divide has also remained significant, but it simply reinforces the importance of the cultural divide (Figure 1).

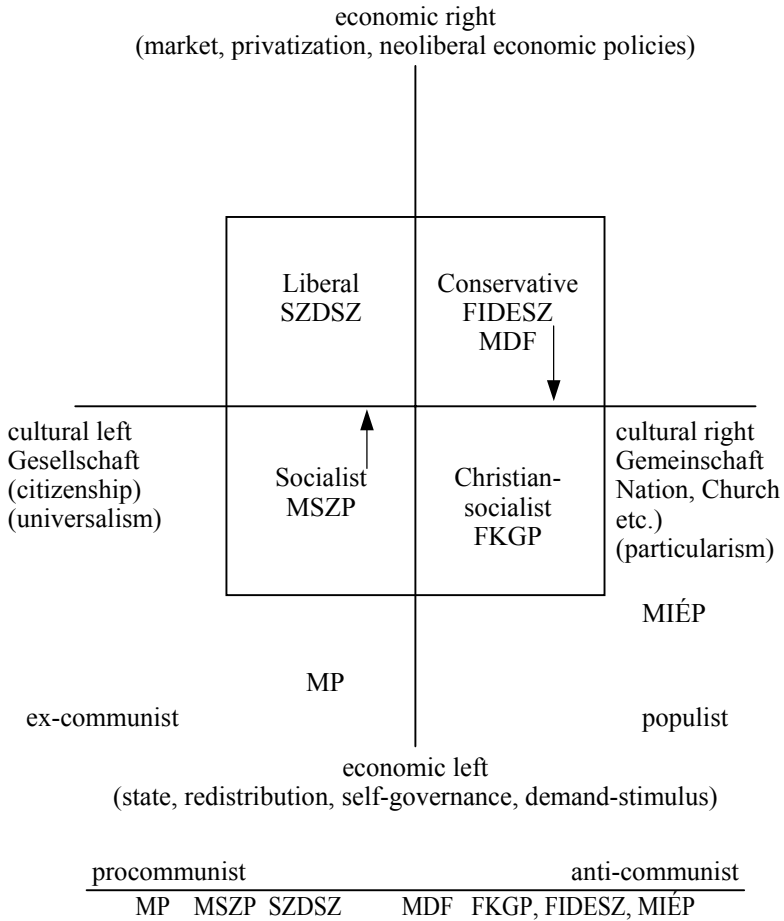
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13 There was also disagreement on important issues like pension reform, the application of demand stimulus, and the role of the state in the economy, just to name a few.

14 'In Hungary, the overwhelming factor for left-right placements is the non-economic divide between Christian, national, and collectivist authoritarians, on one side, and secular, cosmopolitan, and libertarian individualists, on the other... The negotiated transition to democracy leaves its imprint such that parties cannot credibly differentiate themselves much in economic terms' (Kitschelt et. al., 1999: 252).



**Figure 1. Parties Placed in a Two Plus One Dimensional Space Structured by Political Ideologies Representing Political Cleavages, 1998-2002**



**Sources:** Kitschelt et. al. (1999); Bozóki (1996).

There were four elections and four changes of parties in power. In each case coalitions were formed along the cultural dimension; no party coalition could be created across the cultural divide in Hungary (for election results see Table 4).

**Table 4. Election Results in Hungary, 1990-2002**

Parties	The distribution of seats in Parliament (%)			
	1990	1994	1998	2002
MDF	<b>42</b>	9.5	<b>4.4</b>	6.2
FGKP	<b>11</b>	6.7	<b>12.4</b>	-
KDNP	<b>5</b>	5.7	-	-
MSZP	8	<b>54</b>	34.7	<b>46.1</b>
SZDSZ	23.8	<b>18</b>	6.2	<b>5.2</b>
FIDESZ	5.7	5.2	<b>38.3</b>	42.5
MIÉP	-	-	3.6	-
Independent	2.5	-	0.2	-

This does not mean that parties cannot cross the cultural border, it simply means that whenever they do, they change identities and redefine political affinities and antipathies that adjust themselves to the cultural divide. That happened in the case of the FIDESZ which redefined its identity and was transformed from a small liberal party into the largest conservative party.

Due to path-dependency in Hungary, the values of the cultural right including the importance of the nation, the church and the community over the individual are not represented by post-communist parties, as in the Balkan countries, but by moderate conservative (MDF, and later FIDESZ) and radical right-wing parties (MIÉP and for a period FKGP).<sup>15</sup> The post-communist party, the MSZP and the liberal party, the SZDSZ belong to the cultural left. The salience of the cultural divide in party competition in Hungary has contributed to defusing the tension between democratization and marketization by channelling the protest votes of citizens toward moderate parties.

Radical parties that may mobilize mass protest against the system of democracy have found it hard to increase their political

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15 After national-accommodative communism, ‘...Christian-conservative parties have sufficiently removed themselves from the communist regime to present themselves as credible heirs of the national tradition and as critics of boundless market liberalism and individualism’ (Kitschelt et. al., 1999: 73).

support. Since the new system of political democracy was created on the ruins of state socialism, radical left-wing parties facing credibility problems do not have a chance to mobilize popular dissatisfaction against the transition. On the left, the post-communist MSZP can successfully compete as a socialist party with its radical leftist rival. The radical left-wing party, the Munkáspárt (Workers' Party) has not been able to get into the Parliament so far. On the right, moderate parties open to radical voters also could successfully compete with the parties of the radical right. Although the FKGP was a parliamentary party between 1990 and 2002, and the MIÉP was in the Parliament between 1998 and 2002, both parties fell out of the Parliament in 2002. This happened at least partly because the FIDESZ opened toward the radical right and was able to take away votes from the FKGP and the MIÉP.

Furthermore, since the radical right also competes along the cultural dimension, it does not mobilize dissatisfaction with economic development against economic reforms. Populist right-wing parties like the FKGP and the MIÉP did not represent radical anti-capitalist goals; their economic programs do not deviate to a large extent from those of the moderate parties.<sup>16</sup>

The salience of the cultural divide in party competition also contributed to maintaining the link between democracy and capitalism in another way. Competition among parties based on the economic divide allows for a greater variety of possible coalitions than a competition along the cultural divide. Parties differentiating themselves on the basis of cultural identities, as opposed to economic interests, do not enter coalitions with parties from the other side of the divide. As a result, the uncertainty about possible coalitions has been reduced, and what is more important, the alternative of a grand coalition has been excluded. Consequently, whenever citizens resort to the means of the protest vote, and they did it all the time in Hungary, they are able to find a moderate party in opposition to vote for. This increases the chances for

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16 '...Hungarian populism differs much less in its transformation strategy than in its favoured elite executors and beneficiaries' (Greskovits, 1998: 133).

moderate parties to be able to mobilize voters who were dissatisfied with the economic policies of the incumbent parties and creates an opportunity for the new capitalist system to survive and develop, since the new parties coming into power will carry on with economic reforms.

On the other hand, this kind of political democracy also contains dangers for economic development. These dangers are linked to the fact that although political parties are mainly competing along the cultural divide, voters use protest votes against them on the basis of economic considerations.<sup>17</sup>

Under conditions of economic strain, weak relations of economic representation, however, may create popular disaffection with democratic politics because voters feel they have no alternatives to choose from. In countries with greater economic policy polarization among voters and parties, cynicism about democratic competition may be less virulent (Kitschelt et. al., 1999: 316).

This situation may create problems not just for the new democratic regime in the form of low-level of participation or dissatisfaction with the democratic institutions, but also for the economy in the form of macroeconomic tensions. Voters are not very much interested in institutional reforms, but they are very much interested in substantive economic outcomes. Consequently, competing parties do not have incentives to differentiate their economic programs; rather they are inclined to enter a contest in the framework of which they try to outbid their opponents and make sweeping promises about increasing the welfare of the citizens. In other words, parties competing mainly along the cultural divide may try to differentiate themselves from their competitors

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17 'Current political elites, however, may strive to put more emphasis on socio-cultural divides than the electorates can bear, given their daily concern with economic hardship due to policies of market liberalization. The relative diffuseness of socio-cultural divides in the Polish and Hungarian population surveys may signal that mass publics in these countries are not entirely willing to follow politicians in creating a socio-cultural super-conflict, although mass publics in both countries also appear indisposed toward a powerful polarization over economic issues' (Kitschelt et. al., 1999: 267).

along the economic divide by substituting promises about substantive economic outcomes for their blurred economic programs – with possible negative consequences for the economy. The last two elections, and especially the latest one, created a trap of this kind that the MSZP and the FIDESZ were not able to avoid. The two big parties committed themselves to promises that endangered the macroeconomic balance and worsened the competitiveness of the economy. Democratic politics in this way have had a direct negative effect on the economy.

## Conclusion

In spite of the tensions created by the dual transition from state socialism toward democracy and capitalism, the transformation could be successfully carried out in the East Central European countries. Neither the losers nor the winners could weaken democracy and/or stop marketization. Due to the relatively early differentiation of civil society and the political state in pre-socialist Hungary, the winners were not strong enough to capture politicians and hostage them in order to halt economic reforms in the post-socialist transition. Losers did not mobilize against the new democratic regime but used their votes as a protest against incumbent governments that caused them economic hardships as a result of economic reforms. However, protest votes could be absorbed by the democratic system in a way that did not endanger economic reforms. Democratic party competition could also reinforce the success of the economic transformation.

The case of Hungary shows that political democracy may be instrumental for the success of economic reforms even if policy corrections are not directly tied to the alternation of parties in power. In Hungary political learning was also possible without changing the parties in office. The specific characteristics of party competition in Hungary that made salient the cultural dimension and blurred the economic dimension of party competition helped to channel the dissatisfaction of voters for the support of moderate parties. However, these characteristics also create negative economic effects because competing parties may try to differenti-

ate themselves from their competitors by making unfounded promises about substantive outcomes instead of relying on programmatic differences along the economic dimension of party competition.

The dual success of democratization and marketization was possible only because of the existence of specific international constraints. The process of Europeanization and the economic requirements raised by the international financial community and institutions created those necessary conditions that drove party competition toward the centre and helped policy convergence and cumulative learning by putting a check on the deviation from reasonable economic policies.

## Appendix

### List of Hungarian Political Parties

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FIDESZ	Fiatal Demokraták Szövetsége	Alliance of Young Democrats
FKGP	Független Kisgazda-Földmunkás-és Polgári Párt	Independent Smallholders' Party
KDNP	Kereszténydemokrata Néppárt	Christian Democratic People's Party
MDF	Magyar Demokrata Fórum	Hungarian Democratic Forum
MIÉP	Magyar Igazság és Élet Pártja	Party of Hungarian Justice and Life
MSZP	Magyar Szocialista Párt	Hungarian Socialist Party
MP	Munkáspárt	Workers' Party
SZDSZ	Szabad Demokraták Szövetsége	Alliance of Free Democrats

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