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CONTENTS

REVIEWS

BOOK REVIEWS

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BOOKS RECEIVED

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EFFICIENCY AND SOCIALIST DEMOCRACY

R. NYERS

The parallel development of socialist democracy and economic efficiency is one of the fundamental problems of Eastern European countries from the viewpoint of their future development. Beyond a general analysis of these issues the author discusses not only the possible solutions determined by the Hungarian historical circumstances, but also the chances of a solution as well.

If we attempted to measure the frequency of notions and terms nowadays used in Hungarian public life, the palm would in all certainty be won by "socialist democracy" and "economic efficiency". It does not, however, follow that either of these notions is always used exactly and in the same sense in everyday life. Ambiguities are particularly frequent when efficiency and democracy are related to each other or to such requirements as "organization", "work discipline", "expertise", "work morale", "equality and equal rights". In such cases it becomes palpable how widespread the opinion is that human action striving after efficiency either does not tolerate democracy or accepts it to a limited extent only; and, according to this concept, democracy also works against people undertaking sacrifices for the future in any given case. Accordingly, democracy can only assert itself in the case of plenty and richness, while efficiency can only be based on authoritarian decision and discipline.

In mutual interaction

Whether efforts at economic efficiency can be coupled *in metrio* with the developing socialist democracy is a fundamental problem of the future development of the East European socialist countries, Hungary being among them. If our present assumptions are verified, the two efforts will help each other; if, however, it turned out later that democracy had still to be constrained in the interest of an "efficiency breakthrough"—and the latter is no doubt a harder requirement—then intensive economic growth and the cause of democracy would get separated from each other. The former would develop *better than the latter*. I am, however, of the opinion that in the course of the development of socialism it is impossible to lastingly curb the development of democracy, since otherwise the necessity of later political reforms would become so urgent that only the elimination of restrictions could bring a solution. Also, a political crisis necessarily sets back the economic efficiency to a certain extent and, in a worse case, it could be catastrophic. Thus, what is won on the swings is lost on the roundabout. Therefore, the way forward is to develop democracy and increase efficiency *in mutual interaction*.

It would be a grave mistake to think that in Eastern Europe there is no chance for an essential and relatively fast improvement of economic efficiency. It would be a similarly dangerous error to think that there is neither a chance nor even a truly massive demand for the development of economic and political democracy. If not in a wide circle, I have met with such or similar negative views even among influential leading personalities. This amounts to projecting East European backwardness as a future fate, under the pretext that a great part of the people are uneducated, unskilled, and an even greater part are selfish and hardly suited for community life. Even if these views are not quite unfounded, they are not entirely true, because present (and future) general education already provides people with a wider social horizon, and the information-explosion faces them everyday with the events of their environment and the world. Also, there are massive community conditions (for instance infrastructural ones) of their individual existence and success. The texture of society thus becomes day by day denser and stronger, although it is also true that—as against earlier assumptions—the sphere of private life remains strong. Thus, the people of today and of tomorrow demand greater democracy from socialism, and claim a more direct say in matters than what the present state of affairs allows them. This holds both for the economy and the sphere outside the economy.

But what should be the shape of the democracy of the future? In what matters should we follow the actual methods and where should we look for new ways? What can be utilized from the achievements of the development of bourgeois democracy, and *in what matters have we to go our own socialist ways?* It should be obvious that the achievements of bourgeois democracy cannot be refused in their entirety, since certain parts of it are products of the development of humanity and do not merely serve the bourgeois class. It is, however, also certain that we cannot merely follow the road of bourgeois democracy, not even that of its most popular version (the Scandinavian model), because the economic order of socialist society would, even now, demand a deeper solution relying on wider foundations. Anyway, the socialism of the future demands that we surpass bourgeois democracy.

A further essential condition of progress is that we should consistently break with the illusion that socialism can be completely separated from capitalism. In the Stalinist era we once took a false road. Today, even the capitalist world cannot leave the competition and impacts of the socialist system and movement out of account, but the socialist economic and political system cannot develop, either, by dismissing the challenge of the competitor, nor free itself from its impacts. The competition has to be used as a *propelling force*.

Integration of interests and flexibility

Competition between the different social systems is no doubt the determinant phenomenon of our era and, by all certainty, this will remain so in the future as well. This is a special kind of competition, not to be compared to combat in which one of the contestants finally forces the other to his knees. It may rather be compared to collating performances, with the difference that the competing systems also cooperate during the competition. There exists, namely, a common superior interest of humanity: however sharp the competition between capitalism and socialism may be, it is in the last resort the only possible form of *coexistence*.

In the competition between social systems *the two forms of democracy are competing* in that people are more satisfied in the one or in the other system. All that depends on the efficiency of operation of the economic, cultural and political institutions and thus on the ability of implementing the goals set. The result, the degree of progress made and of satisfaction, can truly and *reliably* be measured only in a democratic atmosphere and by democratic instruments. However, the notion of democracy obtained different interpretations in the social fights of the last century: the bourgeois notion of democracy is related to governing the *state*, while the socialist notion of democracy *expands into social democracy*, where *economy and culture* get a central place.

If we examine the composition of countries belonging to the two social systems, we find substantial structural differences. In most *developing countries* no characteristic difference can be found among the countries following the market economy principle or that of socialism, in respect of either economic development level or political democracy. Within the group of more developed capitalist and socialist countries, however, a marked difference shows in the ratio of *developed and medium-developed countries*. In the capitalist world it is the role of the most advanced industrial countries (essentially the OECD members) that is dominating, while in the socialist world it is that of the economically medium-developed countries (the majority of East-European countries). It is thus unavoidable to confront the economically better developed countries with medium-developed ones when the two systems are compared. The distinction is also important from the viewpoint of the system of political institutions, since on the one side we find countries that went along the way of bourgeois democratic development, while on the other we find those where this process has not taken place. Thus, from the institutional systems of these latter countries several elements of the bourgeois democratic system of institutions were missing, even though they could have continued under socialist circumstances. Thus it is very difficult to separate the system-specific and the system-neutral phenomena from each other, but an attempt still has to be made.

In respect of *using* power—in this case, the disposal of power over the national economy—*in the public interest*, the present-day socialist systems have passed the examination by international comparison. It can be verified that the activity of the economy as a whole is indeed directed at improving the economic and social situation of wider groups of the population than that of systems of capitalist type. This becomes possible because the state power of a socialist type disposes of the resources of the economy across a wider range, and because the socialist political systems are capable of integrating a greater range of different economic group interests in fact almost totally, through the socialist planned economy. In the capitalist systems, on the other hand, the state—even under the undoubtedly more progressive relations of the welfare state—excessively respects the freedom of capitalist management and thus has lesser chances for influencing the economy in the public interest. Precisely on this account, it is less capable of integrating the opposed and divergent group interests. Frequently, even the majority of the interests of the middle class is left out of the circle.

Thus, in the socialist systems power relies on a wider base of social interests than in the capitalist ones. Nevertheless, as regards the *flexibility* of government, the lead of the developed capitalist countries can hardly be debated. It can also be said that they adjust faster to changes in management conditions, and in many respects they do so more effectively. This was particularly conspicuous in the two oil-crises of the seventies, but it can regularly be observed in the rate and consistency of adjustment to market changes of the production pattern. From the point of view of the future the question may be formulated in the following manner: Will the socialist system be capable of greater government flexibility and, on the other side, will the capitalist systems be capable of expanding the social-interest basis of their policies? In reality, it is an open question as to whether the socialist systems can preserve their wider social interest basis amidst the foreseeable changes; whether they will be capable of implementing adequate economic reforms and democratic renewal in the interest of the masses—and whether the capitalist systems will be capable of coupling flexible government with greater continuity of government under the future conditions, which, in many respects, will be new. These are questions which will be decided by practice, yet we must trust that they will be successful. However, to proclaim a certain, automatic success in advance would only be good for disarming the political action.

What picture can be drawn about the competition in the democratization of relations within enterprises, at the workplace. In this field the socialist systems possess more advantageous possibilities than the capitalist ones—owing to the dominating role of social ownership, and the wider organization of employees; in practice, however, they are only exploited to a restricted extent.

Trade unions have a much greater membership in the socialist countries, with 80–90 percent of all employees being members. In most capitalist countries their ratio is 20–30 percent—even the 40 percent ratio of the FRG is an exception, while the peak is represented by Great Britain with 57 percent. Yet, the intensity with which interests are represented is greater in the capitalist countries, particularly in everyday matters on enterprise and industry levels. On the other side, in the socialist countries the expression of interests is strong on the level of national and economic policy matters. However, this is mostly hidden, it does not come to expression at public forums. Thus, from the aspect of developing democracy, it "gets lost", or at least is not satisfactorily utilized.

As regards the development of partnership in the industrial relations, societies of a socialist nature also possess better chances, since in the framework of "socialized management and employee representation" there is a greater possibility for creative cooperation than in that of "capitalist management and employee representation". The former, being based on a consensus regarding wider societal interests, the differences in concrete short-term interests can be more easily bridged by compromises. In reality, however, in the prevailing practice of the socialist systems a bureaucratic form of factory or enterprise participation has developed (a cabinet-like cooperation on the level of management) as against a more democratic form where reconciliation is made and a compromise is struck on management level with the participation and checking of the employees. Owing to the long domination of the model of the Stalinist era, the building and development of a partnership model has been retarded in the socialist countries. The possibility, existing in principle, has, unfortunately, not or hardly been realized in practice. In the majority of the capitalist countries factory democracy has not come to a decisive turn either, though it is a fact that in some countries with long tradition of social-democratic government the system of participation has taken roots and has led to remarkable achievements.

Under socialism social relations render more advantageous opportunities for the self-administration of employees in enterprises and establishments than under capitalism, but their utilization was for a long time hindered by uncertainties and ambiguities regarding principles to be adopted. Cooperatives, for instance, are more widespread than in capitalist countries. In spite of their spreading and their considerable presence they were for a long time (and in some countries they still are) considered as a transitory form of management of merely subordinate importance. Their operation was restricted by government regulation and even interference. In some socialist countries cooperatives are nowadays being "rehabilitated" ideologically and, at the same time, room is being opened for the *principle of self-administration* in economic life.

In the wake of experiences with the Yugoslav system a self-administering enterprise sector is also emerging in the scope of state enterprises; and at such places, self-administering worker communities become established within the enterprises as well. The process has started in Hungary and China, and certain efforts have emerged in Poland, and, quite recently, the idea of socialist self-administration has reappeared in the Soviet Union, too. It must, however, be emphasized that a precondition of the truly democratic functioning of both the independent cooperatives and of the self-administered state enterprises is *abolition of direct centralized control through the plan,* and the bringing about of an economic environment relying on a regulated market. Without these conditions self-administration is at most a name-plate, not a determinant of content. If the socialist system consistently avails itself of this opportunity in the future, it can achieve a considerable democratic superiority in the fields of cooperatives and self-administration.

Experiences also prove that the existence and operation of the small entrepreneur sector may be an essential ingredient of economic democracy—if it works under competitive conditions and not on a market with shortages. The small units depend on the consumer's judgement more directly and more strongly than do the large organizations. True, they can only be competitive in a relatively smaller part of commodity production and in a part of the services sector, but where they do exist they offer a wider and quantitatively better choice to consumers than the large enterprise formations which are more inclined to bureaucratization. It would be a mistake and an error to reduce the problem to the confrontation of "large-scale factory or small establishment", because none of them can squeeze out the other. In this respect the socialist countries were on a false track for a long time and, therefore, the small economic organizations offered more to the consumers under capitalist conditions. The lag in this field can be made up for relatively quickly if we have the necessary determination; and it seems that our countries are gradually starting on the right way.

Finally, it must be pointed out that socialism and capitalism compete with each other not only as social *systems* in respect of democracy, but also as social *movements*. The latter appears in the international arena in a much wider range than the competition between groups of countries. The future of socialism—and the future of the popular character of democracy—cannot be decided in the competition between groups of countries, as is erroneously thought by some people, but only through the fight of the worldwide political and economic movement for socialism, with cuts through groups of countries. The ways leading to the socialism of the future must also be searched for in the socialist countries, while in the non-socialist ones an answer must be found by asking with what kind of programme and by uniting what social forces can the fight for socialism be carried on successfully. The former implies the realization of existing socialism through reforms, while the latter depends on the creation of a united front of "democratic socialism", represented by social democracy and the "revolutionary socialism" of the communist parties—not only in the fight for peace and security, but also in that for social progress. A joint impact of the two processes might be the ending of the division of the European Socialist Left—that is, an end to the politicizing at the expense of each other. This would open a great opportunity for the European and worldwide development of democracy.

The stages of development

The way people think consciously about the economy, and with what political identification they act in their economic occupations are factors that can be less and less neglected. The key question of developing a positive identification constitutes, today, a correct historical judgement of the possibilities and role of democracy.

Parallel to the political history of Hungary after its Liberation, the following stages of development may be outlined in this respect:

— The years between 1945–1948 were a short-lived era of "pristine democracy".

It was a *search for ways*, revolving around the alternative of "bourgeois or people's democracy" and with wide opportunities to have a say in public matters; when the building up of democracy from below (works committees, national committees, claims submitted for land decided by popular committees) was interlinked with a building from above (operation of parties, the constitution of the republic, parliament). Democracy was great and wide, but it was undecided, and in many respects even dim, where this road would lead to.

— The year between mid-1948 to mid-1949 was that of a sudden, to a certain extent unexpected, turn—when almost every earlier existing institution and organization ceased to exist and when the political life got a new framework along with economic management.The main form of asserting democracy was then nationalization, the "conquering"of economic positions by workers. The Hungarian Workers' Party, coming about through the union of the communist and the social democratic parties got not only a hegemonious role, but an absolute one. At the end of 1948 public opinion was amazed by the statement of Mátyás Rákosi that "we already are under the dictatorship of the proletariat". Later it had an even more bitter experience of the fact that the dictatorship of the proletariat then existing was a very narrow-minded one.

— In the period between 1949–1956 an overcentralized political and economic system was constructed. This was essentially modelled on the Soviet system of the Stalinist period, and thus it adjusted to it accordingly, yet it also analysed the experiences of the Hungarian Soviet Republic (of 1919). At any rate, no trace was left in public life of the communist ideology of the years 1945–1947, that is, of the "people's democratic trend". The system institutionalized in this period started as a workers' democracy, in which the peasantry and the intellectuals were formally given the role of allied partners—yet not even the workers' democracy could evolve. The Party leadership wished to represent the worker class alone, and thus it came more and more antagonistic against even the concrete interests of the real working population. Eventually, dictatorial instruments were applied against the peasantry and the intellectuals. A part of the Party, headed by Imre Nagy, tried to break with this policy, but failed.

Workers' democracy began truly to evolve only after 1957. The political leadership gradually abandoned the dictatorial methods of the earlier period. The substance of this period was reestablishment of the organic relationship between the Party and the worker class, and then the extension of the material basis of socialism to agriculture. With the consolidation of the form of existence of the cooperative peasantry in the second half of the sixties we could speak, as regards the substance of the matter, of the emergence of a *worker-peasant democracy*. The basis of democracy thus became much wider, but the integration of intellectuals, the administrative employees, and of small producer-entrepreneurs into the socialist economic policy could not yet be achieved. It was only with the 1968 economic reform that the worker-peasant democracy got a real room at workplaces and in public administration, as it was then that the working people got real rights of decision in economic and, later on, in personal questions as well.

— We may call it a task on the agenda of the eighties that the worker-peasant democracy has to be expanded, on an even wider social basis, into a true people's democracy. Also, it must bring about and simultaneously operate its political, economic and cultural systems of institutions. In this process every group has to join institutionally, relying on its own interests, yet on the basis of a strong alliance of interests between manual workers and intellectuals. The Party, playing the leading role, no longer represents merely a class interest, but integrates the social and political forces. It does not merely declare social interests, but forms and expresses the social consensus in the major problems. Also, the observance of the rules of democracy is guaranteed by constitutional bodies relying on constitutional instruments.

The systemic relations of democracy

Both Hungarian and foreign experiences are unambiguously showing that democracy can only operate well and purposefully in the whole of the economic process; that is, only if it permeates *the whole* of economic life, for a *partial* democracy can only have a limited impact. Thus, the main requirements of democracy are: the participation in decision-making of representatives of every interest; an understanding and acceptance of the majority decision by the minority; open and democratic checking of the economic processes; and an effective feedback system in economic control activities in the interest of making corrections already underway.

From the viewpoint of the total operation of democracy, the simultaneous maintenance of three systems of relations are of great importance: *on the central level, the horizontal relations clarifying the interest-content of the decision; the vertical relations serving a confrontation of central targets with local possibilities; and the horizontal relations serving the ranking of local interests and their harmonization with possibilities*. While in the vertical relations between the centre and the local bodies it is the economic and financial problems that play the primary role, in the horizontal relations the economic problems emerge in their full social context on both central and local levels. Economic planning and regulation thus becomes to some extent the planning and regulation of social processes. From the viewpoints of things to be done in Hungary none of these systems of relations can be preferred at the expense of the two other ones; in each of them many things have to be developed.

A more democratic method of economic control demands above all, and decisively, *a greater democratization of planning*. This holds both for the whole of the national economic plan and for the planning of the central state budget—and beyond these even for the plans and financial estimates of the productive, service and cultural spheres as well as for those of social security and social policy.

In the application of democratic methods of planning, substantial progress was made in the course of preparing *the seventh five-year plan* (1986–1990). The social discussion was wider and more substantial than earlier, and the essence of the plan concept was clarified in the Parliamentary committees in more concrete terms and through lively debates. In spite of this improvement, there is still much left to be desired; the major problems may be summed up as follows:

— The scope of movement of the economy is not yet satisfactorily outlined in the democratic decision process. The variants only show this roughly while for responsible decision-making both the constraints and the resources have to be clearly seen. The same holds for determinations reaching over from the past: they are not given sufficient attention, although these must be known to decision-makers, since only then can they know in what they can freely decide and in what matters their hands are tied. It is particularly the opportunities and limitations of international relations that could not be presented with the desirable thoroughness and detail in either socialist or capitalist relations. The planning workshops, of course, analyse the general situation of the economy in much greater depth, while wider public opinion rather gets acquainted with the system of goals in the interest of which action should be taken. A contradictory situation derives from the fact that the clarification of the situation is made (and remains in) the economic workshops, but the plans are publicly discussed and debated in many details.

— The general discussion of the plan and the state budget is not joined by a series of intensive and detailed discussion relating to major aggregates. All this can be undertaken in the *standing committees* of the National Assembly (and of the councils of various levels), with the participation not only of the MPs (council members), but also drawing in the affected *representations of interests,* scientists and *experts.* These detailed discussions should be held in two rounds: the first before the compilation of the final plan and financial estimates of the national economy (the local council), and the second would then be linked to the discussion of the total estimates. The aim of the first discussion might be the selection from alternatives. Earlier, the planners were afraid that a preliminary discussion of sectoral problems would upset the equilibrium of the national economy, since they experienced that the latter introduced the tendency of materially-financially unfounded development projects into the planning process. This should, indeed, be forestalled and thus it is *activities,* rather than industries that should be democratically discussed. In the last resort (in the prevailing situation) the danger of exaggerated demands is not eliminated, since the surplus demands of the industries are pushed with invariable vehemence *after* the approval of the plan. Therefore, efforts should be made to place the government financing of industries (activities) on some *normative basis,* thus forestalling the exaggeration of demands.

— Greater publicity in questions of drawing away (taxing away) and regrouping incomes related to the economy would be anyway correct and necessary. To ask for the opinion of the elected bodies and, in other more essential matters, to ask about the occasional democratic stands taken, are equally important questions, not only on the part of economic organizations but also on that of the population. The political intention has to be intelligibly declared in every case: from whom do we want to draw away surplus income and confronting this with, if possible, to whom we wish to regroup the surplus income drawn away and on what considerations? It is generally true that a deepening of economic democracy is always concomitant with the demand for a *public handling of incomes policy*, and for an increased say of social factors in the matter. The leadership has to gradually answer this requirement.

From the demand for a democratic development of economic control it also follows that *science* should get greater possibilities and even help for a sociological survey and analysis of planning and control. With some exaggeration, *today the planning and control methods which could call for a wide critical analysis are still handled as if they were "state secrets"*.

Public confrontation of interests

Beginning with 1969 and, more recently, since 1982, Hungarian economic policy has been going along an unbroken path in order to introduce an up-to-date democracy of a socialist type in the micro-sphere of the economy. In principle, it has abandoned the overcentralized, direct economic control which did not grant a critical measure of freedom of decision, which is a precondition of democratic management, to economically active people. The minimum of freedom of enterprise and management is today secured by law, but economic emergency situations invoke the recurring danger of forced administrative interferences and restrictions being reborn and even expanding. This works against efficiency in a double sense: through its direct economic impact, and also indirectly by restricting democracy in the economy, thus reducing the value and role of the human factor in the microsphere. In the last resort, the way chosen is certainly good in the long run, but the progress made cannot be called ideal, or even satisfactory.

Institutionalization of *several (social) sectors in the economy*, and a freer adjustment of the sectors to social requirements and to demand, amount to significant progress from the viewpoint of socialist democracy as well. It expands the *freedom of choice of a workplace* for employees as well as the consumer's range of choice (therefore optimizing consumption) and, finally, it serves the common interest of society by drawing such *surplus resource* into management that would otherwise remain unexploited. There are further opportunities inherent in the expansion of this multisectoral development which will benefit the community without endangering the dominating role of the state and the cooperative sectors in the economy.

The highly desirable utilization of further opportunities must no longer be sought through new reforms, but with the aid of methods of continuous development.

In a multisectoral socialist economy, governmental economic control has still to be developed for some time in the interest of a harmonious cooperation between sectors and their good fitting with each other. This should be done partly in order that the sectors should *complement* each other (state and cooperative trade, cooperative farms and household plots), and partly in order that the *competitive situation* should be a propelling force in raising the standards of activities, so that the state system of conditions of management should be, on the whole, identical everywhere. It is a further important goal that the development level of market segments should come near to each other and the valuation of labour (hourly wages) should not differ as regards order of magnitude. Competition between the various sectors (small commodity production, services) may thus lead to a better satisfaction of the needs of society, while the related interests of *producers*, consumers and *the state* get, from time to time, publicity and thus the "settlement" of conflicts of interests behind closed doors will become less and less frequent.

There are still serious "differences in weight" among the various bodies representing interests in Hungary. Beside the well organized bodies (trade unions, cooperatives) the representation or interests of certain groups is "under-organized". These include, for instance, retired people, employees working in some special fields (e.g. those in the scientific sphere), various small ventures and, as a matter of fact, the representation of different consumers' interests. There is, of course, much to be developed even in the well organized fields, since within the trade unions and cooperatives there are wide groups carrying on the most diverse activities in different situations. Thus they require a continuous and, in many cases, a more satisfactory reconciliation of interests. An economic democracy based on a satisfactory balance of interests ought to lead, eventually, to a higher level of "economic tolerance" towards each other, and to a more conscious and more organized order in the social cooperation among groups, enterprises, sectors and occupations.

The reform measures related to *ownership rights* open up a new and promising phase in the democratization of socialist enterprises by relieving the state administration of the formal responsibility for enterprise assets, for their augmenting, and coupling this with the responsibility of firms for continuous management. As regards future development, the guideline to be followed seems to me important for the principal reasons listed below:

— The development of democracy is actually necessary for every type of state-owned firm and with every form of cooperative, and not even the state enterprises remaining under state administrative control, nor the joint enterprises of cooperatives should remain exceptions to this rule. With these, too, a further development of the system of democratic control is necessary. The extent and form of democracy will, eventually, be diversified in the future. However, what is certain is that the sphere of socialist enterprises cannot be torn into antagonistic types of firms with one having democratic management and the other authoritarian control.

— In the self-administering enterprise sector the order of management of *cooperatives* has already become established, but in the work on the forums of internal democracy there is still much formalism, thus internal reforms are also needed here. In the case of the self-administering *state enterprises*, however, the practice of self-administration still has to be developed. This consists not only of simply electing a management, but also of effectively and collectively solving the tasks related to the ownership functions, augmenting the wealth of the firm, and those of development. The self-administering sector should be developed mainly with the aim of making it better suited for self-administration, and self-government fused with efficiency.

— The functioning of the *enterprise councils* also promises much, in respect of both democracy and a more rational management of enterprise assets, but much still remains to be clarified in this field. From the viewpoint of the future, sooner or later an answer has to be given to the question about the direction of development of the enterprise councils: whether they develop towards *self-administration, self-government,* or *participation* (the social partnership of management and the employees). This is a problem not only of enterprise development, but also of the model of democracy in this field, and decision on it will sooner or later become important, because both solutions may have wide and different social consequences. At the moment, the choice of the principle is not yet pressing, for we are still in the period of gathering experiences.

— A great many opportunities are inherent in securing the freedom of self-administration for smaller worker communities, in the form of so-called autonomous working collectives, coupled with some possible method of economic accounting. The opening of a freer way as a method of development should be emphasized; a campaign-like organizing activity from above would only harm the cause, since it would also be enforced where the economic conditions are missing and cannot even be brought about. As a matter of fact, this is how the practice of democratic management can be introduced and can take roots in the thick of economic life. This method can be applied in each of the forms of enterprise, but its massive application requires adequate changes in the internal order of control of firms.

Wage increases and relative earnings are an important area of democratic expression of interests and participation in decision-making. It is common knowledge that workers, other employees and cooperative members are very interested in these problems and wish to assert their interests most strongly in these matters. The presently prevailing situation severely restricts democracy in this field, since the role of wage regulation is too much within government control. In fact, it is a forced measure to counterbalance the facts that the economic environment has a relatively small impact on cost management, and that the desirable equilibrium of the labour market has not yet been achieved. The combination of the two, that is, the low sensitivity to wage costs of enterprises together with the exaggerated demand for labour would lead to inflation, if there were a freer management. But the forced measure must not be made into an ideology. As soon as we can, the present practice should be abandoned. It is likely that in the future the lasting and democratic solution will be provided, even under socialist relations, by the regular "wage bargain" between the trade unions and the firms—this being carried on within the framework of the national economic plan and with government coordination.

ЭФФЕКТИВНОСТЬ И СОЦИАЛИСТИЧЕСКАЯ ДЕМОКРАТИЯ

Р. НЬЕРШ

Эффективность и демократия предполагают друг друга, обе являются ареной соревнования между различными хозяйственными системами. В социалистических системах база власти является более широкой, чем в капиталистических, но в последних управление и руководство предприятиями оказались более гибкими. По мнению автора, в венгерской экономике должен быть предоставлен больший простор открытому формулированию и представлению интересов.

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STRUCTURAL GROUPS AND REFORM

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In the first part of the study the structural groups are analysed under conditions of redistributive and market mechanisms. The second part discusses the interpretation of social and economic reform and its possible directions. The sources of the original reproduction model have become exhausted in the East-European socialist countries. These countries reacted on that either by rationalizing the original model or by strengthening the autonomous movements. It is the latter which the author calls as reform. Finally, in the third part, the relationship of individual structural groups to the reform, thus interpreted, is analysed. Particular stress is laid on the examination of those groups which are in a position to influence politics directly or indirectly.

This paper does not use the strictly scientific tools of verification. It is a particular kind of essay, mixing the partial results of research work with the personal experiences of a Hungarian citizen. I shall attempt to work out a logical model with a view to examining, how structural situations can influence attitudes on the group level towards economic and social reform. On this level of abstraction I shall, of course, disregard quite a few factors (such as age and political convictions) affecting actual behaviour and only look for such interrelations as can logically be inferred.

The structure of Hungarian society has been my main field of research for fifteen years. I am trying to find out, which group structures seem to cause inequality in Hungarian society and to understand the functioning of this society. The question that intrigues me most as a Hungarian citizen is the Hungarian society's perspectives, how Hungarian society can prevent itself from lagging behind the developed regions of the world, and—as an indispensable condition—the ability of the society to reform itself. I wish therefore to investigate the different social groups' attitude towards the reform. I have no scientific results or data at my disposal in this field. What I am going to say is thus mostly the result of speculation. As a scientist, however, it is my conviction that such speculation must be based on as firm ground as possible and that an attempt must be made to describe clearly what I understand by the terms 'structural group' and 'reform'.

The structural groups

Structural development is determined by two intertwining tendencies: disintegration of the inherited class structure, and evolvement of a multidimensional social structure based on the newly emerging social conditions. This is to say that the units of the traditional social structure (classes and strata) get internally differentiated; the different groups occupy new positions within the evolving social structure.

The new social structure has itself undergone very radical changes (notwithstanding the short historical period of the last forty years). The changes of the late 1940s, abruptly breaking the continuity of historical development, pointed towards the development of a social reproduction model in which a political centre tried to centralize all available resources in order to use them as required by its politically determined objectives. The society became hierarchically subordinated to the political centre (with all its internal divisions) although it largely survived in a historical continuity. The centre tried to regulate social reproduction processes through the institutional system of this hierarchically built, administrative type of apparatus.

Within the framework of extensive development, this reproduction model produced spectacular results in the short run, while also creating serious tensions. As these tensions, latent in the model from the outset, were accompanied by sinful political mistakes, their accumulation was accelerated and led to an explosion in 1956.

The political management that took over inherited a paradoxical situation. It made, or rather was forced to make, the double attempt—owing to its communist alignment as well as to the international connotations—to reconstruct the centralized hierarchical reproduction model and to develop a practice of social control which would minimize tensions and conflicts, bringing about a kind of consensus. That is why it has tolerated (to different degrees at different times) the development of such reproduction mechanisms that contradicted the logic of a hierarchically centralized institutional system—in fact, at times it has made their development into a political programme. Thus, in the last thirty years a reproduction model has emerged, the logic of which could be represented by a model of the form L: one axis of which represents the redistribution mechanism of the original socialist reproduction model, and the other one the market regulation of reproduction.

In my earlier studies ([1], [2]) I pointed out that an inner division developed within the political centre of economic management and organization ([3]), in which it became legitimate that each central political organization should represent different partial interests. "Behind the back" of the institutional system of redistribution based on hierarchical subordination a playfield of reconciling interests has come into being: first by recognizing the importance of commodity and money (market) relations, and later on, as enterprise and local independence increased and the system of economic control and management underwent modifications, the role of the market has also increased in the regulation of economic processes. At the same time, market relations in the enterprise and cooperative sphere can only assert themselves still under the strong pressure of (income) redistribution; while in the regulation of the processes in the second economy, having grown to significant dimensions, only the market regulation is asserted, although distorted from several aspects because of the above-mentioned factors. Within this sphere, the redistributive intervention can only move between the alternatives of drawing or slackening the reins. The emergence of this model "L" affects not only economic processes, but the whole of social reproduction as well.

If we attempt to specify the three outstanding positions of the model "L" by social groups—on a rather abstract level—the meeting-point of the two axes of the letter L is occupied by producers in the broad sense of the world. In the redistribution process, producers are faced with political power, and in the market relations they are in contact with entrepreneurs. The production model valid in Hungary can thus be described on a most highly abstract level, as it is shown in *Fig. 1*.

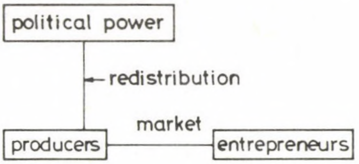

Fig. 1
Abstract model of redistribution

If we wish to fill this abstract model with an actual sociological content, we shall immediately perceive that only a relatively small part of the population is found in one of the three outstanding positions; the overwhelming majority are in transitory positions.

Although no scientific research results on the sociology of power are available to us, we assume that in Hungary no such unit of social structure has developed around the *political power* position that could be called a class. On examining the career of the heads of political and administrative central organs with national authority, we can see an extremely colourful picture. There are, in decreasing number, the leaders who grew up in the workers' movement before the socialist change, worker-cadres raised to high positions in the period following the end of the war, representatives of the "new intelligentsia" shaped by those revolutionary times, intellectuals raised to power, economic managers turned into politicians, and also people wo have slowly risen through the hierarchy of the apparatuses of political power. Although this sphere is covered by a network of complicated interrelations, there are also a few factors that strongly divide it. First, the firm hierarchy following from the logic of the redistribution. Second, the asynchronism between the elected corporate membership representing formal power and the real power position. Third, the informal political division which is an inevitable consequence of a one-party system. Fourth, the internal division of interests that positively exists among the central organs, as has been mentioned above. Fifth, last but not least, the deliberate political effort made to prevent an isolated reproduction of an élite holding political power, by minimizing the privileges concomitant with power positions.

The emergence of an *entrepreneurial group* functioning purely on the basis of market conditions is even more strongly constrained. Following from the socialist nature of society, the accumulation of private capital is strictly limited, and the question does not even arise that the newly created and strongly restricted private entrepreneurial group should share political power. Thus the main reason why the entrepreneurial position, determined by market conditions, becomes important for the whole of the reproduction process is not the number and importance of those filling such position, but those in transitory positions who also tend towards it.

On the one hand, the question is about the *managerial* position taking shape in the duality of political power and entrepreneurship. The process, in the course of which enterprise and cooperative managers holding positions in the local representation of political power grow into a managerial group of a specific nature requires separate analysis. Some of the economic managers already occupying a "contradictory position" [4] in the redistribution which is "restrictive downwards, representing interests upwards", [5] (i.e. divided hierarchically as well as into domains of reconciliation of interests) have taken, parallel to the appearance of market regulation, yet another "contradictory position" between political power and the entrepreneurial attitude. Within this managerial group, there is a high degree of differentiation according to the closeness of ties with the redistributive or entrepreneurial mechanisms. However, it definitely develops in the direction of an independent agent of reproduction.

On the other hand, the duality of the entrepreneurial and producer positions appears in an ever increasing number in society; partly within the traditional small commodity producers' sphere and partly within the framework of the so-called second economy. By 'second economy' I understand non-illegal and non-centrally organized gainful activities and income redistributions [6]. Within this second economy, that of the *small-scale commodity producers must be distinguished from entrepreneurs,* just as in the official private sphere there exists a considerable difference between the type of small-scale industry of small producers (artisans, handicraftsmen), entrepreneurs and the private peasant farm.* A special internal division can also be outlined within the group of *producers*. On the level of the abstract model, this internal division is determined by the duality of the redistributive and market subjection. American sociologist David *Stark* has constructed a model according to which the fundamental difference between the capitalist and the socialist economies is in that in the capitalist world inter-enterprise transactions are subject to market regulation, while the division of labour within the enterprise is administratively and hierarchically regulated; in the Eastern European socialist states enterprises move within the framework of a hierarchical-administrative regulation, whereas within the enterprise , especially in the

* By the distinction between small-scale commodity production and entrepreneurship I mean that in the former, the magnitude of the countervalue of the work performed is primarily regulated by the quantity of the labour input, while in the latter, by the calculated market perspectives. In the attitude of small producers, therefore, labour market and commodity market are separated, while the entrepreneur considers all perspectives of the market. Thus I put under the category of small producers' second economy the small-scale agricultural commodity production which is either self-sufficient or only places surplus products on the market, and involves the use of one's own labour in the second economy; while under the category of small producers' small-scale industry I put the artisan working on his own. Entrepreneurship, on the other hand, demands a rational market calculation as well as the utilisation of others' labour, whether it is in the second economy or in the private sector.

relation between workers and managers, a market regulation asserts itself. This highly abstract differentiation is, in reality, much more complicated. In a more complex approach, however, it helps to explain that, within the framework of the redistribution, in the enterprise there develops a group of employees in a 'central', and another one in a 'peripheric' position (Csaba *Makó*'s terms). Outside the enterprise, however, the differentiating factor is the segmented labour market, and the different chances of entering the second economy. Thus the duality of redistributive and market subjection opens up a kind of "playfield" for a significant group of producers, while for the groups occupying peripheric positions within the enterprise and for those having the least favourable possibilities on the segmented labour market and in the second economy the subjection means a dual subjection. As a matter of fact, only the latter group—15–20 percent of the economically active population—appears in a clear position, while again a contradictory position is predominant with the rest.

Thus, six groups of producers, each in a different structural position, may be distinguished:

1. The above-mentioned *group in dual subjection,* consisting in most part of unskilled manual workers; they are enterprise and cooperative workers in a peripheric situation, occupying the least favourable positions on the segmented labour market, unable in any way to assert their interests and also unable to compensate this in the sphere outside the enterprise. (Their situation is determined by this dual subjection even if some of them earn relatively high wages as a consequence of labour shortage.)

2. The *group situated on the redistribution axis* of the model "L", some occupying the wide middle field of the redistributive hierarchy, while others succeeded in obtaining more favourable positions than the first group in the field of the reconciliation of interests. Here belong the workers of enterprises, cooperatives and institutions who belong to the centre, in the sense explained above, and whose activity is in fact not influenced by the market conditions. Three typical sub-groups may be distinguished: those workers of large establishments in cities for whom a labour market does not really exist; a large part of the white-collar workers (administrative apparatuses); and representatives of certain intellectual occupations (the intelligentsia of the armed bodies and of the political-administrative apparatuses, judges, attorneys, about two-thirds of teachers, about half of the technical intelligentsia, about a third of physicians and scientists) whose activities in their full-time jobs are not regulated by market conditions and who, for different reasons, cannot take part in the second economy.

3. The group comprising a relatively large number of people who are in an identical position with the first group in respect of full-time job, while the possibility is open for them to *enter into the second economy as small producers* and thus to obtain some compensation for their financial situation. The majority of this group consists of those semi-skilled and unskilled workers and employees living in villages who complete their income with small-scale agricultural production for the market.

4. A presumably small group is made up of those who, in their full-time job, are

in a situation similar to that of the first group, while *in the second economy they appear as enterprising small producers*. This group is of a diminishing size in the agricultural cooperatives and elsewhere it only includes workers whose full-time job is essentially an alibi.

5. The next structural group is composed of a mixture of the second and third groups, which in its full-time job occupies the *central spheres of the redistribution, while pursuing small-scale production activity to complement its income*. Typical examples are miners and railwaymen engaged in household-plot farming, skilled workers of the building industry and mechanics selling their labour in the evening hours and on weekends at much higher price than in their full-time job, teachers giving private lessons, and intellectuals earning money in the second economy by routine-like activities below their level of qualification.

6. Finally, the group of *entrepreneur producers* is composed of a mixture of the second and fourth groups. Most of them behave like entrepreneurs in their full-time job and, if they enter into the second economy, there, too, they pursue mainly enterprising activities. This group includes some of the intellectual élite, and we find here people participating in the new forms of enterprises, as well as the skilled workers heading the economic workteams (VGMK by the Hungarian abbreviation*) of enterprises.

This arrangement of the structural groups is clearly related to the hierarchy of social inequalities. In the model "L" a straight line representing the hierarchy of the general statuses can be drawn, with one end at the meeting-point of the two axes of the L, and the straight line itself between the two axes. In this system of social reproduction, it is thus possible to reach identical levels of the status hierarchy by starting from different structural positions. This is one of the essential reasons why our pattern of inequality is structurally inconsistent and why the different structural groups reckoning with this multichannel system of social (upward) mobility can develop so widely different life strategies, even when striving for roughly the same living conditions.

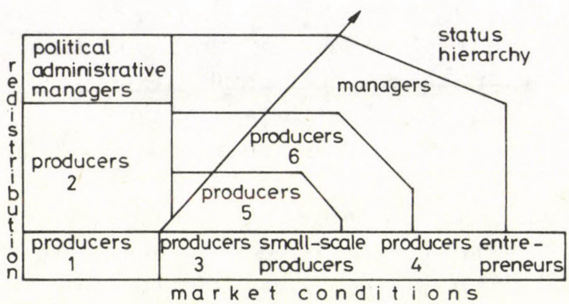

Fig. 2
Arrangement of the structural groups

* Working after legal worktime—Ed. note.

Of course, the model is far from covering the whole of social reproduction, or the whole of the population. In the regulation of social reproduction quite a few such mechanisms are functioning as have not been mentioned. First of all, let us think of the regulations of social reproduction going beyond the existing social system, or of the household economy which is of growing significance nowadays ([8], [9], [10]). What can be included here is the reproduction method especially effective and predominant in the Hungarian society of today. Thus, the structural groups listed above cannot cover the groups of the population that are not directly participating in the mechanism outlined—for example, the dependants.

On the interpretation of the reform

Let us stick, however, to our chosen subject and investigate the other concept indicated in the title. Ever since the reform policy was officially admitted, it has been a basis of reference for, and written as a slogan on banners of the most widely different political efforts in widely different senses. That is why I deem it important to specify my own interpretation of the reform in Hungary in the late 1980s. Thus I wish to make clear the *context* in which the relationship of the above-listed structural groups is being discussed.

Quite a rich literature has already been dedicated to the question of how the so-called 'original model' of socialist reproduction was born in Soviet Russia and what it brought with itself. Almost as much has been written on the question of how the same model worked in various states of Central and Eastern Europe after World War II.

This model has produced—right now, we shall not ask at what price—a relatively fast, extensive economic development, enabling a strong centralization of resources and thus their relatively free utilization by the political leadership. Further, it made it possible for the model to be functionally combined with the realization of communistic and socialistic demands (and the ideological legitimation based on it).

We also know the successes the model has achieved, the structural-functional disturbances it has produced, the social tensions it has raised, to what extent it has been a challenge for capitalist countries to introduce reforms, and how much it has discredited ideals within the workers' movement. The process of changes starting in the socialist countries after the 20th Congress of the Communist Party of the Soviet Union is also well known. These aimed not only at purifying the model politically but also at making pragmatic openings in its wall of strict logic.

In the course of the 1960s, however, the economic and social resources of extensive development were slowly exhausting, while the structural changes on the world market and in the capitalist countries presented—and still present—a fundamental challenge. The essential point of the internal challenge therefore, is that the original model is based on the logic of extensive development, whereas its resources have become exhausted or are on th point of exhaustion. At the same time, the model has created a structure and an institutional system which resists change. As for the external challenge, I see it in a world economic crisis that has degraded the economic activities that had been given priority in the model and upgraded certain social spheres—I am thinking mainly of communications and the necessity of fast reaction arising from the technological revolution. The functioning of these is, from the outset, in logical contradiction with the logic of the original socialist model of reproduction. Yet the countries in question have been compelled to enter the world market exactly in this period, and thus the challenge is felt even more strongly by the countries of an open economy.

The statement can be made, even without any detailed analysis, that the socialist countries can react to the double challenge in two different ways. (Let us now disregard the chance that they do not react.)

I call one of the possible reactions the *rationalizing-retreating* reaction. It concentrates on preserving the original model and thus moves in two directions. On the one hand, it makes an attempt at rationalizing the socialist redistribution, and with this in view, it endeavours to make use of the latest technical achievements. It tries to rationalize the reproduction process and to utilize the centralized resources with the most rational calculation possible. Its symbol is order and discipline and it tries to find the technical basis of this centralized rationality in information theory, automation, and scientific work organization. (In the Hungarian literature, this way of utilization of computer technology was demonstrated and most sharply criticized by Tibor *Vámos* [11].) On the other hand, its efforts at rationality lead it to let the partial elements of alien reproduction models infiltrate—temporarily, of course—in the spheres of social reproduction where it cannot assert its centralized rationality. (*Manchin* and *Szelényi* call this reaction the "scientizing" of planning and redistribution [12].) In my opinion, in an open society and a world-market-oriented economy this strategy does not have encouraging perspectives in the long run.

It is the other possible reaction that I call *reform*. Its substance lies in the realization of the fact that it is impossible to react in the long perspective on the dual challenge outlined above within the framework of the original reproduction model, and thus the reproduction model must be re-formed. It should be emphasized that it is not only an economic reform, but also the reform of the social and political conditions governing the former.

With the hierarchical *redistribution* model two reproduction models can be confronted on a purely theoretical level. First, a *market reproduction* model, second, a *corporate-reconciliation-of-interests* model. The latter means that in the allocation of social and economic resources an institutionalized forum for the reconciliation of interests is functioning. The different interests are integrated into the institutional system of specialized departmental administration. It is the reconciliation of interests by these administrative apparatuses controlling one another ([13]) that regulates the distribution and redistribution process and determines what proportion of goods is to be redistributed, and not the hierarchical subordination. To avoid any misunderstanding; in both cases—when speaking about a market economy and about reconciliation of interests—I mean a socialist model restricting the private ownership of the means of production. The two models are different from the hierarchical redistribution model in that both infer a relatively high degree of *autonomy* of social units in a broad sense (enterprises, cooperatives, settlements, societies, families, individuals). Therefore, still on the level of abstraction, I consider the relationship to these autonomies as the distinctive mark of reform orientation.

All this already gives an indication of the many possible variations of the efforts within a reform that is so interpreted. Without analysing the possible variations, I wish to make it clear that I am for a multisectoral socialist social reproduction model which equally includes the real market, reconciliation of interests and bargaining, as well as hierarchical redistribution. It is a fact that the (so far) best known, though by no means perfect, regulator of economic processes is a well functioning market. However, the idealization of the market, sometimes also found in Hungary, is contravened exactly by the development of capitalism, the most advanced market economy so far known. Therefore, the answer to the dual challenge may be a reproduction model which would try to ease the necessary internal contradictions and tensions of each of the three models in question by means of the contradictions and tensions of another model.

In the existing social structure the three reproduction models are actually present. However, *the fundamental problem lies in that the other two models* are *only* functioning *in subordination to the hierarchical redistribution model,* and that also the institutional structure is based in most part on this prevailing model—although the last 4–5 years have produced accelerated changes in this institutional structure. Only the units representing a smaller weight in the production of the national income are functioning under real market conditions.

The majority of enterprises are functioning on a quasi-market, under the pressure of the hierarchical redistribution (called manual control in the economic policy usage) and use the non—or little—institutionalized armoury serving the reconciliation of interests for turning this redistribution into the direction favourable for them.

Thus the necessary immanent disorderly state of the multisectoral model appears as a real disorder, thus giving an impulse to the first type of reaction which only rationalizes redistribution, and thereby also lends weight to the objectively anti-reform tendencies. However, a settlement in accordance with the spirit of the reform as interpreted above demands that the legal and institutional guarantees of a real market and an institutional reconciliation of interests should be provided, thus clearly delimiting the sphere of authority of the hierarchical redistribution.

In distinguishing between the three models of reproduction, attention must be drawn to two misleading paths. One sees the guarantee of socialism in the hierarchical subordination of the three, with redistribution at the top, continuing to identify socialism with the original reproduction model. The other wishes to differentiate according to horizontally-coexisting spheres of economy: a market-oriented sphere (for example, personal services, retail trade, certain branches of agriculture), reconciliation of interests (for example, scientific research, local politics, some of the industries), and a redistributive sphere (for example, strategic industry, public utilities, health, education). Instead of these two, a system of relations seems to be desirable in which the mutually-correcting influences of all three reproduction models (of equal rank) can institutionally assert themselves in all spheres of the reproduction of social conditions.

It is not the task of the present paper—and a scientist on his own would be unable—to provide an exact description of the three reproduction methods integrated into one structure. According to the actual purpose of the analysis, all I have undertaken to do is to outline the tendencies pointing towards reform and those running against it. First we have made the statement that the establishing of autonomies independent of the central power (and the democratization of the central power necessarily concomitant with it), the extension of real market conditions to further social spheres, the institutionalization of mechanisms of reconciliation of interests, and the delimitation of the sphere of authority of redistribution are in conformity with the reform—whereas steps taken in the opposite direction seem to be anti-reform tendencies.

The next question is, what kind of reform is needed to build an efficiently functioning socialist society: a market autocracy based on last century's visions, or a corporation of national scale making everything the subject of bargaining between group interests, or the model of mutually controlling reproduction methods as outlined above? In this last model economic processes are mainly regulated by the market, but market regulation is permanently corrected by an institutionalized reconciliation of interests, and for this correction a redistributive mechanism is created, whether the questions concern the satisfaction of basic social needs, strategic production, or infrastructural or scientific-development innovations that are non-profitable under short-term market regulation.

The battle that has not been fought

Having clarified the two basic concepts, we now come to the investigation of their mutual relations. I am well aware, of course, that the attitude towards reform is not determined by group qualities and the resulting macrolevel group interests alone. Individual manifestations are strongly motivated by personal choice of values, insights on the scientific level or in everyday matters, social connections and current fights for positions, ties of the past and expectations towards the future, and the citizen's sense of responsibility. From this complexity I shall try to grasp just one section: the attitudes towards reform of the above-listed six structural groups—as expected in view of their position.

With this analysis I do not wish to say that the fate of the reform is decided by the attitudes of these groups. *Two-directional will* is needed for every reform. A reform is effectuated, or a reform process receives new impetus if determination of the political leadership and mass support by those interested in the implementation are simultaneously present. From this aspect, it is a secondary question (objectively it is, of course, of fundamental importance), whether the determination of the political leadership is motivated by economic or social forces, strategic conceptions within the political spectrum, or deliberate conceptions about the future. It seems that at present international conditions are favourable for carrying on with the reform process, and the dual challenge, already analysed, renders it extremely urgent that such a *political will* should take shape *in a strategic conception*. By describing the attitude of the structural groups towards reform the purpose is exactly to promote the development of conscious mass support for such a political will.

Let us start from the 'quasi-pure' groups. It should follow from the abstract logic of the model that the market actors, i.e. entrepreneurs and small producers are *for* the reform, and political leaders occupying high positions within redistribution are *against* it. The formula is, however, not at all so simple. The syllogism best holds in the case of *entrepreneurs*. Their mere existence is tied to the reform. At the same time, two factors cast their shadow on the picture. On the one hand, in the entrepreneurs' recruitment an important role is played by a group of intellectuals who interpret their entrepreneur existence as a kind of substitute. They were attracted to entrepreneurship by the prospect of material well-being and more freedom, or pushed towards it by bureaucratic structures of intellectual work, or their failure within these structures. Therefore, this group of entrepreneurs—only representing a minority within the anyway small group of entrepreneurs—will advocate the reform only as long as a rational and more just distribution does not offer them positions of higher prestige. Another small group of entrepreneurs is in fact afraid of an institutionalized, real market; for them the present amorphous situation offers better prospects. Therefore, they are not interested in further developing the reform, but rather in stabilizing present conditions.

This is basically also characteristic of the attitude of a considerable number, perhaps the majority, of *small commodity producers* towards the reform. By restricting the market, i.e. competition, and through the liberalism resulting from the taxation system being from the outset impossible to observe, the *status quo* amply compensates them for existing uncertainties. Thus, only those small commodity producers are interested in carrying on the reform who could become entrepreneurs. It is another question that, if the present quasi-market were to grow into a real market, the number of small producers who could become entrepreneurs would propably considerably grow, as would also the number of those who—because of their ceasing monopoly position—would be prompted to abandon even their small commodity producer position.

The most complex attitude towards the reform is that of the political leadership.

This attitude is determined by the contradiction that political leaders hold the top positions of redistribution, while it is in their fundamental interest to strive for consensus, which can only be maintained in the long run through the reform. At the same time, by virtue of the original reproduction model, the political leadership has a relatively high degree of autonomy, so that its freedom of choice supersedes its structural ties. The result of this is that the attitude to the reform of those belonging to the political leadership is much more strongly determined by the multifariousness of the political and economic tendencies, and by the internal division of power (mostly hidden, however, from the public eye by the prevailing structure of the one-party system), than the structural position it occupies as a quasi-group.

The *most ambivalent* attitude towards reform is found at the other end of the social hierarchy: in the first group of producers. This is not only because they are (because of their dual subordination) inevitably the losers, but also because they are the least able to voice their interests—to use Csaba Gombár's expression: they are politically nameless. [14] For them, reform or rational redistribution are the same thing; what is important is that they can satisfy their needs not on a deteriorating, but rather, on an improving level. Also there is no foundation for the assumption that a more rational labour management following from the reform would be most threatening to the employment stability of this group. The position of this group on the labour market is similar to that of the guest workers of the developed capitalist countries and, at the present level of the division of labour, every economy needs such labour. It is another question as to whether this group is, exactly on account of its defencelessness, the easiest to manipulate and to influence by demagogy.

The situation of the third group of producers is similar in several respects. The main difference is that this group has at least some possibility for compensation in the small producers' second economy. Of course, they want to keep this possibility and would give it up only if a rational redistribution offered another, tangible alternative. At the same time, such an alternative is excluded for the fourth, half-entrepreneur group, but it can be perfectly real for the fifth group of producers. The latter group already uses the possibilities within the enterprise and in the second economy as *tactics*. (A very good description of this type was produced a few years ago by Héthy and Makó [15], based on their investigation of electricians in a large enterprise; in many respects, however, the situation of intellectuals belonging to this structural group is similar.) In the present situation, this is the group that is capable of the most efficient adaptation, having the means at their disposal in the situation of either a reform-oriented, or a restitution strategy.

At the same time, it is to the common property of the producer groups so far examined that their attitude is necessarily *a following and adjusting* one. They have no means with which to influence either conditions or events; the difference between them shows rather in their ability to adjust to the events, and in the degree of their adjustment to the different types of events. There is every indication that, through a non-negligible transmission, *the objective interests* of these groups *are also tied to the* *reform*. This is because, if the reform process were to slow down, the lag of the whole Hungarian society would increase and this would eventually lead to worsening living conditions and chances of mobility of the following and adjusting groups. As for the formation of events, however, the decisive role is played by the reform attitude of managers and of the remaining two groups of producers.

At present, the most contradictory situation is that of the group of *managers*, while at the same time they have the best means to force changes. This group is not only situated at the crossing point of political leadership, entrepreneurship and producers, but is exposed to pressure from three sides. In recent times enterprises have come under a quasi-market pressure in such a way that the pressure of redistribution on them has not eased, but even increased financially. (An increasing part of the profit is taxed away by the budget—from several respects already unbearable for the enterprises—and the so-called manual control of the economy creates a totally incalculable situation for managers.) Further, with the introduction of the new forms of enterprise management, the managers came under the pressure of internal groups representing different interests, in such a way that the pressure from their superiors has not decreased by anything like the same extent. Obviously, even the most market-oriented entrepreneur will demand redistribution, if the market devaluates his activity in one way or another; while the adherent of a centralized economic management will long for the market, if all redistribution does to him is tax away his income—and even the most democratic of managers will have quite a number of sleepless nights before the decision of an enterprise board or meeting—not always taken in an open battle—affecting his personal life.

It is the consequence of this pressure coming from many sides that, currently, the group most *oriented towards change* is that of the managers. The essential question now concerns the content of the required change. This is finally decided by the manager's own attitude, the changes of the enterprise in his charge and, to a smaller extent than what would be necessary, by the manager's market value. (This is because the chances of structural transformation, wanted in principle but constrained by the regulation basically aimed at easing tensions, reduce the attachment to the enterprise to attachment to its present structure—perhaps hopeless from the market aspect—while the reduced mobility of managers renders their market value secondary.)

Of the two groups of producers not yet investigated, group 6 is the *mass base* of pro-reform tendencies, and group 2 is that of anti-reform tendencies which are largely independent of the subjective wishes of the individuals concerned. That is why it is worthwhile investigating these two groups in more detail.

For the groups attached to the *intermediate fields of redistribution*, the market only functions when they come to this market as consumers. In their quality as producers, the market acts as their enemy, being a field which offers other social groups the chance of rising—of course, of sinking, too, but those who go down are no basis of comparison for any social group—while for them, this type of upward mobility does not exist. For a long time, rising in the hierarchy of redistribution has been virtually the only way of moving up the social ladder in Hungary. This group has perfectly adjusted itself to moving along this path—and then it suddenly finds that another path has opened, while mobility has decreased on its own path.

This group—and especially the leading intellectual circles—are sounding the alarm. Their argumentation, strongly simplified, is about the following: professional knowledge has become significantly devalued, both financially and morally; therefore, the number of highly-qualified professionals leaving their field is growing. The predominating economic approach depreciates human values. The tragic consequences can only be prevented if the primacy of rational redistribution is restituted through central intervention. The income conditions of the prospects of self-assertion on the market should be reduced. A school system selecting on the basis of talent should serve the rationally calculated labour demand, quantitative over-training should be stopped and a quality élite responsible for the future should be created. In the confusion of values unquestionably prevailing today, the primacy of the traditional system of values should be brought back.

To avoid misunderstandings, I wish to make it clear that what I object to is not the factual truth of some of the statements, but the suggested solutions or even more their underlying logic—that is, the approach according to which the real tensions existing in society can be exclusively relieved through the logic of redistribution. According to this approach, it is not the rigidity of central income regulation imposing constraints from the top that has to be eased, but instead, certificated professional knowledge has to be centrally better paid. The tensions between the market sphere and the redistributive sphere are not to be resolved by making the redistributive sphere adjustable, but by constraining the market sphere. The crisis of values is not to be treated by changing the values, but by restituting the traditional system of values.

Upon this platform, this structural group has recently started to form a *special coalition:* that of intellectuals of the liberal arts staying away from market, and those trade unions inclined to narrow down the representation of workers' interests to that of workers of large factories in towns. This coalition makes its voice increasingly heard in mass communication media and tries to influence the groups of political leaders and managers.

Obviously, because of individual efforts, this group, too, is internally divided. It would be impossible to tell exactly what part of it is consciously opposed to the reform efforts.

I assume that there are quite a number of individuals who personally confess to be for the reform, and in a theoretical discussion stand up for it, or at least definitely refuse the well known practices of redistribution. However, their manifestations in practical questions often promote anti-reform tendencies, often quite against their real intention. A secondary aspect concerns the extent to which such manifestations arise from the wish to have a share in the redistributive power, or are enforced by the existing conditions.

I know perfectly well, of course, that reality is a lot more complex than the situation described; yet what I think important at the present moment is to outline the deep-lying and bared structures. This is especially so because, while this group appears as a veritable "pressure group" formation, what is found with the group of *entrepreneur-producers* is more like an uncertain articulation. In principle, this group could provide the most important mass support for the reform process (its estimated number is not smaller than that of the former group). However, two factors hinder its growing into a group in itself. On the one hand, this group has separated, quite clearly, from the former one during the last 15–20 years, so that the traditions of its former structural existence persist in its system of values. A member of this group, if an intellectual, has become objectively an *intellectual-entrepreneur* or an *entrepreneur-intellectual,* while subjectively he still wants to be more an intellectual than an entrepreneur. On the other hand, his historical experience also puts him on his guard. So far, the reform process has shown a periodicity of opening and restitution—therefore, at present he is justified in fearing now the perspective of a restitution period. His attitude is not based on an offensive but on a defensive strategy. He is determined to keep the maximum of the increased scope of activity, yet his main concern is to keep it and not increase it.

This is how the situation is created in which the battle is not fought and frontlines are not consciously separated. Structural groups remain latent groups; momentary interests do not just blur perspective strategies, but the latter do not even get articulated. The entrepreneur-intellectual borrows the redistributive intellectual's phraseology, and the redistributive intellectual only acts upon the logic of the redistribution, without even considering what he could gain by the improved conditions of the reconciliation of interests, or by toleration of the market.

The battle is unfought also because the present political structure does not allow an open and democratically controllable clash of the different interests and views. Therefore, a political learning process cannot evolve, either. The risk is run that actual dissatisfaction with actual matters will cumulate into an anti-reform wave—for lack of seeing the political interrelations.

There are, of course, other kinds of processes. Lately, the group of managers has started to develop its own distinct character. (A useful framework is provided for this by the Chamber of Commerce.) Also, in the course of the internal differentiation process of the working class, within the skilled workers' élite, the weight has shifted fast towards the group representing the mass base of the reform process. (In this respect, the importance of the much debated enterprise economic workteams is much greater than their economic role, or their impact on the work organization.) Among intellectuals, the number of those who wish to be specialists and entrepreneurs is slowly growing—and not only 'intellectuals' as this term is interpreted in Eastern Europe. These tendencies may strengthen our faith in the belief that the battle that has not been fought is yet not impossible to fight.

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СТРУКТУРНЫЕ ГРУППЫ И РЕФОРМА

Т. КОЛОШИ

В первой части своего научного эссе автор, социолог, занимающийся исследованиями общественной структуры, анализирует распределение структурных групп в зависимости от механизмов распределения и рынка. Наряду с политической властью, предпринимателями и мелкими товарными производителями он выделяет шесть специфических по своему положению групп т. н. «производителей».

Во второй части работы автор высказывает свою точку зрения на социальную и экономическую реформу. Он указывает, что резервы первоначальной экстенсивной модели воспроизводства исчерпаны и в длительной перспективе попытки ее рационализации не дадут результатов. Необходима такая реформа, которая ограничит компетенцию государственного распределения и обеспечит простор отношениям рынка и согласования интересов при соответствующем регулировании и институционализации их.

В третьей части анализируются структурные — т. е. независимые от субъективных намерений отдельных личностей — отношения отдельных структурних групп к реформе. Автор различает группы, заинтересованные в повороте назад, в сохранении нынешнего положения и в радикальном проведении реформы, а также группы, способные оказивать влияние на политику и лишь идущие за событиями.

Основной вывод состоит в том, что связанные с этим конфликты должны быть разрешены в рамках формальных институтов и что необходимо открытое выражение групп, заинтересованных в реформе.

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DEVELOPMENT OF SETTLEMENTS, DECENTRALIZATION AND COMMUNAL MANAGEMENT IN HUNGARY

G. GULÁCSI–P. JUHÁSZ

The authors analyse the domestic results and failures of forty years' experience of centralized infrastructural development in Hungary. They have come to the conclusion that, at present, the only possible way for the development of settlements and infrastructure is decentralization. Adopting this principle the two authors of the study develop two (partly conflicting) concepts for the development of settlements.

Most tensions prevailing in the Hungarian settlement system are rooted in one-sided economic development. For a long time only the interests of *quantitative production and extensive industrialization* received the support of the state development policy (which centralized resources) and also the support of the control agencies organized by branches of economy. Also the prevailing scale of economic values worked in this direction. The development of the sectors serving production and the infrastructures of settlements were repeatedly neglected. Few of the social burdens accompanying the profound reorganization of society owing to industrialization were undertaken by the government control agencies. Therefore, while the sharing of settlements in industrialization and in the accompanying advantages/disadvantages was strikingly disproportionate, all of them suffered because of the lagging development of social systems and infrastructures. For example, the so-called complementary investment projects were transferred in vain mainly to the centres of industrialization for they were not sufficient to satisfy even the additional demand for staple supply originating from immigration, let alone being enough to improve the more and more backward standard of supply. Those settlements which had not been chosen for industrialization were *ab ovo* left to their fate by the state allocation of investment projects.

Cities come first

This cumulation of infrastructural neglect accompanying stepped-up growth lasted till about the late sixties. Then, at last, an economic and political shift in favour of infrastructure was decided upon in order to alleviate the ever graver housing problems and supply tensions. Utilizing the good opportunities of growth, the share allocated to the infrastructure was increased within state investment projects.* The infrastructure's loss of fixed assets was slowed down—though not halted—and the provision of consumption and services with assets somewhat improved.

It was not absolutely incidental that acceleration of the development of infrastructure by the state coincided with the formulation—in the framework of a comprehensive concept—of central preferences and selection criteria concerning the development of the settlement network. With this rate of increase of investments it was already necessary and possible to rise above treating the whole of communal investments as direct complementary investments of industry. However, it was *ab ovo* forecast (by the way in which political institutions perceived the regional tensions as well as by the centralized practice of investment allocation) that the increased state funds would flow to bigger towns and industrial centres and would be intended to alleviate the supply problems chiefly in those places—and so it happened. This same trend was also supported by the National Concept for the Development of the Settlement Network (OTK) passed in 1971. The said concept served the allocators of investments as an ideology for the one-sided development of big cities and county centres and for the subsequent centralization of supply functions and roles. The hierarchical classification of settlements itself inevitably gave encouragement and titles for the inconsiderate actions of the 1970s—regionalizing and amalgamating public institutions, administration, schools, health care, etc. That is, the smaller settlements were not simply neglected but were even damaged. Alas, the latest changes in the central allocation policy have not been connected with a thorough criticism of the previous practice.

In the 1970s the centralization of state investments was eventually successful in alleviating the accumulated general supply shortages in the *bigger cities*. By now the staple supply requirements caused by the swollen population attracted to cities by industrial developments are, as a rule, satisfied.

On the other hand, this degree of concentration of state investments would have irreversibly impaired the *small cities* not sharing in the funds (and nearly all the villages) if their destinies had only depended on the state development policy and on the big organizations of the enterprise sphere. Luckily enough, however, another story was also taking place in the meantime. In this story the National Settlement Development Concept and the central bargaining and county interests played little roles. Beside the state-financed growth through central allocations there emerged another trend of development fed from decentralized resources. A significant number of villages could survive because they were included in this second stream of development

These settlements could offer ambitious citizens suitable premises for their undertakings to earn complementary incomes. Here, the proximity of cities, the

* In the 4th five-year plan period these investments increased nearly twice as fast as investments into material production. As a result, by the mid-seventies the share of the infrastructure in investments became exceptionally "high" (50–55 percent) relative to the other socialist countries. In the other socialist countries even now more than 60 percent of total investment is still made in the directly productive sectors.

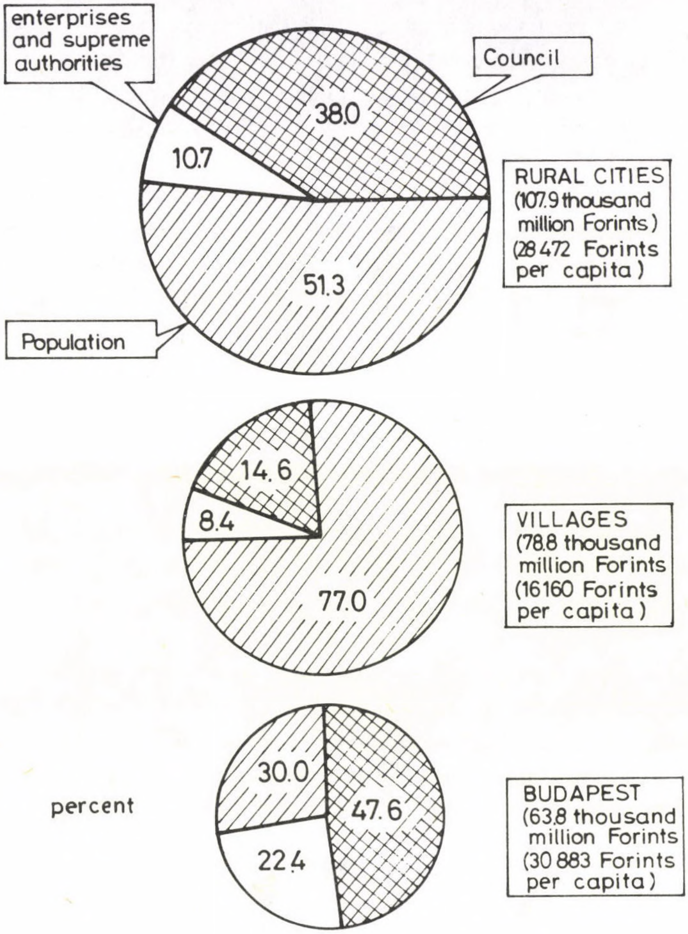

Fig. 1

Percentage distribution of communal investments by investors and settlement types (1981–1984)

Source: Own computations, according to actual classification, on the basis of county statistical yearbooks.

wide-spreading of specialized small-scale production, the advantageous combinations of agricultural business organization and family work and, last but not least, permanent self-exploitation, produced financial gain and wealth. This, complemented by cooperatives capable of helping and led by competent local leaders, enabled an unexpected flourishing of many settlements.*

* Irrespective of the central "index numbers" and county preferences, in the 1970s tens of thousands of family homes were privately built by the owners in villages. People paved roads, the communities built several hundreds of "above-plan" nursery schools and outpatient clinics, they joined and even undertook substantial burdens to have good drinking water. Although the looks of villages and the infrastructure of their communities still show the traces of backwardness, these villages are vivid and possess a great deal of energy for development.

Those settlements which have found themselves in acute crisis could not join either of the streams of development. The situation is grave in the villages abandoned by younger citizens (most of the dwarf villages), the *"slums" of the city centre zones* with an ageing population, and the *concrete jungles* ("sleeping districts") that are unable to offer an attractive living environment for their inhabitants. However, if we do not find new solutions, the rural cities that have so far been solid might be slowly driven into a dangerous situation because of the abating of the creation of industrial jobs and the decrease of state housing construction over the last few years.

The Hungarian system of settlement management policy and development is laden with tensions. Problems are already bred by the sharp delimitation of the central and the regional modes of development and their unpeaceful juxtaposition. The most acute tensions, however, originate from the fact that the necessary restriction of the domestic use of national income has also reached this sphere. By the late seventies it was realized on more and more levels of control that the state budget could not afford the burdens devolving on it owing to the further concentration of population.

Sensing the pressure for change, in the early eighties the central leadership first amended the allocation policy, raising the share of villages in the diminishing volume of investments; then it set itself to reforming the control system and, as a result, it took a number of reform measures* which are also important for the future. These measures reach beyond consolidation and are likely to bring about considerable advancement in several respects. However, it can also be admitted that the new regulations do not mean any profound amendment of the hierarchic character of the council economy or of its unnecessary isolation of the subordinated handling of the development of the entire infrastructure.

The need for readjustment

The starting point of nearly all further ideas for alleviating present economic problems and moving towards future development lies in the changing of the system of institutions organized around the interests of big industrial organizations, and the readjusting of proportions of investments and opportunities of growth. *How* these are to be achieved is, however, another problem.

Zsuzsa Ferge and her colleagues justly emphasize that the preservation of unequal chances of members belonging to different communities are rooted not only (or not primarily) in the lop-sided systems of settlement management policy and economic development, but also in their weak position in the system of socio-political

For example, from among the new measures: amalgamation of the council's monetary funds instead of the separate budget for operational expenses and development funding—this extends a hope for bettering the financial integration; earmarked county support instead of county orientation activity, providing an opportunity for refining the higher intervention; per capita quota (instead of unlimited county redistribution) and task-breakdown involving an incentive towards the levelling of the unequal distribution of resources; the emergence of the chance for alternative planning; and the losing of ground by the belief in a sectoral breakdown of the budget.

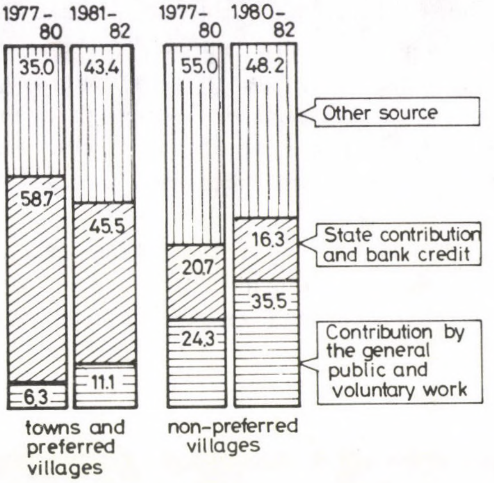

Fig. 2
Composition of council development funds by sources
Source: [1]

redistribution in the broad sense—in the primitive "economism" of our social establishments. This has lately been added to by Gábor Vági (in consonance with many economists and many citizens trying to make their living) who pointed out that giving greater accent to the treatment of infrastructural development (and in this context of an infrastructure assuring fair living conditions in each and every settlement) in central distribution is imperative. A shift in economic policy which will result in a political upgrading of the infrastructure is required. To reinforce the improvement of distribution positions and to counterbalance the lobbying of industrial/agrarian interests a—so far missing—representation of settlement interests ought to be set up. On the other hand, according to Gábor Vági, the ideas which would shift the governmental responsibilities for supply and development on to the population under the title of decentralization and democratization are harmful. Instead, there should be economic-political sponsorship of the infrastructure.

At this point the agreement of our opinions has come to its end. Moreover, even the previous recommendations need cautious treatment. We venture to state that there are very few chances of an infrastructural expansion within the budget of state investments and that the barriers to such expansion are also set, besides the pressure of the economic-political situation, by the real economy and by the economic mechanism.

Although it is true that the major proportions of investment are decided in Hungary on the level of central control, this is most unlikely to be an advantage for infrastructural development. The sectoral allocation of investment tends, "by nature", to "save" the infrastructural investments that are difficult to quantify and mostly yield external returns. It can do so all the more as, similarly to predictable benefits, the losses suffered because of non-investment are difficult to take into account in the infrastructural sectors. In the planning approach oriented towards quantitative growth the infrastructure is not a growth factor but a non-productive user of incomes earned elsewhere. Thus, when planning would support a non-productive objective then it would prefer wage rises and the boosting of consumption instead of infrastructural development, for such measures would work in a broader range and in a shorter term.

From the point of view of central control the neglect of infrastructural development also follows from the lasting inefficiency of investments (and production) in the directly productive sectors. Thus their share in investments must not be reduced, for that would be detrimental to the growth of the entire economy, and this would become palpable within a short time. We have to admit that with the given conditions and institutional system of the real economy in Hungary this neglect is a normal symptom and the opposite should be regarded as exceptional.

Such an exception was the period between 1969–1975 when the economic policy was able to increase the investment shares of infrastructural sectors by 8 to 10 percent. After this extremely favourable period of economic growth the economic policy efforts could do no more than maintain this position.* The 5–10 percent by which Hungary is still lagging behind the infrastructural proportions that can be regarded general in market economies derives from the unique institutional system of income distribution and investment, and its reduction cannot be expected without a radical changing of this system.

Even the setting up of a national representation of settlement infrastructures cannot be expected to produce more than two kinds of favourable advancements: it may be that the preferential projects within the state infrastructural development programmes would become organized not exclusively by sectors and would not be too project-centred (e.g. building of primary school classrooms, enlargement of hospitals, housing programmes) but there would also exist better integrated regional projects (e.g. to assist areas with dwarf villages). Furthermore, at last there would be a body which would not only lament for the dissatisfactory consequences of allocation from its own point of view but which could also negotiate about the considerations of redistribution. These are important things but they are of a perfectly different nature and much less significant than to achieve the up-grading of the entire infrastructure.

However, even if chances were good for an infrastructural shift in the central economic policy, it still remains a question whether the main endeavour now must be this or something else. When, fifteen years ago, the state investments allocated to infrastructure were surging subsequent to shifts in economic policy, this was translated into the building of residential districts, the biased urban centralization of investment

* Then, in the early 1980s, the share of the infrastructure in the total investment of the national economy again increased by a few percentage points. This, however, is a brand new symptom: the point is no longer the changing structure of state investments but that while total investment is stagnating, the private inputs of people, for the purpose of housing, are increasing.

funds, the supported expansion of big building industrial organizations and their politically encouraged monopolies, wasting, poor efficiency in meeting requirements, and the frequent neglect of the actual pattern of demand of the consumer community.

It is probably impossible to repeat the same process in the nineties and it is obviously inefficacious to let the infrastructural development carried out by the state operate in this manner. Today, however, positive alternatives, free of the said shortcomings, are not discernible at all.

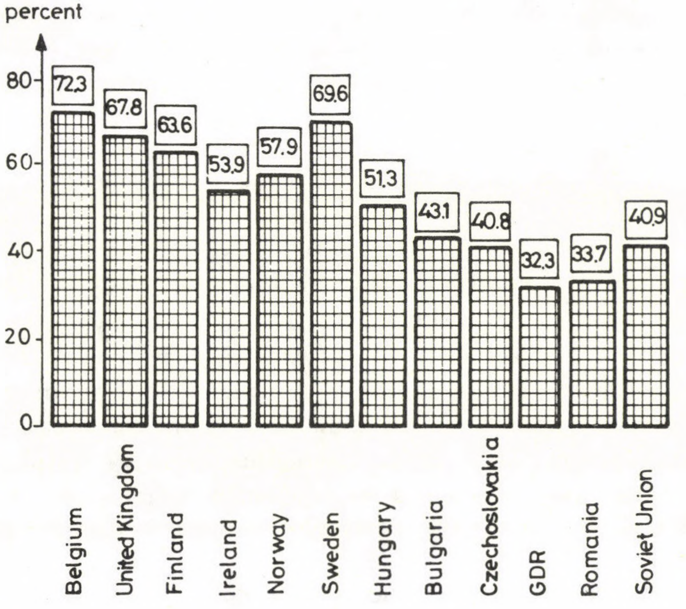

Fig. 3

Share of investments in the tertiary sector in total investment in some CMEA countries and market economies (1982)

Source: [2]

So it is not sufficient to pursue the economic-political upgrading of the infrastructure alone. What is needed is more than that and something different. It would also be necessary to reorganize the institutional system so that not only the positions in the bargaining about allocation should matter but that the economy itself should "turn out" a higher appreciation of the infrastructure. Also, as many elements of efficiency as possible, serving the increased participation of those concerned in the development system, should be involved. Towards this end:

— the *division of labour* and *cooperation* between the central authorities, the county and local councils, the enterprises and the population must be reconsidered. Public participation must be enhanced wherever this works towards faster development, while the delimited central tasks (such as transport and telecommunication—

without which the inequality of chances of settlements cannot be levelled) require concentrated and stepped-up state development activity;

— the *primary distribution of the national income* must be gradually *redistributed* in favour of employees and consumers, otherwise the public cannot be expected to increase its share in financing. At the same time, this would also guarantee a faster development of the infrastructure because among the income-holders it is the public that is the most interested in infrastructural development;

— *decentralizing institutional reforms are required* in the interest of (local) economic development. The integration of management must be improved, the wasting of costs must be controlled as much as possible, and the incentive for saving and in increasing the resources must be strengthened. Such institutions of development and management are required which pursue activities adjusted to the needs of, and controllable by, those concerned.

Two trends

No perfectly comprehensive and minutely drafted concepts exist as yet for the unfolding of the decentralization outlined above—there is simply a reform reasoning along these lines that can be stated. It is, however, already apparent that there are several alternative ways of decentralization and thus several reform concepts are conceivable. A rather traditional version of the settlement reform ideas is the so-called "self-financing" concept while a more recent line is the so-called "communal management" orientation. In spite of their palpable links the two represent different alternatives, both in formulating the main problems and with respect to the solutions assumed to be desirable. It will be useful to make a brief comparison of the two.

The self-financing line considers the economic and institutional reinforcement of local (council) autonomy to be the main task, hoping that this would bring about an upswing of local management and political participation. In pursuance of autonomy it finds that the lifting of the restrictions on the use of resources by councils is not enough and it is also deems it necessary to base the financing of councils on local resources. Furthermore, the hierarchic redistribution should be delimited and controlled and its importance should be, as a rule, decreased from the present level. This concept considers the development of settlements based on a decentralized formation of resources more important than that fed from the enforcing of interests in allocation. The more radical versions of this line put it as follows: the development opportunities of settlements ought to be differentiated according to the local formation of incomes (where excessive inequalities would be reduced by a state redistribution levelling them. The moderate version, however, does not insist on the close link between the aggregate production of incomes and the development opportunity of the settlement. The reliance on local resources in this case merely plays the role of making it clear that the development of the settlement is hinged upon two things: first, on the economic activity of the local people and enterprises; second, on the decisions of various bodies concerning the use, distribution, and redistribution of incomes. For this very reason it is unnecessary that taxes and revenues precisely reflect the local incomes—it is sufficient if connections are established in a broad enough circle of economic activities. Furthermore, the decisive points in the selection of the kinds of taxes are the assurance of a relatively *balanced formation of resources* and the satisfaction of other technical requirements of council financing.

By such a change in the character of financing and a shift of emphasis, the councils would perhaps be prompted to pay attention to the general public and to improve their management instead of trying to assert their institutional interests at a higher level. At the same time it would also encourage the citizens to be more willing to interfere, control and participate.

The self-financing orientation is adjusted to the actual separation of economy and administration and, therefore, it would give separate encouragement to the loosening of hierarchic subordination. Also, fearing the overgrowth of red tape, it refrains from vesting any kind of integrator (master) role in the basic units of the system of administration.

It counts on the results to be expected from the updating of the political system and it also deems the quest for the political methods of decentralization to be important. It would like to restrict the redistributing activities of higher state authorities to activities serving welfare and social interests, seeking far more civilized forms of such activities than those now applied.

The other line of ideas, namely, the communal management orientation (referring precisely to local experience) finds much deeper problems and seeks the solution elsewhere. Accordingly, the councils and, more generally speaking, the methods, instruments and institutions, of redistribution used in the regional policy of recent times, need to be profoundly renewed because they are inexpedient from the economic point of view. This is because, owing to the biased concept of the updating of administration, the management policy of autonomies have been partly paralysed and partly encouraged to waste. This orientation does not accept the separation of the impersonally functioning business, political and administrative systems as a solution nor does it accept that the latter should be updated by their own specialists. It is assumed that the solution is much more likely to be found in a new and capable micromechanism, and forms of enterprising and advantageous integration between the local autonomy and communal management. This orientation does not study the way in which the current solid system of hierarchic dependencies could be gradually eased from above in an endeavour to strengthen the local management. Yet it tries to find out a way of regional and nation-wide construction setting out from a profoundly different settlement policy as well as asking what integrating co-institutions this would imply. The train of thought of this concept is economic-anthropologically, sociologically and economically motivated. The usual political, sector-rationalizing, administrative and regionalist considerations get less room here. This concept also differs from the self-financing orientation in that it builds on local initiatives and thus it does not deem the uniform national adoption of such forms necessary—while, where such forms are intended to be applied, the institutional relations between councils, the population and enterprises need to be powerfully changed. Also the social forces expected to spread the ideas mentioned above are different : while in the self-financing orientation the basis is rather the enlightment of higher authorities and the commitment of officials to the reform, the communal management concept counts rather on local leaders who are responsive to changes, on the revival of local ambitions of enterprise and on the inclination of communities to organize themselves.

It would be unwise to pass a quick judgement on these ideas and then to discard either the first or the second one.* Now the differences have been stressed; it can be seen that they are closely akin and in alliance. In the following section of the article the theoretical postulations of the communal management orientation will be reviewed.

The communal management orientation

The unforeseen recent developments that have suddenly and simultaneously cast doubt on both the settlement development concept and its critique, indicate that the earlier anthropological and economical views were one-sided. Our anthropological idea assumed that the human being as a producer is able and willing to make his living inside the big organizations of the socialist sector in jobs under the industrial system of control. On the other hand, as a consumer, he consumes either individually or through the channels of state care. We thought the dynamism of this economic system was guaranteed by the updating of the traditional enterprise pattern of the socialist sector alone and the secondary economy was merely a contingency for the purpose of supplementing incomes. Today, on the other hand, we must face the fact that the enterprise system is conservative and that it is unable to take the suctions* of the economy even if the forms of control are changed. What we need is new institutions that introduce order into the economic space. Our anthropological ideas, again, must be completed with the idea of man producing individually and in *ad hoc* groups, and of the associated consumer.

The problems of settlement and communal management policy can be freed from the ambivalencies of treating the management system in accordance with the incompatible values of redistribution only if the system of communal management can be adjusted to the fact that the community is specific in each settlement and thus it must solve its own problems in specific ways.

In devising a new institutional system we must bear in mind the values deemed to be important from the point of view of updating the Hungarian national economy

* The opinions of the authors of this paper are also at variance in this respect. While the village management orientation has been drafted by Pál Juhász, Gábor Gulácsy has studied the chances of application and the characteristics of functioning of a moderate system of self-financing. As it can be seen, disagreement does not mean that cooperation is ruled out.

* In the sense explained in J. *Kornai*'s "Economics of shortage" [3].—Ed. note.

along with its entire conservative enterprise pattern. Such are *the degrees of economic integration of the society*. A solution must be found for putting an end to the division of the national economy deriving from the fact that there is hardly any cooperation between the council system of budget, the non-council budget system and business pursued in the enterprise sphere and in the private sphere. The criterion of civilization postulated by Ferenc *Erdei*, namely, that it is accompanied by "an easily changing uncertainty of social status", can only assert itself in a multilaterally-integrated society.

When the possible and expedient new institutional system of the economy is sought the following general aspirations should be borne in mind: to provide far more room for enterprises other than the company type; to promote the qualitative openness of the market; to enable proprietors belonging to different social groups or sectors to cooperate; and to free the authorities that administer public property from the restrictions deriving from the handling of "physical" wealth.

Two social types of enterprises can be distinguished:

Capitalist and nationalized enterprises *after the model of the manufacturing industrial organization* (in Hungary also most agricultural and trading companies are of this kind) which seek or create for the capital (and in the better case also for the market) a work culture capable of carrying out the necessary activity. An enterprise setting out from the company only utilizes that work culture and, consequently, it only perceives that opportunity for an enterprise which can be fitted into its power system. Therefore, its role is limited in the economic space.

The other type is the individual and the community enterprise which seeks markets and gets capital for the work culture offered by, or which can be developed in, the participants.

It is a concomitant with the first one that it dissolves the given communities' qualities as an unconscious outsider, forms the infrastructure according to its own enterprise interests and the values of its own power system, and thus it does not acknowledge the needs of social groups not represented in this system. Also, it only satisfies those demands of its workers that crop up in connection with work at the enterprise. In the second type the strain of differences in prestige and influence within the community are influential. The reproduction processes are stiffened by the manufacturing industrial organization (the enterprise separating the partial societies of managers and of those managed) and the capital and time requirements of the circles of reproduction are increased. From the point of view of economic growth this type is only successful when it is able to balance all that clumsiness and expensiveness by growing productivity. As under the circumstances of market economy the enterprises organized according to the model of manufacturing industry were able to come into being and survive only when they could guarantee the necessary rate of growth of productivity—the *appearance* which emerged suggested that enterprise concentration was the only way towards growing productivity. Of course, under normal circumstances there is no way to achieve such a fast growth of productivity in the system of economic aetivities as a whole. What is more, the new trends of technical progress often produce significant productivity increases outside the large-scale manufacturing industrial forms.

The set of enterprises without administrative organization changes its relations and system of division work, sometimes even its work culture, much more promptly and so it is much more successful in reorganizing the circles of reproduction and in diminishing the time requirements of reproduction. Such institutions of village and communal management worthy of being sought are the ones suitable for the promotion of forms of enterprise other than the model of the early 20th century, that is, the new forms should be capable of satisfying the needs of production and consumption.

For the assertion of the regulatory function of the market it is not enough to let value forms represent the relations between the actors. When any given scene and circle of actors of the market are set or confined by statutory and power instruments then this regulation adjusts to the actual cost conditions. It requires an open market to allow market competition to lead to cooperative relations and thus also to a transformation of input proportions (relative inputs). It is thus not enough to make the given companies autonomous and profit-motivated. The restrictions of lines of production must be lifted—especially in the over-regulated turnover sphere—and, first of all, the mechanisms of the *"birth" of enterprises* must be developed. Without this the liquidation of failing companies, financial rehabilitation and the regional policy cannot be real. So we are after business organizations suitable for becoming part of a financial system which serves the mechanisms of enterprise "birth".

From the point of view of regional policy this function attains importance because the network of the enterprise system is unable to profit—in deconcentrated plants, and by the integration of private and family enterprises, as well the exploitation of the general manifold strivings of people—from the new work culture which has developed because of the considerable fluctuation between regions and jobs and the second economy.

For rendering the market an active actor in the spreading of social integration it is not enough to emancipate enterprises of a different social nature (i.e. belonging to different social sectors), nor is it enough to bring about institutions "producing" enterprises or entrepreneurship—it is also necessary to have a system of financial institutions consisting of a rich network of institutions of a different social nature. In addition to the banks working with a given group of enterprises and the small banks (branches) set up for their special purposes, it is also necessary to have savings banks, credit cooperatives, communal banks, insurance institutes, and non-profiting financial funds using their money in quasi-market ways. This is the only way to prevent assets from being "trapped" in some given partial circle of the reproduction process and freezing in an immobilized segment of the national economy, and yet making assets available for other types of enterprise.

A communal bank or a credit cooperative can pump the money it gets from elsewhere into the development of the local communal system, and into enterprises serving this development or coming into being on their grouods. When, instead, the means are collected and allocated by the budget, the propensity to save (to build up reserves) will dangerously abate in both the enterprise and the consumption sphere and the proportions of allocation between the partial areas of reproduction become rigid. This is apparent in the present-day Hungarian practice.

This is obvious, of course. However, we must not fail to notice that the tardy updating of the Hungarian system of financial institutions (and consequenty of the enterprise system and of the methods of enterprise) is due, among others, to the slow rate of the emancipation of property handling organizations representing different forms of public ownership. The budget and the control of money circulation is still "captured" by that part of the national wealth which is in central ownership (meaning the property of ministries). The discharging of the state's control (and supervisory) functions is hindered by this proprietary limitation.

Although we have moved very far from the ideals of a councils' republic, we should not totally abandon these ideals and the opportunities implied by council ownership. We should become aware that the third basic form of socialized property is represented precisely by council ownership, in addition to ministerial and cooperative ownership (the latter being able to become far more diversified than now). We are of the opinion that the reform processes of the economy could unfold if—beyond the separation of the system of state enterprises and the system of state control, and of the enrichment of forms of cooperatives and self-administration—the councils also became property-managing organizations capable of enterprise, expansion and reduction, and capable of entering into any one segment of the accessible economic space.

Considerable obstacles to the active business management role of the councils are: first, that they have been deprived of the productive parts of earlier communal and urban property; second, that they are in charge of managing that kind of property (schools, nursery schools, outpatient clinics, cultural centres, etc.) which acts as a double "imprisonment". This latter point is because it is not only property but also a type of property which, lacking "earmarked" taxes, is not suitable for producing income. Therefore, the councils are reduced to dealing with the problems of the community of a few persons belonging to its own institutions—instead of increasing and utilizing the economic potentials of the settlement and attending to the consumption, business, social and employment requirements and needs of the community. Like the state, the local council can be a servant of the community's interest if *business management takes the shape of a financial institution*. It treats its wealth and institutions as a bank would handle the wealth being wholly or partly to its property, yet the local council is an organization which is an autonomous legal entity and which therefore maintains relations independently of the bank. In a commodity-producing society the sole adequate expression of public wealth is the general equivalent, i.e. money.

The institutions of communal management

Similar chances of a solution are also derived when the tasks of, and the limitations to, the present functioning of council management are studied. As a matter of fact, the present system of council management is disabled by its methods, scope of authority and financial rules to the extent that it cannot treat the socio-political, communal and economic development tasks with a view to their mutual connections. The disintegration of the spheres of management is particularly striking on the very level where their combined handling would be the most desirable and is also feasible: in the villages (settlements, city quarters). At the same time, this disintegration also hinders the cooperation of communities living in a coherent space. Rivalry between settlements for the alms of central redistribution thus becomes a dominant feature.

The creditworthiness of the village (council, magistracy, some institutions of theirs, public-purpose associations and their federations) is a conditional upon their ability to tackle suddenly emerging tasks (communal or social establishments, creation of jobs, generation of enterprises to serve local requirements, etc.) by managing their resources economically.* Again, it is a condition of creditworthiness that the revenues of the community (village) be statutorily guaranteed, that it should be granted the right to levy (local) taxes, to issue securities (bonds), to be able to cooperate as a partner with associations capable of mobilizing private accumulation and to be able to create and increase an interest-yielding public wealth.

Communal (council) management is at present an ambiguous term. Firstly, it means the tasks of parsimony: to find cheapest ways of meeting the acknowledged needs. On the other hand, it means expansive tasks: how to develop the latent needs of the community for the benefit of the members of the community. Therefore, a council's business efficiency cannot be measured by the council itself. The tension between the need to encourage the officials to discharge their tasks as cheaply as possible while giving the richest possible service to the needs of the community *cannot be resolved within one single organization*. Therefore the institutional system of village management needs to be multiplied.

According to our idea, the core of management should be a financial institution which lends and raises credits, collects taxes, and handles the funds serving subventions and foundations. The institutions under its supervision would partly be organizations of a budgetary nature—like schools, water works, etc.—and partly enterprises paying concessionary rents on public property, and having credit or tax allowances, and/or which are also in charge of communal tasks. The enterprises could be autonomous legal entities (eventually one person) or employees of entities external

* To be able to build multipurpose buildings by local *ad hoc* work teams, to create alternate jobs in the light of the given personalities, to satisfy socio-political and cultural requirements in forms matching the economic opportunities in the given social space, to loosen the dependence on enterprises of the given space, to be capable of tackling the risks of unemployment or under-employment, and so forth.

to the settlement. Any contract with them would be open, negotiable and competitive vs. other offers.

The budgetary-type organizations would exist in a double dependency. Beside the council of magistracy directly in charge of supervision, supervision would also be exercised by social associations which—even occupational organizations—are interested in the functioning of the institution and which cooperate with national professional unions. In some cases even the running of the organization may be entrusted to such social associations (cultural, schooling, health and social policy organizations).

The local banking *core* should be in charge of assuring the mutually supportive use of funds originating from various sources and serving various purposes, so that the use of the money should not be determined by the social form and expansionist ambitions of the organization supervised by the council (e.g. a budgetary establishment or a building company of the county). There should also be an opportunity for joint ventures with other councils and other banking institutions.

The undertakings that carry out the physical tasks of village management are separate legal entities or suitable persons, so that they are accountable and so that the rationality of their functioning should not be restricted by their public utility character. The cultural and economic associations should serve not only the division of power but should also be instruments of national cultural and market integration.

Redistribution between settlements requires several channels (actually, it already has several channels). This is partly because historical and geographical inequalities indeed require compensation and partly because it does not stand to reason to *always* use the resources in the framework of the same community where they have been generated or where they were transmitted through state redistribution. According to the concept, however, redistribution would be carried out mainly by a system of institutions built up from below. The community associations, regional federations of associations and their enterprises may not be organized according to the rigid administrative-regional boundaries but should cover areas varying by functions, locations and historical stages so as to be permanently suited for a connection with the actual task. According to this concept the service and supply functions of the county administration, with its rigid regional arrangement, would be strongly reduced and their activities would be concentrated on the supervision of legality and on the administrative functions in the strict sense.

Thus there is a need for joint enterprise managing the affairs of the financial institutions of communities in different localities, for a system of agencies acting by appointment of various local institutions, for regional credit institutions to be owned and supervised by the communities (but which should also handle funds), and for state subsidies which necessitate banking institutions and agencies in charge of functional funds attached to federations of associations. Moreover, as already indicated, the social-communal fiscal system need not be separated from the financial systems of other various undertakings of social nature. Beside the legal opportunity for credit turnover in both directions, the guaranteeing of interest, compulsory subvention quotas and, on the other side, the right of the basically non-profit communal banks to indulge in business activity, are also necessary.

A financial and regional business policy system based on the autonomy of regional communities can give a great deal of incentive to the members of the different communities to make more and more effort to participate as much as possible in the national market—yet this does imply the risk of particularization. Beside economic integration it may preserve cultural segmentation. Beside the redistributing organizations of big regions or of the state, the task of the federations of associations or chambers is the mediation of values, the social supervision of the member associations, and the formulation of professional and statutory norms and values on the national level. The necessary system of political control should be one that on the one hand mobilizes legislation and on the other hand mobilizes the local communities for combating the particular order of values of institutions.

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РАЗВИТИЕ НАСЕЛЕННЫХ ПУНКТОВ, ДЕЦЕНТРАЛИЗАЦИЯ И ХОЗЯЙСТВЕННАЯ ДЕЯТЕЛЬНОСТЬ СЕЛЬСКИХ СОВЕТОВ

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За прошедшие сорок лет в ходе развития инфраструктуры проектировщики отдавали преимущества городам. Сложившиеся таким образом непропорциональности сегодня уже мешают дальнейшему развитию инфраструктуры. Авторы хотят не просто перераспределения налоговых поступлений в пользу сел, но и значительного преобразования системы институтов, ответственных за расходование увеличившихся доходов. Суть их предложений в том, чтобы население имело возможность как можно более широкого контроля за использованием уплаченных им налогов и чтобы организацие, работающие под знаком доходности, осуществляли бы как можно больше инфраструктурных капиталовложений.

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FREEDOM OF DECISION-MAKING AND SECURITY OF DEVELOPMENT

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Considering the further development of the Hungarian local and higher-level councils' reform coming into force in 1986 the author argues with those who emphasize self-financing. It can be established that not only has the productive function of tiny villages ceased (these having been struck by the prevailing settlement development practices), but they do not even provide the comfort expected from a dwelling place. In the author's opinion progress would require not only an efficiently operating regulation system, but also a democratically built up national organization of local governments.

In the last 10–15 years many *criticisms* have been levelled at the control and regulation system of the network of Hungarian settlements and its social mechanisms, from the viewpoints of economics, administration science, politics, sociology and economic geography. One part of the proposals advanced by the critics have been embodied in some important government decisions that may even be called reforms. The division of the country into administrative areas has changed, a new electoral law has entered into force, new administrative institutions have come into being (magistracies, coordination committees for the suburban regions), and the National Settlement-network Development Conception of 1971 has been replaced by a new one approved by Parliament. Finally, in 1986 the new regulation system of council management came into force.

There is no more money available...

It should be quite obvious that in 1986 only an experimental stage has started in this field. Partly owing to the difficulties of the general economic situation, partly to the traditionally weak economic policy positions of this sector, more money than was up to now available cannot be expected. The usual scarcity, although unacceptable, will thus continue and the shortages, having cumulated for a long time, will determine where the scarce resources have to be used. All that does not amount, of course, to saying that all the resources available under the seventh five-year plan (for 1986–1990) are committed moneys because there still remains room for central, county and local decisions. The degree of freedom of decision of the local councils will grow, but it is still a far cry from the locally decided use of freely disposable resources making up the greater part of council investments. The central allocation of resources will become somewhat more normative, and this forces a similar behaviour onto the county-level allocation, too, but there still remains ample room for *individual, ad hoc* central and county-level development decisions as well.

The question of what part of the national economic development resources may be spent on the infrastructural branches deserves particular attention. For fifteen or twenty years analyses have frequently been published which call attention to the general backwardness of Hungary in infrastructural respects. Beyond international comparisons of Hungary's infrastructural relations, several analyses also discuss the disproportions and anomalies of the regional and settlement network. Yet, despite the widening knowledge of facts, the results of scientific investigations have never led to *changes in economic policy* under the impact of the arguments. As a matter of fact, it is becoming more and more obvious that the tasks put off through many years could, at least partially, be fulfilled but it would require a powerful change in policy. Clearly, the weight of the arguments alone is not sufficient: even the soundest analyses turn, involuntarily, into a scare of a prophecy.

In the last resort it is not the weight of arguments but the *political weight of the representation* of the development interests affected that can make the demands of the infrastructural branches, among them those affecting the population, acknowledged and emancipated. It might be some democratically organized common organization of the most affected organizational units, to wit, the local councils, which could form a *national association of local authorities* that could personify and institutionalize—even organizationally—the general interests of the development of settlements. Its role in government and its competence is as important as, and perhaps could be even better delimited than, that of the national associations of trade unions or of agricultural cooperatives. It should be maintained by the councils themselves, and there would remain no doubt—in spite of the highly differentiated, frequently contradicting and divided interests of its members—whom and what the organization would represent.

The critique of the system of material-financial resources and of the financial regulation of councils has not been quite ineffective even up to now. The rules of the operational budget have changed little, yet there have been rather radical changes in the regulation of development resources. We can state as much that the new system is *different* from the earlier one. Since even those having devised the system do not think that this is the final solution, or even that it is a stable regulation for the long run, it will not spoil the experiment if we start thinking about further steps. It has, of course, to be taken into account that such radical change as has been made also comprises such elements which it is recommendable to preserve if we do not want to discredit the intention of change itself.

Problems waiting for solution

As a matter of fact, it has only become clear in the last two or three years that the criticisms of the earlier system of regulation—and those relating to several elements of the settlement development policy—were *not* formulated *on the same platform,* nor with the same intentions, and they were based on highly different sensitivities and principles. Suffice it to refer here to the interventions of some writers and publicists, which linked and still link the problems of the whole settlement network development to the *demographic* situation of the country.

It is finally not at all immaterial to what real problem(s) the continuation of a reform seeks, if not a solution, at least an answer. In the last resort, the questions of economic regulation are dilemmas relating to *techniques,* and, as such, they are mediated and secondary. Which are then the tensions, of almost physical content, which should be most relieved; and what is that prevents those most interested in making things happen? It is my experience that it is precisely in these questions that the standpoints of those expressing their opinion about the matters of settlement development do not agree and they have not even approximated each other. It is thus understandable that the answers concerning the determination or even indication of the direction of further steps also differ.

From the great number of existing problems I would stress the following:

— Industrialization and, in general, the modernization processes of the last sixty years have brought about a strong polarization in the Hungarian system of settlements. While a spatial levelling can be found in several individual economic and social characteristics—from energy supply to employment—the smaller units of the fragmented system of villages, the *dwarf villages,* have gradually lost their productive functions together with a considerable part of their population, and are *becoming relatively impoverished in the social sense.*

— At the other extreme, in the towns condensing the new functions, the evolution of some kind of positive counterpart of the social deterioration just mentioned cannot yet be experienced. It is difficult to find the *absolute winners* of this polarization process. While it may be said that, historically, a good part of the Hungarian villages were adequate forms of settlement of the agrarian production carried on in the provinces, and were so long as they performed this function—for the time being there exists no adequate form of settlement for the large manufacturing industry and the just emerging post-industrial structure of production. And, insofar as they do exist (that is, if the various experiments should be considered as adequate in their given quality), these forms are unbalanced, cumbersome, uncomfortable and inorganic.

However much the settlement development investments of the seventies concentrated on this problem, they have not solved (among other things) the problem of urban *housing shortage*—not to mention the housing shortage in large villages and other settlements attracting immigrants. Yet the problems are cumulating: the extensive urban development has not proved to be extensive enough in respect of the *other urban services* either (schools, outpatient clinics, network of shops, sewage, urban transportation, and so forth).

— Finally, I would mention a further problem: against every earlier official target, in the concrete local questions of settlement development *the decisive word is even today not that of the people most affected, or of those directly representing them.* The freedom of decision of the local councils has remained small. They are mostly compelled to adjust to the ranking of problems by the higher levels of control. Not infrequently, the small local initiatives fail because of petty cavilling—even if they enjoy the support of the majority of the local community, do not demand money from anyone else and perhaps do not even deserve the name of settlement development action. They are merely manifestations of the desire of the population to make their own domicile somewhat more homelike.

Doubts and reservations

The "selection" of the above three problems also means, of course, that I think these are the determinant ones.

I would not choose the standpoint earlier mentioned which finds that the most serious consequence of the spatial concentration of population having taken place in past decades is the *demographic* problem. The shifts in the demographic composition of the population cause ever graver social concern, yet I believe that their *cause* is not the loss of population of the villages and the agglomeration in towns, and thus the remedies should be sought, independently of the spatial aspects, in a general social policy context. Also, the programme of keeping the population in the villages does possess—at least for me—a kind of "demographic" overtone: why should it be *better* if more people lived here than there? I would not even consider it a primary value if the loss of population of dwarf villages slowed down. It seems more important to me *how* people live there than *how many*. (I must confess: I think this holds for the whole country—and I also think that the demographic problem should be discussed in this context.)

Likewise, I would not choose the approach which explains the *social inequalities,* deriving from spatial status, with the unhealthy differentiation in the *economic development level* of the settlements. Although, it is not as if this explanation were not true as a descriptive statement. In fact, in settlements with richer production functions where, in addition, there are successful enterprises, the infrastructure serving the population is in all likelihood of higher standards and better built out. The programme following from this, for the lower end of differentiation, for the dwarf villages, would be that in the lagging settlement units the lost economic (meaning: productive) functions have to be restored. If this happened there would be a livelihood for those who today prefer to move away from these places and there would be productive entities contributing to the national income which could then finance—together with the population having safe incomes—the local settlement development as well.

In my opinion, the main trouble is not that the small Hungarian villages have lost or are losing their earlier functions, but that they are also deteriorating as dwelling places. Instead of worrying about the atrophy of productive functions of today, it would be much more worthwhile to concentrate *on the quality of the domicile functions*. This cannot be measured by some general local "economic development level", but by the state of the local communal *infrastructure*. Economic underdevelopment and retardation are economic historical consequences of a long period, which (mostly) can be said to be objective consequences. Namely, as the extent of the weight of agriculture diminished, so to the same extent the original destination for the agricultural production of the small villages and, in general, of the system of villages, began to dwindle. It is true though, that in many places villages were deprived, by force, of their productive functions, and this tendency is exaggerated even today—but the *historically progressive nature* of the whole tendency can hardly be denied. The country has *developed* and it is no longer an agrarian country, one of peasants. (The reminiscences and traditions of the peasant country are, of course, still alive.) I think that from this state of affairs there is no progressive way back to the reunion of the functions of dwelling place and productive functions in villages. Reunion would mean either the creation of such jobs which would seek advantageous areas for some non-agricultural activities with good market prospects—and then we would chase after an illusion (why should the present villages be the most attractive for these progressive ventures?); or it would mean the relocation of agricultural activities, and these can hardly spread to an area as big as that affected by the problem: the separation of the dwelling and working places of the village population.*

I am afraid that the marks of the peasant past are still too strong in Hungarian society for it to be able to seek a solution to any of its problems in an unbiased way, yet pointing back to these diversified traditions. In fact, the chance for an unbiased *choice* has not yet come—the way is rather indicated and channelled by necessities and barriers, and not by some anthropological ideal enjoying a consensus.

Reviving the productive functions of the system of villages is a contradictory programme because it is linked by a particular ideological relationship to the doctrinaire economic policy principles of the fifties. If we consider the reviving of

* It was almost forty years ago that Ferenc *Erdei* wrote the following words about the then romantic programme of "return to ruralism": "The idea of a return to ruralism... from whatever motive and for whatever goal it arises, falls quite outside the plane of social realities, and is invalid even as a political idea, because it has no direct relationship with the true position and development path of the peasantry. Still, it *might become* a plitical movement, but this will not be the political movement of the *peasantry*. With this idea a political movement can be brought about... among those town-dwellers who have grown disgusted with the forms of towns and of the bourgeoisie, and would like to live a purer life under peasant conditions." Erdei argues that at the time of his having written the work "A magyar paraszttársadalom" (The Hungarian peasant society) in 1941–1942 the task facing the peasantry was quite different, to wit, to emerge from the peasant existence. Finally, he observes (concedingly) that, in general, the idea of "return to ruralism" still makes sense, since the way out from the crisis of the bourgeois world "can only start ... in a situation full of life, near to nature and among consummate people, and this can be best provided by the framework of agricultural life."

productive roles to be the primary task, the question of the domicile functions, of the infrastructure of villages, can only be secondary. If the lag in production is the *cause* (the diagnosis is not even inexact), by changing it, *with time* the consequence, the infrastructural lag, can also be remedied. But if we set the *order* of things to be done in this manner, we arrive precisely at the doctrinaire economic policy principle which so stubbornly preferred the productive investments, delaying everything else.

I know well that it was the best of intentions, and mostly the enthusiasm caused by some experience, which started the programme of reviving the productive tasks of villages. These were experiences of individuals or smaller groups who, initiating economic ventures, frequently settled in villages in very disadvantageous situation, with the promise of at least stopping the decrease of the population. In my view, such instances should be generalized with great caution.

On the other hand, every such initiative should be supported and stimulated, and the spreading of their examples would be useful. There is no general recipe, but it is possible that individual experiences can be adapted. The support might be administrative, legal, through credit policy and of many other kinds.

Finally, I would not choose the demand, which finds the desirable direction of further steps in the so-called local *self-financing*. This idea would link the system of sources of settlement development to the *income creating ability* of the settlements, and thus, naturally, it would consider the development of settlements to be just in proportion to their ability to create income. As a correction it would also apply the instrument of *central redistribution,* as and where the local economic potential were insufficient for maintaining a minimal development of the communal infrastructure. (This demand directly originates in the observation that up to now the redistribution by counties and by the centre has always redistributed resources—through many kinds of channels—among the major regional units of the country and among its types of settlements in such a way that the exact directions of the flow of resources could not be discerned and, at the same time, areas and settlements in a disadvantageous position from the outset were rather consistently afflicted. The development possibilities proportionate to income-creating ability, however, would be ordered in a clear, transparent system, and would expectedly be free from the earlier injustices.) The idea of self-financing also promises that such a system would better stimulate the local, individual and enterprise initiatives, explore new resources and, in the last resort, it would increase the financial means available for the development of settlements.

This idea is burdened, in my opinion, by a great many contradictions. The first is that the choice of values is based on the principle of *performance and reward.* I think this principle should not be followed in matters of settlement development because the *social inequalities* expressed by the living circumstances of the domicile are disfunctional, and, as far as possible, should rather be diminished and neutralized. As against several other dimensions of social inequalities, these inequalities do not possess a dynamizing, stimulating social function. Against the principle of performance and reward, I hold the idea more valuable that the living circumstances of the domicile should be considered an element of the minimum quality of life, of the *socially acceptable existence,* and settlement development as well as its system of instruments should make efforts to guarantee the right to this for everyone.

On the other hand, I think that local income producing ability *cannot be interpreted* in Hungary today on the level of individual settlements. It cannot, since the traditional *spatial unity* of the factors of income generation (i.e. of land and the means of production created by man and labour) has become disrupted. This becomes manifest above all in the spatial separation of workplaces and domiciles. Every fourth or fifth worker is a daily commuter. In 1980, of the three thousand villages of the country, from 1800 *at least half* of the economically active population were working at other places; in almost 1000 villages this proportion was more than two-thirds. To this tendency belongs a feature of the seventies, for, in spite of the industrial locations in villages, the number of *workplaces* diminished in the Hungarian villages by about 150 000, while in the same decade the number of those *employed* in villages only fell by 60 000 (the reason was primarily the phasing out of agricultural workplaces).

Thus, this "lopsided" local economy makes the notion of *income producing ability* (as a potential) and that of *locally produced value* (as a result) uninterpretable in the majority of our villages. The notion of *local economic development level* can be viewed similarly.

Since in almost 1 600 dwarf villages there exists relatively less of *every kind* of factor of production (as, because of migration, even the ratio of the economically active population is smaller than elsewhere), it is almost certain that the self-financing system would have to be complemented by *redistribution* intended for correction. That is, a system would be brought about in which the number of exceptions, of the unities requiring complements, would be greater than that of the really self-financing entities.*

Finally, I also have doubts about the stimulating and new resource-mobilizing nature of self-financing. First of all, this stimulating effect cannot be proven: enterprises can hardly be stimulated by taxes to undertake—perhaps even voluntarily—greater sacrifices in the interest of settlement development. As regards the latent resources of the population we may perhaps ask: where have they been *up to now?* If *nowhere,* if they were merely hiding, it may be feared that this idea of hoping for intensive development builds, in fact, on extensive resources. To wit, on *the curbing of consumption or on surplus labour performance*—and it is now immaterial whether this would be voluntary or not. The non-self-sparing and *puritan work morale* is perhaps the most contradictory and, at the same time, deeply rooted element of the Hungarian peasant traditions; no doubt, it has been a significant source of modernization even up to now. (By the way: it is also part of the contradictory nature of this modernization.) I do not believe, however, that we can rely on this resource for a long time, and besides, it

* To the statement that the general economic development level of some settlement cannot be interpreted today, I would add that developed or rich, underdeveloped or poor villages continue, of course, to exist. But the difference can today be interpreted and measured in the most everyday sense, by the material well-being of its inhabitants and by the quality of the settlement as a dwelling place.

would not be ethical. Although I cannot prove the interrelation, the forced operation of this tradition may have something to do with the deterioration not only of the birth rates but also of the mortality rates in Hungary. Since, however, the human imagination withstands wear and tear better than the power of muscles, I have to stress again: the prohibition and restriction of individual and local initiatives—once they have been born—is generally *harmful,* even if it is unnecessary that they should bear, in a programmed way, *every* local development task.

The idea of self-financing is primarily motivated by well-founded and undeniably well intended critical observations. It can be easily seen that, although the principle of performance and its whole value content is necessarily heaped upon it, the *primary* choice of value in the formulation of the idea of self-financing is still an idea *that comprises decentralization and democracy.* It is precisely by searching for the guarantees of the *autonomy* of local development policies that we can easily reach the conclusion that the best guarantee is if every single settlement manages what it has produced itself. I would repeat that I do not agree with the continuation of this line of reasoning, but I absolutely agree with its motives.

Dictated or chosen objectives?

Instead of debated standpoints involving choices of problems and values, I would now suggest the need to reason in the context of the new economic control system of the councils—in general, in that of council management. Certainly, no universal remedy for the massive impoverishment of the small villages can be suggested. The aim is to prevent their further deterioration, to improve the living circumstances of those living there compared with that of others, and to reduce these shameful social inequalities. The least that would be necessary for this is that they can safely maintain the existing communal establishments.

In the new system of economic regulation and planning of the councils (at least according to the original intentions) there was a notion called: "safe management possibility". This, in addition to the costs of operation and renewals, also comprised acknowledgement of a minimum claim to development—and the demand for money thus defined was centrally acknowledged and guaranteed. The guarantee relates, above all, to the *operation* of council institutions and it means that the necessary and perhaps missing sources of money are complemented by the central state budget. Yet the problem of the scarcity of central resources already emerges here: the *necessary* expenditure was established, using the traditional central planning methods, by adding something to the actual expenses of the preceding period, but very parsimoniously. This procedure, on the one hand, conserves the traditional differences in the outlays of institutions of identical type and thus the differences in the level of services as well. On the other hand, it does not acknowledge, nor compensate for actual inflation. Thus, the "safe possibility" does not at all guarantee safety. The guidelines also speak, beside the central guarantee, about *local responsibility:* the local councils are responsible in the first place for the operation of their institutions. If they do not possess enough money for that, they have to look for other sources. It thus happens that they are compelled to use the so-called minimal *investment/capital resources* as well—determined proportionally to the population—for mere maintenance (let us not forget that this, too, is an element of the acknowledged and guaranteed financial possibilities—only that originally it could have been used *at discretion,* for any development). Therefore, by uniting the (up to now) separate two money funds, the tasks of operation and investments have fallen into an unlucky conflict. Of course, this would have happened anyway, but since the planning of operational outlays has remained poor, even unrealistic, it produces a particularly difficult situation. Management involving the weighing up of alternative solutions, cannot become everyday practice *because of the scarce resources.* Thus, the object of central guarantees is "sliding" to the area of local sovereignty, together with the accompanying responsibilities.

I think that this can be changed partly by a new system of planning operational costs and partly by making available several sources which regularly compensate for inflation. Without going into details: *instead of planning (the costs) individually,* that is, the types of cost of the institutions, such normative planning would be needed which sets out from a *uniform framework* projected to the number of those claiming the services (the population). Obviously, in the cover for this framework the ratio of support would be greater for the councils of small villages—this is why they are interested in that the framework should finally provide a true guarantee for their normal operation, and even for a part of their developments.

For the small villages, on the other hand, the minimal developments should also be carried out in a more advantageous manner. The allocation of the so-called "development possibility proportional to the population" (the guaranteed minimum mentioned) and its differentiation are now in the hands of the county. According to experience, this happens so that the county council (or its apparatus) distinguishes a few settlement categories and each category is then given a different per capita allocation. (The national average is allocated to every county.) The final result is, in fact, shifted in favour of the small settlements even today—at least within this range of allocation. But it would be more reassuring if this procedure were replaced by a more normative technique. At the moment, both the determination of the settlement categories and of the sums allocated to them comprise the subject of individual weighing by the apparatus. Normative techniques could be elaborated quite easily and, because they are transparent, they could be submitted to a vote by the corporate bodies.

I have to mention that the newly established *magistracies* which are mainly active in small villages, do not possess any *safe* own sources of money under the prevailing financial regulatory system. The settlement development contribution to be paid by the population and means taken over from (i.e. voluntarily ceded by) enterprises may be availed of by the magistracies—both are least guaranteed. Either there is an enterprise to give money or there is none. In fact the latter case dominates and the contribution to settlement development cannot be levied always and everywhere particularly for the purposes of an associated village.* The political weight of the new institutions would be greatly enhanced if it could also decide on the use of some—however small—*guaranteed* source of money. It would be obvious, if the magistracies could share in the *development resources proportionately to the population*. Also, a part of the per capita quota valid for the whole common council would, of course, mean the allocation of something, among the individual associated villages in proportion to the number of local inhabitants.**

Setting out from the problems of small villages, but reaching much farther, I have frequently used the term "guarantee". If we think of what has been said about the so-called "self-financing concept", it is almost certain that, analysing the new system of council management from this standpoint, the central category would not be the "guarantee", but the *local source of money*—mainly the ratio of payments by firms. In this new system, these local sources become entirely dissolved in the cover of operational costs, and are not even sufficient for that cover. Thus, this system is very far from self-financing. I would venture to ask here if it would not be worthwhile to clearly separate the areas of "guarantees" and "local resources" from each other and, precisely with the aid of this separation, to amalgamate the notion of "welfare state" with that of "self-financing". (The system will be, whether we like it or not, *mixed*.) This would mean that the operational expenses and a certain minimum of development would be centrally guaranteed, while at least part of the local taxes and a significant proportion of enterprise taxes, would slip into the zone of free disposal, today called *"interestedness source"*—thus at least the responsibilities would not so easily slip there and then back again.

However, in all likelihood the most expensive and most complicated programme necessary for the social emancipation of small villages falls beyond the competence of council management. This is the program of *transportation development*. The problem of the great number of commuters—even if, according to the latest microcensus, their number seems to have decreased slightly—is not so much that they *have to* travel, but *how*. Hungary is a densely populated country, and the distances are not too great; the trouble is rather the necessary time, comfort and price of travelling. On the other hand, we find even among the elementary infrastructural services those which need not be present in every settlement—or at least it is not realistic to expect such—yet they must be within reach. If such elementary service is not within reach or can only be reached circumstantially and expensively, then it *is missing*. The building of a transportation system of higher standards that would also be relatively cheaper demands at least as

* Magistracies are established in dwarf villages, which are too small to elect an independent council, and they are subordinated to the elected common council of a bigger village. That is why they are "associated".—Ed. note.

** This would seemingly fragment the already scarce per capita quotas. In national dimensions, however, this "magistracy fund" would demand a minimal sum, the "fragmentation" of which would not endanger any other objective.

complex a concept and series of actions as does the whole council management itself. A variety of forms of operation and financing may only benefit such a programme,—but the concept *itself* must also comprise certain non-profit approaches in respect of preferences regarding the settlement network. Even if their financing responsibilities would be less, the hopeful association of local self-governing bodies would have great interest in such program.

Owing to the prevailing division of responsibilities among sectors, it seems as if the problem of *housing construction* also began to slip away from the scope of competence of council management. The *direction* of this movement can be clearly discerned but its *goal* cannot. The frequently and justly blamed "lump-sum state housing construction" is no longer a dominant task of the councils. Being able to choose from several goals to be supported, the *county councils*, in general, do not give much support to the so-called social housing construction. Beyond that, they subsidize the housing programmes of the *local* councils with very different conditions and to a varying extent. The private construction taking over the functions of state construction is now better supported than was earlier the case and, also, the spatial favours and discriminations of credit policy are slowly being relaxed. Unfortunately, this is not to such an extent that a massive breakthrough could be felt; the shifting of responsibility is not even coordinated. After so many well-known proposals I cannot advance a new one here. I would only note—and this, too, is only a repetition of what others have already said—that social housing construction does not necessarily mean the building of tenement dwellings with unrealistically expensive technology, but an activity which enables people to get a dwelling place with relatively small capital and in a relatively short time. A dozen of such forms are conceivable and about half of them are already functioning in diverse places. It should be reconsidered whether the programme of social housing construction should not be continued as a "lump-sum" financing program, but with new conditions. In my opinion it is necessary as a central programme with *uniform conditions,* since social housing construction is and will be needed, and no occasional or discriminatory factors should have a role in it.

In conclusion, I shall say a few words about the *freedom of decision* of local councils on development and, in general, on management. There are still many elements of economic regulation restricting it, and there also are many interests in its way. The criteria of the allocation of central subsidies among counties are not made public, and the county system of supporting certain goals is compelled to continue to carry certain so-called expectations reminiscent of the "lump-sum system". The county level differentiates the extent of development resources proportional to population, determines tasks and conditions for its earmarked subsidies, and awards and allocates them. This situation strongly channels the use of local freely disposable moneys. I may add that this system is likely to impose less restrictions than the former one. Further progress should be made on this road—from means of and decisions on development towards the complete settlement management by councils, and from earmarked subsidies to general ones. In general: there should be progress towards decentralizing decisions, and increasing the share of freely disposable financial means. In this process the direct origin of the sources is, in my opinion, secondary: decentralization depends on their use, their rational spending. *Little depends on local resources or redistribution, but much depends on whether goals are dictated or chosen by those affected.* There is a requirement for an economic regulation system that is controlled according to public and obligatory rules, which opens up chances for social minorities (which, hitherto, have been a bottleneck) in such a way that nobody else is restricted in the meantime. Democracy has to guarantee not only freedom, but also responsibility.

СВОБОДА ВЫБОРА И НАДЕЖНОСТЬ РАЗВИТИЯ

Г. ВАГИ

Автор не согласен с теми, кто предлагает увеличить долю расходование поступающих от налогов средств на местах. Самофинансирование увеличило бы отставание находящихся в неблагоприятном положении населенных пунктов, увеличило бы ограничения в потреблении населения или вынудило бы еще больше дополнительно работать. Отдельные цели, как например развитие транспортной сети, требует согласования на общегосударственном уровне. Для того, чтобы села получили бы больше инфраструктурных капиталовложений, необходимо согласованное представление интересов небольших населенных пунктов.

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COMPANY LIQUIDATION WITHOUT A LEGAL SUCCESSOR

É. VOSZKA

The article deals with the, until now, infrequent case of state enterprises being liquidated without a legal successor. By analysing the related decision-making mechanism, it is pointed out in the article that the mechanism is essentially of an administrative nature and resembles the mergers aimed at centralization in the 70s—now judged unfavourably owing to their harmful effects.

The most radical form of eliminating uneconomical production is the winding-up of whole enterprises, not merely dropping the manufacture of just one certain product or group of products. Up to the late 1970s, the Hungarian control organizations had usually applied a single method: organizational centralization.

The motive of the mergers and fusions was, however, not to transform the product pattern and thereby increase profitability often, not even on the level of declarations. When the declared objective was such, the functioning conditions of the economy and the mechanism of the reorganization decisions did not allow the expected result to materialize. It is difficult to measure exactly the consequences of organizational changes. Nevertheless, as much can surely be stated that, with a few exceptions, the mergers brought no considerable success in reducing uneconomical production and in improving profitability in the long run.*

Since 1977–1978, because of the increasingly difficult economic conditions, the economic management has considered the possibility of reductions more seriously than before.** New methods and rules of procedure have been established, among them the *winding-up of enterprises without creating a legal successor*. This is intended to be partially market-oriented and manageable in a uniform and normative manner.

Behind closed doors

To what extent does this new method of winding-up differ from the practice of previous years, i.e. from mergers? I shall examine this question through the actual winding-up of an economic unit: the Business Machine and Precision Engineering Enterprise (IGV). A single case, of course, has no conclusive force. However, seven

* These questions are discussed in detail in Mihály *Laki*'s book [1] and in Kálmán *Kőhegyi*'s study [2] as well as in several case studies.

** The most important characteristics of the measures are analysed in detail in [3].

years after the issue of the relevant order of the Minister of Finance on the winding-up of enterprises, the total number of cases that can be examined is still small. Of the state-owned enterprises only five have been wound up without a legal successor since 1979.* With Erzsébet *Szalai* and Galina *Lamberger,* we have recently drawn up a summary study [4] about the winding-up of enterprises and about two "new types" of mergers, i.e. those that follow a financial rehabilitation procedure. The present article largely relies on that joint work, and the greater part of the statements are also the result of our collective thinking.

From the aspect of the question under examination, the cases of the seven enterprises are not essentially different. The reason why I have chosen IGV is that it is an "average" enterprise by virtue of most its qualities; its special features and problems are by no means unique.

In describing the new form of the winding-up of enterprises, our guiding principle will be the analysis of the *decision-making mechanism.*

Not even in the mid-1980s does the necessity of profitable functioning arise for enterprises directly from market effects. It comes *through the transmission of the market substituting economic management,* if it arises at all. Accordingly, what is most characteristic of the decisions made on the disinvestment and winding-up of uneconomic units is also—as reflected even in the legal rules—that they are *administrative.* [5] The winding up of an enterprise is *the final result of a bargaining* process between the economic and the control organs, *carried on, in several phases, behind closed doors.* Let us follow this process in the case of IGV.**

Selectors and the selected

The initial step of the bargaining process is usually the determination of the sphere of enterprises held to be uneconomical and of a permanently low efficiency. As we know from the legal rules, the economic entities are not put on the list of the Ministry of Finance by some automatism, but as a result of rather complicated computations and collations. They do not simply become uneconomical, but a certain group of them are *"judged or marked out as uneconomical"* enterprises.

* The sphere of economic units actually wound up is, however, much wider. Between 1979 and July 1985 175 organizations had been liquidated, of which 149 were without a legal successor. These were, with very few exceptions, cooperatives, specialized groups of cooperatives, and units established by enterprises: joint enterprises, partnerships and economic associations. Within this sphere, the relationship between the control and management organizations and economic entities, and the decision system highly important from the aspect of winding-ups are quite different from those usually found in the case of enterprises supervised by ministries and councils. The examination of the two sectors can thus be separated. Also, the statements that will be made do not relate to the other method of winding-up state-owned enterprises i.e. organizational decentralization.

** The story is briefly presented in the article by Katalin *Bossányi:* [6]. Apart from this source, I have reconstructed events from the documents of various apparatuses and from several personal discussions. Thus, I shall not make exact references to sources, although I wish to thank enterprise and ministerial experts for their help in my data collection.

As for the IGV, little is known about this phase. However, it is certain that from the first composition of the list in 1979, the enterprise was on it, first as an enterprise lacking funds, and from 1981 as a loss-making one. The indicator, serving as a basis for marking-out, comprises the business result corrected by subsidies (as shown in the balance sheet), which is to say that the negative result of the activity of IGV was not, or not fully, balanced by the budget.

However, what had brought the negative result? In order to understand the discussions before and after the winding-up, let us say a few words about the enterprise itself. On the scale of Hungarian industry (and within it, of precision engineering), IGV was considered a medium enterprise. According to 1982 figures, it had 2 700 workers, a gross output value of Ft 613 m, gross fixed capital of Ft 690 m (net value 469 m), stocks of Ft 611 m, and a credit stock of Ft 448 m.

The enterprise consisted of three factory units and a few small plants, it was fragmented territorially, and basically of a horizontal structure. Each of its three main lines of activity (typewriting, copying technology and cash-registers) each belonged to a separate factory unit.

IGV was the only home producer of each of its important products. It had no competitors, except for a few enterprises from socialist countries, and required a very small amount of Western imports. Most of its products were bought, in equal proportion, on the home market and in the socialist countries. It "produced" a rouble in exports with inputs of Ft 32, and in exports against dollars (consisting 18 percent of net returns) this indicator was Ft 52.6. It had extensive market relations: the documents relating to the winding-up show about 700 enterprises as its suppliers.

Wishing to modernize its product pattern, the enterprise started fast development projects in the late 1970s: it raised loans, signed cooperation contracts with Western firms, and merged factory units. However, the development of new products was lagging behind, problems arose in respect of design, complaints were made about the quality of the finished products and terms of delivery were not kept. At the same time, after repeated restrictions of the regulatory system, the financial terms of repayment of debts grew much harder than expected at the time of signing the contracts. As a consequence, the enterprise became insolvent.

At the end of 1983 a liquidation committee was formed which identified the causes of inefficiency of the enterprise. It found these in development projects surpassing its resources, the lack of research and development and a widely fragmented product pattern. Also, it had no strategic product that could have borne the burden of too high overhead costs and the inefficient utilization of resources. It was added that the technical-intellectual apparatus was small and business management weak.

In the early 1980s, IGV was far from being the only firm with such conditions and such problems. Why, then, had this enterprise to be wound up? This is not a rhetorical question—doubts and counter-arguments were voiced at the time not only by those affected, but also by the representatives of more than one control organization.

To rehabilitate or to wind up?

After its "marking out", the enterprise in trouble received a subsidy from the government. But in 1982 the phenomenon that Mihály Laki had observed in the treatment of inefficient units—the *"half-turn" towards restriction*—also reached IGV. The Economic Committee of the Government passed a resolution to the effect that the "final settlement", i.e. winding up, was to be postponed and the usual preferences (suspension of fulfilment of financial obligations, compensation for losses, financing the increased stock, exemption from the rules of price formation, allowing a small sharing fund) were granted. At the same time, the enterprise was obliged to complement its earlier work plan. The objectives, i.e. the volume of sales profitability, and net foreign exchange returns were stated in yearly specification. The essential point of the resolution seems to be familiar. Earlier, this type of coordination of resources and targets had been called a directive plan. And now it is called a 'contract'. The enterprise executives' bonus linked to fulfilment was specified in the agreement between the supervising deputy minister and the general manager.

In the summer of 1983, relying on the report of the Ministry of Industries, the Economic Committee still made the statement that the enterprise had *"climbed out of the trough"* and that tasks *were "successfully carried out"*. A few months later, however, it could no longer be denied that the plan was impossible to fulfil.

At the December meeting of the Economic Committee the questions were debated: whether, six months earlier, a fulfilment of the above-mentioned workplan was a realistic expectation; whether the delays were due to causes within or without the enterprise; whether the problem was merely one of time, or the impossibility of eliminating the loss. The decision made was severe: a ministerial commissioner was appointed beside the general manager, the winding up of IGV was decided, and an inter-departmental committee was to submit a proposal on the mode of final settlement. Although the document that was drawn up did not clearly state that the existing organizational framework could not be kept, it was clear to all that the fate of IGV was sealed.

The decision on liquidation was the joint work of numerous bodies and organizations: various supreme authorities and social organizations, but not enterprises or business partners. Negotiations were carried on personally between the members and heads of apparatuses, in committees formed to settle the future of the enterprise, and in other kinds of committees—all behind closed doors.

Several of the participants still argued against winding-up. Relying partly on the arguments of the enterprise managers, the supervising ministry said that the products of IGV, or at least, some of them, were wanted on the market. To liquidate its lines of production would lead to certain international difficulties and cause a loss of foreign exchange. It was important to maintain, and even to develop, a considerable part of the manufacturing capacity, as the products in question could represent a pulling force in the industry. According to the Ministry of Home Trade, if the manufacture of cash-registers was stopped, the need for additional convertible imports would subsequently arise. OMFB (National Committee for Technological Development) expressed the view that some of the products of IGV had good prospects: the enterprise was "an important force of production in precision engineering", and it would be a mistake to liquidate it.

IGV's monopolistic position in home production spoke, therefore, against liquidation or the cessation of the enterprise's lines of production, as this would cause supply problems in a situation aggravated by foreign exchange restrictions and by the mechanism of the CMEA cooperation. Further, it threatened international complications and increased Western imports. (The inner horizontal structure of the enterprise did not help the situation: if only one line of production is wound up, the others cannot take up the discontinued line, and the same problems will arise again.) These arguments are, however, acceptable only if other enterprises cannot replace the liquidated enterprise—because of their limited capital and creditworthiness, or because they cannot or are unwilling to run risks—if, in fact there is demand and technical basis for the manufacture of the products in question. This is to say that *the difficulties of winding-up are jointly caused by the industrial structure, the enterprise organizational structure, the various kinds of obstacles to international cooperation, and the many different hindrances of domestic enterprise.*

Therefore, under the given conditions, the arguments brought up in support of maintaining the enterprise were not entirely unrealistic. At the same time the view, held mainly by the financial control organizations, according to which the enterprise's production had been for years loss-making, could not be ignored—not even a government subsidy could lead to recovery, and there was no guarantee of achieving any success, even by means of considerable investments, within the existing organization.

The decision-makers were moving on uncertain grounds. In the negotiations between the apparatuses, most of the information upon which decisions were made concerned one or another part of the enterprise's activity (size of demand, market position, technical standards of the products, prospects). Owing to their situation, their knowledge of these questions could only be partial, and further, it could be distorted by the interests of those submitting the information.

In these decisions not only the factual knowledge, but also the direct interest of the participants in the negotiations were missing. In other words, the objectives of the different control organizations are contradictory in themselves (efficiency *versus* domestic supply and the volume of exports.) Depending on their main task, each institution represents another aspect of the conflicting interests, so that not only arguments, but also apparatuses collided with each other. Thus each control organization observes its special institutional interests, more or less independent of the enterprise's profitability. These unfavourable features are necessarily and generally characteristic of negotiations and decisions of state apparatuses on micro-level questions—apart from intentions and partial solutions accepted.

In the case of IGV the result was that liquidation was decided upon as a final solution. The bargaining position of the opponents, among them of the enterprise managers, was weakened by the fact that the crisis had been dragging on for several years—which was in itself a factor contributing to the disintegration.

One sign of this, and a further aggravating factor, was that the managing director, having strong political and social connections, was pensioned in 1982 and several other executives of the enterprise also left. The new executives had little time left for transforming the product structure and for strengthening their position internally and externally. As for the control organizations opposing liquidation in principle, they had little choice but to accept the decision because of the existing power relations, the general economic situation, and the fact that IGV was only a medium-size manufacturing enterprise*

Acceptance may have been made easier by the fact that, at the time of making the decision on liquidation, no decision had yet been made on the actual form and conditions, i.e. on the distribution of losses and profits interpreted in both the wide and the narrow sense of the word. Thus in the new phase of the bargaining process, all parties except IGV could entertain some hope.

Many organs... many aspects

In the early 1980s the three basic forms of liquidation were organizational decentralization, *merger* (amalgamation), and winding-up. The first version in its pure form was not considered in the case of IGV, as each one of its factories would have been loss-making after a separation, and the control organizations had already felt the disadvantages of this on several occasions. Therefore, the latter alternatives had to be considered. Of these, merger means that the enterprise that is taking over as a legal successor takes over debts and other obligations (including partial and perhaps temporary continuation of the production line), but it does not pay a purchase price. Creditors do not suffer losses and the enterprise that is taking over must fulfil inter-enterprise contracts and international agreements. At the same time, it can apply to the state budget to cover some of the losses of the enterprise that has been wound up.

In the case of liquidation without a legal successor, losses are jointly borne by the state budget and the suppliers; fixed and circulating assets can be sold in bulk or in parts. Depending on the price and on the preferences granted to customers, some of the expenses are refunded. In such cases yet another subject for bargaining is whether the enterprises taking over will carry on the earlier lines of production, and in which way and to what extent they can employ the workers.

* For more detail, see the article of Mihály Laki [3] and the study of the Lamberger–Szalai–Voszka [4], according to which it is not accidental that among the enterprises suffering a similar fate there were no large enterprises, or such as were part of the basic vertical stage of production, not even if they were in a much worse situation—except for the special case of the Csepel Trust.

It is clear, therefore, that the reason why the determination of the form is important for the control organizations is that the key questions—financial conditions, the maintaining of the lines of production, capacity, and of „technical culture"—are the same as in the case of a decision on liquidation. As a consequence, positions get polarized according to the earlier situation, and arguments are also similar. In this case the apparatuses directly responsible for production and supply took a stand for merger, thus causing a small shock. They said that merger, and the stability of employment in the earlier line of production, could also be advantageous for the budget, or would at least compensate for some of the losses. In opposition to this the financial organizations, supported by the National Planning Office, proposed liquidation *without a legal successor,* for then the enterprises could be drawn into the settlement of losses, i.e. it seemed that this solution would be less demanding on central resources. Besides, the intention of creating a precedent may also have played a role; that is, to show that liquidation was possible in an industry supervised by the ministry, too. Also, it may have been a useful experiment for the new bankruptcy proceedings to be introduced.*

Decision was again to be made by the Economic Committee. By the middle of 1984 the situation had grown less complicated for the decision did not involve the whole of IGV, but only the central factory in Budapest, and a plant closely attached to it. The other two factories had been sold with he help of the ministerial commissioner; the buyers were graned credit and funds from the budget to pay price (composed of the net value of fixed and circulating assets) and hey undertook to carry on te lines of production.

As for the remaining parts of IGV, the Economic Committee decided that the Ministry of Industries must first attempt merger, through competition—on condition that those who would take over should pay a purchase price, but they would be exempted from fulfilment of payments arising from "contractual obligations". In case of failure of reorganization—the Economic Committee said—liquidation would follow and, contrary to legal rules, creditors would be satisfied proportionately.

Thus merger and liquidation have not only formally become parallel, but also their content has got mixed up and the legal framework has loosened. The essential elements of the merger as laid down in the decision are, significantly, mostly characteristic of liquidation.

The announcement of a competition did not make it clear, either, what form the liquidation of IGV would take. The conditions were hard: no smaller unit than a factory was to be bought; contracts were to be fulfilled and the existing labour force employed; the purchase price amounted to Ft 1.2 thousand million and this was to be

* The legal rules establish a strict order in satisfying creditors. Some groups get full compensation as long as the assets of the liquidated enterprise allow this. Therefore, it might happen that those at the end of the queue, i.e. suppliers, cannot make good their demands at all. As against this, the principle of proportional satisfaction means that losses are, at least partially, refunded to all creditor groups.

paid either from the development funds, or from sales returns earned in four years. No preferences were mentioned.

It seems, therefore, that each sectoral and financial organization could assert its own most important viewpoints. Thereby, however, combining all the disadvantages of merger and liquidation for a possible buyer. It is no wonder that *there was not a single competitor able to fulfil all the conditions.*

The bargain is concluded

Before, however, an agreement was made on the form of winding up IGV, it had been virtually decided, who should take over. The competition was not made fully public, though the Ministry of Industries addressed it to 115 enterprises. The invitation itself was even less impersonal: 15 managers were verbally asked to consider the possibility, and *"personal discussions were held on several occasions"* with the 7 general managers *"most interested in the matter"*. Finally, four offers were submitted within the rather short time available. The Ministry of Industries had the decisive say in the selection, the most important criterion of which was to hold together the production capacity and thereby to preserve the chance of carrying on the lines of production. This information was not given to the competitors themselves; they could only know of it from other sources. Only one enterprise offered to take over all the remaining parts of IGV: *Medicor*.

There were, however, several aspects in which this enterprise could not fulfil the expectations of the control organization. It emphasized that the manufacture of typewriters depended on profitability. It would fulfil running contracts and supply parts, if it could come to an agreement with the customer on price. That is to say, Medicor did not undertake to carry on the lines of production, though it left the question open. It clearly refused, however, to be the legal successor of IGV, i.e. to receive the assets through a reorganization procedure.

Regarding this point, the position of Medicor and of the financial organizations coincided. The enterprise, however, came nowhere near fulfilling the financial conditions as they had been laid down. It offered about *a third* of the selling price and even asked for additional preferences.

Notwithstanding, Medicor came out as a winner among the potential purchasers, presumably because it cleverly fulfilled the most important criterion of each of the control organizations debating among themselves: the holding together of capacities, and the form of winding up IGV without a legal successor. Besides satisfaction of the formal expectation, both groups of apparatuses could then still hope to assert the essential content of their viewpoint later on: the carrying on of the lines of production, and the sparing of the central resources. The actual conditions were, at that time, still not made clear.

The control organizations had decided which enterprise should take over IGV even before the method of liquidation and the distribution of the financial effects were clarified. Thus the final agreement was the result of negotiations with only one enterprise. This, of course, tied the hands of the interested organizations to a considerable extent: if they could not come to an agreement with Medicor, the entire difficult procedure, including a new competition with an uncertain issue, had to be started again. Therefore, Medicor felt its bargaining position to be strong, and used it to its advantage.

This is the phase of the negotiations that most resembles market bargaining, at least inasmuch as the question was about prices and financial sources. It followed, however, from the lack of a capital market, that the magnitude of the prices could not be calculated on safe grounds. Finally, the parties were not led exclusively by profitability considerations: only in the sense that Medicor wished to reach the lowest possible price (and, what is closely related thereto in the given situation: the most advantageous financing resources), while the partners wished to cover the greatest possible part of IGV's losses through the selling transaction.

At the same time, Medicor did not conceal that through this purchase its direct aim was not to increase its output, but to achieve two targets formulated in physical terms: "enlargement of the capacity for technological development" (they needed a new building for their research and development institute), and the establishment of a factory for the manufacture of parts in the countryside, in order to substitute for external cooperation. The enterprise could not correctly evaluate the impact of this on economic efficiency at the time of the purchase, not even at the end of 1985; and the control organizations could do so even less. In a period of restriction and of administrative curbing of constructions, the external resource that could be obtained by taking over IGV's plants represented in itself a high value: it was credit which was available in no other way, and it was especially favourable in that the conditions of the loan were a lot softer than usual.

The final offer of Medicor, higher than the original one, was also determined by the actual physical targets, i.e. the extent of substitution, and not by the value of IGV's assets. Medicor could finally purchase the fixed and circulating assets at about *half* the original price announced in the competition. What is more, the credit it received (with no contribution on its own part) was not to be repaid from its development funds, but from sales returns, partly with interest allowance. Further advantages comprised the following: the budget did not impose the usual investment tax in the case of a new kind of utilization of the buildings, the reorganization costs could be separately accounted, and the enterprise managers' incentive fund was protected from the effect of the lower profitability of the capacities that had been taken over.

Another important element of the bargain—which was not a market bargaining—between the control organizations and Medicor was the holding together of earlier IGV capacities, the carrying on of the production line, and employment of the existing labour force. As for the latter, Medicor assumed the obligation and fulfilled it. It did not promise, however, to carry on the lines of production and, following a brief investigation, it did not continue the traditional line of manufacture (with the exception of one peripheral product) in spite of repeated requests by the supervising ministry. Instead, it immediately started to sell the equipment and stock it did not deed. The actual physical objectives of Medicor were thus fulfilled on favourable conditions. Yet the impact on profitability in the long run was uncertain.

The Ministry of Industries failed, in the end, to assert the standpoints upon the basis of which it decided for Medicor, partly—and only partly—because it could not assert the form of its intentions for winding up IGV. In August 1984, several months after the selection of Medicor, the agreement was concluded on liquidation without a legal successor. Finally, therefore, it was the supplying enterprises left out of the procedure and thus unable to formulate and represent their interests, that were left in a disadvantageous position.

In this question, the standpoint of the financial control organizations prevailed, though the actual terms were not clearly favourable for them, either. For instance, the selling price did not cover all IGV's losses and debts and the buyer had to be granted several kinds of subsidy. Finally, it is not sure that the liquidation imposed a smaller burden on the central resources than the merger would have done.

In addition to financing some of the losses, and granting subsidies, the costs of the new organization of production must also be counted among the expenses. For example, the purchasing firms do carry on the manufacture of some of the earlier IGV products, even if, for the time being, there are problems of design, quality, and profitability. At the same time, other products disappeared from the market as the enterprise was wound up, and this fact was resented by domestic trade organizations as well as by previous customers from the socialist countries. Therefore, manufacture of other special lines was restarted in enterprises only upon persuasion and allowances granted by the Ministry of Finance and the sectoral ministry. As a consequence, central resources are to bear subsequent expenses—not measurable at the time of making the decision on the liquidation of IGV.*

Another consequence is that the launching of production, designation of the producer, solution of the inter-enterprise conflicts, allocation of resources and the continuous financing of production contribute to the expansion of central control methods which assume the nature of a dispatcher service. It is not only liquidation, but the averting of disadvantageous effects, too, that cannot be implemented with market methods. Operative intervention is thus increasing, while part of the earlier losses of IGV has not been eliminated, but has rather been distributed within the economy, possibly necessitating, later on, further central measures.

* The article by Ágnes G. *Barta* [7], and the above-mentioned study by Lamberger–Szalai–Voszka [4] treat the question in detail.

Blurred effects

The winding up of IGV was the first liquidation without a legal successor among the enterprises supervised by a ministry. Lack of experience, and the resulting uncertainty must have played a role in the delay of decisions and their execution, and in the development of consequences unfavourable from several aspects. Yet I think that, as a summary, a few lessons of general validity can be learnt from the case.

We have seen that liquidation is a series of decisions taken by state apparatuses, necessarily laden with uncertainties on many different points. *Inputs and savings* on the national economic level *cannot be exactly compared.* Within the existing system, the question of whether an enterprise ought to be wound up, or its losses covered from central resources cannot be decided unambiguously. For this microlevel economic questions must be decided, for which the control organizations are not well suited for the above-mentioned reasons. Further, the costs of the liquidation cannot be exactly known at the time of making the decision. Since the process of liquidation is divided into several separate phases of bargaining, the forms to be applied and the actual financial conditions only develop in the course of subsequent negotiations. When the procedure starts, none of the participating institutions can be sure of the extent to which they can assert their aims.

In general, it also cannot be decided whether it is a merger following liquidation, or winding-up without a legal successor that imposes a greater burden on central resources. The borders separating the two methods have become indistinct. Though it does make a difference whether suppliers have a share in making up for the losses, and whether enterprises taking over are ready to undertake earlier obligations and if so, to what extent, *the decision system and, therefore, the final result, are similar.*

First the enterprises to be wound-up, just as those who are to take over, have been marked out in the course of negotiations among the apparatuses. The economic units are, however, not passive: they use their available resources to influence the control organizations (fighting in this way against their being wound up or merged) and for the distribution of expansion prospects. Second, in this fight the entities wishing to grow are not exclusively, and not even primarily, led by profitability considerations, but by the mere prospect of getting the resources needed for the realization of physical objectives. They cannot judge the future development of economic efficiency nor can the decision-makers, but that is not the main criterion. In the final result, the liquidated organizations are, almost without exception, small- or medium-scale enterprises, while the receivers are large enterprises of considerable means. This is to say that the method, quite apart from the actual form it takes, *may be the means of a continued preference for large enterprises.* Centralization carried out by the force of a decision made by the state apparatus, and the ensuing settlement of the consequences, indicate the strengthening of *operative central control* and its improved perspectives.

These features are characteristic not only of a merger following liquidation, and of winding up without a legal successor, but also of the classical method of fusions applied in the 1970s. That kind of centralization was qualified on the whole as *unfavourable* by the professional literature, and later on by the official evaluation, too. On account of the similarities, not much better results can be expected from the new forms of liquidation.

However, there are differences. On the one hand, as distinct from earlier mergers, actual (computed) enterprise profitability plays a greater role now both with the preferred and the non-preferred. On the other hand, the sphere of those affected is now determined not solely by the supervising ministry, but by a joint decision of several control organizations. While the former factor is in itself favourable, even if it does not eliminate the individual characteristics of the system as a whole, the latter element involves certain risks. Since liquidation without a legal successor formally breaks away from the supervisory function of the ministries, *it opens up a pespective* of organizational *centralization, which is also applicable in the system of conditions of the new forms of enterprise management.*

Yet its widespread occurrence may be prevented by the fact that the liquidations so far implemented—among them the IGV case—have given a lot of trouble to the control organizations: they were concomitant with sharp conflicts. The present procedure results in compromises which meet with the parties' intentions *even less than the mergers do*. The traditional (and partly the new type of) fusion promises the taking over of obligations, the solution of employment difficulties, and at least a temporary continuation of the special lines of production. This makes things easier for the supervising and trade ministries, than cases of liquidations directly exposing difficulties. As for the financial control organizations, the situation is similar: even if not profitable in the long run, a merger can momentarily ease the pressure on central resources. In contrast, liquidation means immediate loss, and may later become a source of further demands.

If we consider future chances, and our considerations remain within the existing framework, two possibilities will offer themselves: either the process of liquidations which has hardly begun and is increasingly indispensable for the whole of economy will stop because of the difficulties and conflicts or, if it continues, it will give impulse to a new wave of organizational centralization. The choice between the two evils can only be avoided by radically changing the existing system of liquidations, in a way coordinated with the whole of the economic mechanism.

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БЕЗ ПРАВОПРЕЕМСТВА

Е. ВОСКА

В статье рассматривается редкий до этого случай бесправопреемственного роспуска основанных не хозяйственными органами государственных предприятий на примере предприятия по производству канцелярской техники (ИГВ). Анализируя связанный с этим механизм решений, статья отмечает, что названный механизм в основном носит еще характер государственного аппарата и по многим аспектам похож на «слияния» 70-х годов, приведшие в силу их централизующего эффекта к неблагоприятным последствиям.

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CHANGE AND UNCHANGEABILITY IN STOCKPILING PROCESSES IN HUNGARY

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The value of stocks (inventories) increased nearly three and a half times in the Hungarian economy in the seventeen years between 1968 and 1985, owing to the increase partly of volumes and partly of prices. Along with this marked increase in value, its material-technical composition underwent profound transformation. However, in spite of all these powerful quantitative and qualitative changes, the structural proportions of the sectoral distribution of stocks and their composition by degree of processing, remained perfectly constant through this long period. At the end of 1985, and in every year in the meantime, they showed "ghostly" resemblance to the end-1968 state. It is precisely this unchangeability, i.e., the rigid pattern of stocks, that is looming in the background as the cause that triggered the grand change, the steady and significant growth and the established high level of stocks. This conservation of the stock pattern can be traced back to the market pattern which, in turn, follows from the production and product pattern. Consequently, all attempts at enhancing the efficiency of the inventory situation in itself, that is, the regulations and interventions (in most cases alien to the spirit of the reform) have had to be and will inevitably be futile.

Steady growth, structural standstill

The basic structural characteristics, whereby the high level of stocks was formed and conserved in Hungary for a long time, become clearly apparent when a longer span of the Hungarian stock situation is studied.

Table 1 presents the sectoral pattern of the stocks on December 31st, 1968 and 1985. The great quantitative change and the nevertheless preserved rigid structure—virtually identical between the two dates over a span of 17 years—are clearly apparent. During this long period of time, owing partly to growth in volume and partly to price rises, the value of the stocks increased nearly three and a half times and its composition by actual use value (i.e. its material-technical composition) was, of course, totally exchanged. Still, these significant quantitative and qualitative changes notwithstanding, the ratios of the sectoral pattern did not change at all and remained about constant. (Exactly the same structural ratios are typical of intermediate years not figuring in the table.)

The arrangement of the table requires one remark. The sectors listed under I are named as "mainly user" fields. These are, naturally, not only users of materials and products, but are also "producers" of commodities and services at the same time and this is why the adverb "mainly" is used. They are still and typically those that buy material stocks for the purpose of use. Those appearing under II are the sellers and

Table 1

Stocks in Hungary: sectoral pattern and changes

Enterprises and cooperatives	Stocks on December 31 1968	Stocks on December 31 1985	Change between December 31 1968 and 1985	Stock on December 31 1985 as a percentage of that on December 31 1968	Sectoral pattern on December 31 1968	Sectoral pattern on December 31 1985
	thousand million Forints		thousand million Forints			
I. The mainly user sectors						
Industry, excl. food industry	70	238	+168	340	35	35
Food industry	19	73	+ 54	384	9	11
Building industry	15	35	+ 20	233	7	5
Agriculture, forestry	41	137	+ 96	334	20	20
Transport, Post, Telecommunication	6	23	+ 17	383	3	3
I. The mainly user sectors, total:	151	506	+355	335	74	74
II. The mainly trading sectors						
Trade in						
— means of production	17	57	+ 40	335	8	8
— wholesale procurement	5	16	+ 11	320	3	2
— consumer goods	24	91	+ 67	379	13	13
Foreign trade and others, total	5	24	+ 20	500	3	3
II. The mainly trading sectors, total:	51	189	+138	370	26	26
Grand total (I+II)	202	695	+493	344	100	100

circulators of the products and goods as fields of the turnover sphere: in fact the turnover sphere ought to be in charge, primarily, of making the products available to users. According to this arrangement, which reflects the connexions of the reality, even if not perfectly yet at least with respect to trends, it shows that the stocks of users are constantly the majority of total stocks (74 percent), that is, always more than three times of the stocks in the turnover sphere—the latter being constantly a mere 26 percent of the total. This long immobile and settled ratio is a laconic description of the "suction" economy: the actual users permanently drive home, "suck away" the commodities from the sellers. It is apparent that the ratios are totally unchanged not only with respect to the total of groups under I and II but also between the different sectors belonging to the two main categories. It needs to be noted with special emphasis that the stocks to be found in the trade in means of production (a type of enterprises also in charge of the role of stockpiler and dependable supplier) constantly amount to only 8 percent of total stocks, reflecting the regularly low offer.

The inconsistency between the robust quantitative and qualitative changes vs. the total unchangeability of the structure is shown in the trends not only by sectors but also by degree of processing. This will be illustrated in the industry (not including the food industry) as this is the most clearly relevant for the said arrangement. Besides, as can be seen from *Table 1*, these stocks represent relatively the greatest share in total stocks, and the industry, owing to its nature as producer of a significant part of the stocks, is determinative also from the point of view of the stock trends in the other sectors.

It can be seen from *Table 2* that the stocks of industry (not including the food industry) running to 238 thousand million Forints on December 31, 1985 were 3.4 times the end-1968 value. This considerable growth occurred if not evenly yet gradually, year after year, and in all the three groups by degree of processing. However, the same table also presents the total rigidity of the pattern, this time according to degree of processing. The average for the 17 years shows that, without any appreciable shift in the structural proportions of each year relative to the average, the overwhelming majority (i.e., 71 percent of stocks) was represented by materials already purchased but not yet used in production (the inputs of stocks). In the stage of the production process actually creating value, only 17 percent of the stocks was present in the form of incomplete production. Moreover, only their smallest share, regularly amounting to a paltry 12 percent, was ready for being sold as finished product (the outputs of stocks).

This kind of stock structure, established many years ago and reproducing itself ever since in unchanging proportions, is one of the most significant indicators (being a consequence) of the market of excess demand and short offer. János *Kornai,* referring to the author of this paper, puts these structural ratios of stocks in the first place among the so-called shortage indicators of the production sphere and notes that this indicator is "one of the most important synthetic indicators. It indicates the stagnating intensity of shortage." [1] The constant preponderance of purchased (input) stocks is, namely, a manifestation (and an outcome) of a compulsion that, owing to an accustomed mode of conduct in consequence of the lack of security of purchase and supply, enterprises must stockpile the different materials themselves, instead of the spheres of supply, sales and circulation. In other terms: they must constantly invest a good part of their working capitals into stockpiling means of production not yet participating in production. Ont the other hand, the constantly small share of stocks of finished products (output) indicates, in close connection with the high input, the always insufficient actual offer of industrial suppliers, i.e., the insufficient stock of products exhausted by excess demand and manifest in turn in high inputs.

This settled pattern of stockpiling outlined above is in fact the creator and "reproducer" of the regularly high engagement of assets in the Hungarian economy. Keeping purchased but not yet used assets at many places of production (instead of

Table 2

Stocks in Hungarian industry (excluding food industry) according to degree of processing

(Data for December 31st of each year)

Year	Stock of assets thousand million Forints			Structure, by degree of processing	Total stocks = 100 (in percent)		
	A	S	F	T	A	S	F
1968	49	13	8	70	70	19	11
1969	53	14	8	75	71	19	10
1970	57	15	8	80	71	19	10
1971	63	15	11	89	71	17	12
1972	65	17	11	93	70	18	12
1973	68	17	12	97	70	18	12
1974	79	19	14	112	71	17	12
1975	92	22	14	128	72	17	11
1976	96	25	16	137	70	18	12
1977	105	26	17	148	71	18	11
1978	119	29	17	165	72	18	10
1979	120	28	18	166	73	17	10
1980	132	29	22	183	72	16	12
1981	142	31	24	197	72	16	12
1982	151	32	27	210	72	15	13
1983	157	34	26	217	72	16	12
1984	162	36	26	224	72	16	12
1985	174	37	27	238	73	16	11
December 31, 1985, if December 31,	in percent				Mean pattern at the end of the year period		
1968 = 100	355	285	338	340	71	17	12

Legend:
A = Stock of materials
S = Incomplete semi-finished products
F = Finished products/commodities
T = Total stocks (A + S + F)

stockpiling by sellers who could carry it out in a much more concentrated manner) necessarily *deconcentrates* and scatters the stocks in the economy. Thus a multitude of identical products are stored with a multitude of firms whereby the stocks requirement of the economy of the given products is not simply increased but multiplied; multiple need for an investment of working capital is caused in a country short of capital. Consequently, stocks sufficient for 65 days' sales were stored in the Hungarian

Table 3/a

Per unit indicators of stock engagement

(In the complete sphere of enterprises and cooperatives)

	p	a	$\frac{p}{a} \times 4$	$360 \times \frac{a}{p}$
Year	Net price receipt thousand million Forints	Chronological average stocks thousand million Forints	Chronological average stocks per 100 Fts of net price receipts, in Forints	Circulation time, days
1968	784.1	165.8	84.60	76
1969	838.8	175.4	83.64	75
1970	997.4	218.9	87.76	79
1971	1118.9	237.2	84.80	76
1972	1189.9	252.1	84.72	76
1973	1322.9	262.0	79.20	71
1974	1494.1	286.9	76.80	69
1975	1690.5	328.1	77.64	70
1976	1837.3	360.0	78.36	71
1977	2040.4	388.7	76.20	69
1978	2225.5	436.8	78.52	71
1979	2337.9	463.9	79.36	71
1980	2612.4	495.0	75.79	68
1981	2843.5	533.1	75.00	68
1982	3028.6	561.4	74.16	67
1983	3211.0	690.2	73.52	66
1984	3457.3	614.6	71.12	64
1985	3583.9	649.7	72.52	65

economy and those sufficient for 67 days' sales in the industry (excluding food industry) stocks (as shown in *Tables 3/a* and *3/b*) along with that from the domestic use of GDP represented the 3 percent which was allocated to the increasing of stocks (see *Table 4*).

Some international comparisons

It will be revealing to study the said data in international comparison. As against the 67-day stocks of the Hungarian economy, in the advanced (as well as semi-advanced) capitalist countries the industry, in its capacity as user, does not keep more than a few days' stocks. Moreover, as *Yoichi Shinkai* presents: "...Japanese car manufacturers have learnt to work without stocks of materials." [2] The reverse market pattern, i.e. the buyers' market of the advanced market economies, demands

Table 3/b

Per unit indicators of stock engagement in industry (not including food industry)

Year	p	a	$\frac{p}{a} \times 4$	$360 \times \frac{a}{p}$
	Net price receipt, thousand million Forints	Chronological average stocks, thousand million Forints	Chronological average stocks per 100 Fts of net price receipt, in Forints	Circulation time, days
1968	278.0	67.1	96.48	87
1969	296.5	74.1	100.00	90
1970	329.7	78.7	95.48	86
1971	353.0	86.6	98.16	88
1972	379.5	92.6	97.60	88
1973	414.2	95.6	92.64	83
1974	465.5	105.5	90.64	82
1975	557.5	126.7	90.84	82
1976	599.2	133.7	89.24	80
1977	652.3	144.4	88.56	80
1978	716.1	158.5	88.52	80
1979	760.8	166.0	87.28	79
1980	887.7	181.2	81.64	73
1981	956.6	195.0	81.52	73
1982	1 015.0	201.3	79.32	71
1983	1 078.8	210.1	77.90	70
1984	1 162.6	217.3	74.76	67
1985	1 232.7	229.7	74.52	67

that stocks be stored not by users but by their suppliers and mostly by retailers, ports, storehouses, etc. This is in the national economic sense and with a much higher degree of concentration than what user (input) stockpiling can do, and thus demand is better and even instantly met. Owing to the same reasons, the ratio allocated from the domestic use of GDP for the purpose of increasing stocks is in the range of 0.5 to 1.5 percent—as against our ratio of 3 percent.

Above, we presented the structure of the industry's stocks where the share of materials was 71 percent, of incomplete production 17 percent, of finished products 12 percent, and the cycle of circulation of the stocks of industry was 67 days. Let us compare that with Japanese data.

The small share of purchased materials is an expression of a moderate demand. The user does not need to "collect" stocks, as those are available from suppliers, for, as it is also shown by the high share of finished products, a sufficient offer is always present. It needs to be emphasized that these longed-for but unattained proportions, as

Table 4
Data on the growth rate of stocks

Period	National income Domestic use	Value added (GDP) Domestic use	Growth in stock	Growth rate of stocks: Growth in percentage of domestic use of the national income	Growth rate of stocks: Growth in percentage of domestic use of the value added (GDP)
	in thousand million Forints, at current prices				
1963	174.4	208.9	9.5	5.5	4.6
1964	185.6	222.4	10.3	5.6	4.6
1965	177.7	216.5	11.4	6.4	5.3
1966	193.7	235.1	9.9	5.1	4.2
1967	218.6	261.6	13.1	6.0	5.0
1968	232.1	283.3	16.9	7.3	6.0
1969	252.3	305.5	10.6	4.2	3.5
1970	286.7	342.3	15.1	5.3	4.4
1971	322.6	385.2	20.0	6.2	5.2
1972	321.5	389.2	10.6	3.3	2.7
1973	343.1	416.0	18.5	5.4	4.5
1974	397.8	477.4	36.2	9.1	7.6
1975	428.1	513.7	21.2	5.0	4.1
1976	463.3	555.1	31.2	6.7	5.6
1977	499.6	604.0	27.0	5.4	4.5
1978	570.4	685.7	41.1	7.2	6.0
1979	577.7	704.3	10.4	1.8	1.5
1980	596.8	734.3	21.3	3.6	2.9
1981	643.1	788.1	30.1	4.7	3.8
1982	689.6	841.1	30.9	4.5	3.7
1983	720.6	879.2	21.7	3.0	2.5
1984	773.2	947.6	24.7	3.2	2.6
1985	804.3	1008.6	30.6	3.8	3.0
Years 1963–1985 (average of 23 years)	429.2	522.0	20.5	4.8	3.9

regards Hungary, developed along with a very small volume of total stocks. More accurately: the Japanese national economy can operate with this low volume of stocks because of this kind of stockpiling structure, owing to concentration by the sellers. Again, this indicates that—in contrast with the 67-day stocks of the Hungarian industry (not including food industry), in Japan the average time of stock circulation was 2.8 days in 1983. It must be emphasized that the Japanese data which might amaze Hungarians did not "just happen". They are remarkable and represent concrete

Table 5

The structure of stocks in Japan

Japan, average for the year 1983	Stock of materials	Interproduction* stocks	Finished products
	in percent of total stocks		
Manufacturing industry:	26.0	42.0	32.0
Of this:			
Chemical industry	26.5	7.6	65.9
Rubber industry	24.8	10.8	64.4
Electrotechnical industry	12.3	43.4	44.3
Wood industry	28.4	15.5	56.1
Textile industry	25.6	30.6	43.8

* This corresponds to the term *incomplete production* used in the Hungarian statistics.
Source: [3]

evidence of the savings of multiple recycling which might be achieved by a stockpiling policy relying on efficient production organization. However, organization is only a part of the explanation. Although efficient organization in itself can produce good results and cut back the tying up of stocks with enterprises, methods of organization and business management, however good they may be in themselves, are still not enough to produce anything near to the said effects. This degree of organization itself is only capable of functioning in a medium called the market, and this market produces the offer that allows users to have next to zero stocks.

Roots and superficial treatment of the stock problem

If it is true, and most probably it is, that the settled high engagement of stocks developed by input-type stockpiling is rooted in the market structure (i.e., in the sellers' market of excessive demand), then it must also be assumed to be true that the clue to a substantial cutback of stock engagement, to a profound changing and bettering of the stockpiling conditions, lies in the transformation of the market structure. The stock problem originates in the last resort from the pattern of the actual offer (which has become established up to now), in the domestic pattern of production and products.

It can also be admitted that as long as the sellers' market is not replaced by a buyers' market, the Hungarian stock pattern will remain what it is, and the volume of stocks tied up cannot diminish either. It may be stated that this volume of stocks (naturally not counting here the clearly wrong, mistaken and unreasonable stockpiling policies that could be simply eliminated by better organization under the given conditions) accompany and correspond to the present structure of the economy and represent its "normal state". János Kornai argues in the same sense: "We must avoid associating any value judgement—expressed or implied—with the term 'normal state'. . . To assert that a system is in its normal state is neither praise nor rebuke; it is not condemnation, but not an excuse, either. By this, we say no more and no less than that a system functions in accordance with its own inner nature." [4]

I have no intention of suggesting that there *are no more reserves inherent in the rationalizing* of enterprise stockpiling policy, in the spreading of more advanced methods, or in the elimination of frequent shortcomings like unfounded orders and so on. There are a good many possibilities of that kind. However, the order of magnitude of their probable beneficial effect is much too low in comparison to what could be reached through the stock pattern of a buyers' market.

It is realistic to admit that only a buyers' market, coming into being by relying on a much more modern production pattern than the present one, capable of adjustment to changing internal and external demand (that is, through demand steadily met by sufficient offer) is suitable for the profound changing of the stockpiling conditions. In other terms: the stock situation cannot be bettered—in the long run—but by consistently advancing on the path of the reform. The various central measures taking the nature of direct intervention kept on the level of superficial treatment which we have experienced and, what is more, implemented (with inevitable failure) for many years, are not suitable by any means.

Barely a single year passed during the last one and a half or two decades without adoption of "rigorous" resolutions toward cutting the volume of stocks. The volume, however, "did not comply". It went its own way, the one outlined above. The statute MT 64/1982 is the most generally known from among the central stock control wishes—as too many people had to deal with it, painstakingly, at enterprises as well as authorities and banks alike. On the grounds of this, the Ministry of Finances may draw away a sum of up to 10 percent of the value of stocks from the working funds of those enterprises whose stockpiling policies were considered dissatisfactory, and their volumes "exaggerated', by the National Bank of Hungary and by the assessment of the National Board for Material and Prices.

The implementation of this directive is just another one that could be appropriately described as efforts in vain. In 1983, the National Bank of Hungary studied the stock positions of 1018 enterprises on the basis of the said statute. The review found the stockpiling policies of 933 enterprises to be "correct" and of 85 enterprises to be "not satisfactory". Against 71 of the enterprises mentioned above a recommendation was made to draw away 2 million Forints of working funds. Finally, in 1983, a total of 1.3 million Forints of working funds was drawn away by the state budget from 54 enterprises. In 1984 the Bank inspected 314 enterprises and found the stockpiling policy to be "satisfactory" with 306 enterprises and "not satisfactory" with 8 enterprises. However, it was only found appropriate to recommend a drawing away of funds in the case of 2 enterprises, and only of small sums.

Needless to say, the drawing away of 1.3 million Forints of working funds in two years caused a great deal of work (and produced conflicts) and perhaps resulted in somewhat more care being given to stock problems. Still, it could make absolutely no contribution to solving the problems of a stock running into Ft 700 thousand million or to decreasing the tying up of assets. Yet make no mistake please: the fact that the majority of inspections did not end up in drawing away working funds does not mean that the stock situation was really "all right" everywhere. It only expresses that the investigating bodies could not be sure whether the stock problems of a given enterprise were actually its own "fault": because the given environment, the suppliers' attitude (another consequence of the environment) *might not have allowed* them what is called "satisfactory" stock management.

I would not indulge in one single statute if it were merely symbolic of a rather typical symptom, namely, taking a problem in isolation, removing it from its relationships and trying to solve it separately; whereas this problem is only a part, causation and consequence of a greater whole and thus the cause remains unchanged. The stockpiling process is a mere part, function, causation and consequence of the basic processes of the economy. Its "separate" regulation is hopeless.

Legally, the statute is still effective in 1986, despite the fact that the Bank, together with the National Board for Material and Prices, and with the consent of the National Planning Office and the Ministry of Finances, initiated that higher authorities should repeal it. The arguments of the request included, firstly, that only minimum drawings from working funds could be made on the basis of the statute and, secondly, that the stock situation could not be improved by this method, not even by making more substantial drawings eventually. The roots of the problem were, namely, the market (that is, the given type of the product pattern), and, last but not least, such central interventions and actions that were alien to the entire system of indirect economic control and regulation.

Examinations of the stock situation on the basis of this statute and recommendations to the effect of drawing away working funds unavoidably led to subjective judgments. The officials of the Bank and of the National Board for Material and Prices in charge of the procedure, do not and cannot possess any set of objective criteria suitable to guide them toward stating an equitable and in all respects correct opinion concerning the qualification of the stockpiling policy of the enterprise under study as "satisfactory" or "not satisfactory" (to use the terms of the statute). This is not to mention that when "not unsatisfactory" stockpiling policy is stated then, like an arbiter who decides which punitive sanction is equal to the degree of guilt, in this case the colleagues carrying out the inspection must propose what percentage, within the ceiling of 10 percent, should be drawn away from the working funds.

The stock problem and the Bank

The updating of the banking (and the credit) system inevitably raises the problem of the future treatment of stock problems by the National Bank or the banking system.

One point is certain: quasi-official authority actions (e.g. carrying out actions like the ones mentioned above or other banking activities showing the colours of official authority action, which are not rare either) cannot be applied in the future by the banking system against the enterprises. The bank of issue will simply not be in that position as it will not have any direct lending relations with the enterprises.

As to commercial banks, they will probably maintain business partnership relations, and good ones, with the enterprise sphere and this can only be achieved on the basis of full and mutual equality. Between business parties on an equal footing it is absurd to vest one party with a right, moreover, give it a task to make administrative decision with financial consequences about some activity of the other party. Finally, sooner or later, the commercial banks will compete with one another. It may be ventured to suggest that if a commercial bank becomes more "rigorous" or "authoritarian" than the other (e.g. in its judgment and sanctioning of the enterprise stock position) then the client will decide to go to another one.

When I advocate the reduction of official authority actions I do not mean to suggest that the banks should be indifferent to harmful processes (e.g. robust domestic tying up of assets). Yet it should not beat the air in such matters and not act in a role alien to its proper function. I should like to recall the root of the solution to the problem: through creating a buyers' market and updating the patterns of production and products. This (also) means that, in the last analysis, the banking system can promote more rational stockpiling processes than the current ones if its development credit policy achieves a substantial change in the commodity pattern. Thus, the solving of the stock problem with the bank's assistance is paradoxically—considering that the stock is a working fund—rooted not in the lending of working funds but in investment credits.

The rationalization of the stockpiling processes must and can be naturally enhanced in the sphere of the lending of working funds. This is not so much from the aspect and with the instruments of "prohibitions" but rather through business financing methods and, first of all, by typical banking instruments. Let me point out just one of them, namely, the bill of exchange.*

The institution of the bill of exchange has, with its numerous economic benefits, another advantage, i.e. that it can be an instrument of putting an end to the widely prevailing liquidity problems or at least of our endeavours to relieve those problems. The rigour of the rules of the bill will prompt any one debtor to hold sufficient monetary assets to settle the debt when it has matured, whether the owner of the bill is an enterprise or the bill has been discounted—thus the bank is the beneficiary of the

* On the revival of this business tool in Hungary see: [5]. (Ed. note)

bill. This endeavour of the liable party will be successful, that is, he will be solvent provided that he is capable of continuous sales and thus of continuous earning of money receipts. However, he cannot achieve unless his stocks are mobile, available for use at any time, and can be quickly translated into money (that is, they are not too much and not doomed to be frozen). In this way the bill of exchange may, indirectly, become an element contributing to healthier stockpiling policy—especially when the bank discounts those bills which, in the first place, are covered by mobile goods.

Moreover, the banking system can also enhance the therapy of the stockpiling processes by promoting a better allocation of capital and by accelerating the flow of capital. The present inexpedient placing of stocks (that is, users stockpiling materials and not the sales sphere keeping stocks of commodities) is at the same time a reflexion of the inexpedient placing of money capital assets. A successful mode of flow of capitals can certainly be devised, through which a considerable volume of capitals tied up by users could flow, in the form of credit, to places where it can become commercial capital. In other words, a better allocation of stocks can be promoted by a better allocation of money capitals.

To sum up: the way toward achieving a healthier stock situation leads through the consistent carrying on of the reform—and not through applying methods inconsistent with the reform.

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ИЗМЕНЕНИЯ И НЕИЗМЕННОСТЬ В ПРОЦЕССАХ СОЗДАНИЯ ЗАПАСОВ В ВЕНГРИИ

Э. ФАБРИ

Стоимость скопившихся запасов в венгерской экономики за 16 лет частично вследствие их объема, а частично — повышения цен — возросла приблизительно в три с половиной раза. Одновременно с этим значительным стоимостным ростом произошли основательные изменения и в потребительской стоимости благодаря появлению новых материалов и технологий. Однако несмотря на эти громадные количественные и качественные изменения структурные пропорции отраслевого распределения этих запасов, а также состава в зависимости от степени обработки за это долгое время нисколько не изменились: в конце 1985 г. — и в конце каждого года — они

поразительно напоминают те, которые были в конце 1968. г. Именно эта неизменность — застывшая структура запасов — стоит в качестве причины за большими изменениями, т. е. постоянным значительным ростом и сложившимся высоким уровнем запасов. Эта консервация структуры запасов объясняется структурой рынка, которая, в свою очередь, определяется структурой производства и продукции. Поэтому попытки повысить экономичность запасов сами по себе, то есть стремления «улучшить» состояние запасов (большей части чуждые реформе) с помощью регулирования и вмешательства были и будут бесполезными.

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CHANGES IN THE PURCHASING POWER OF THE HUNGARIAN FORINT BETWEEN 1946–1984

E. HUSZTI

A short historical overview is given by the author on the domestic inflation measured by the progress of the general price level. The development of the purchasing power of a forint unit is shown from the period of stabilization to the present day with special regard to the main economic processes and events which determined this development. This relatively long period is divided into five phases for the purpose of analysis; and this spotlights the fact that the main fall in the purchasing power of the forint took place primarily in that phase when we operated a planning system based on binding direct instructions and fixed prices. The author claims to show that the undisguised process of inflation had a restrictive influence on the rate of increase of the price-level. Consequently it had a favourable effect on economic life. The author points out that the development of the general level of price can be regarded as a process under control. Naturally this does not mean that on certain markets and during every period the direction of development of prices has been satisfactory and without problems.

A correct examination of inflation is possible only if a period of some length is taken into consideration. No precision scales are needed for this, nor absolutely unobjectionable computation methods. Forty years' experience in Hungary already allows to draw certain conclusions.

For measuring inflation, i.e. the changes in the purchasing power of a unit of the currency, the indexes of the consumer and wholesale prices as well as the general price index and its reciprocal can serve as a basis. The analysis of changes in the consumer price level—as the most easily available and most obvious category—has recently been spreading. This conception is justified to some extent by the fact that, for the man in the street and, not infrequently, for economic policy makers, too, the rise in prices becomes a social and political problem when it shows in the rising consumer price level, i.e. when, after numerous transmissions, the consequence comes to the surface. This is, however, only the top of the iceberg; while little or no attention is paid to what is going on deep down: to the fundamental changes in the prices of production, investment, stockpiling, exports and imports.

In reality, the changes in prices taking place in the said fields have incomparably more numerous and serious economic consequences and, after a certain period, they are bound to cause a rise or raising of the consumer prices, even if these can for some time be prevented through budgetary measures. No isolated rise or raising of prices exists; it is only a question of time, and it will spill over, affecting all fields of economy. Inflation is an economic phenomenon on a national scale, reflected in the combined rise in prices of factors of production and consumer goods, not to be deduced from and explained exclusively with the processes taking place on the consumer market.*

*For the measuring of inflation the yearly average rise or decline of the general price level (rate of inflation) or its reciprocal value is used, which shows the change in the purchasing power of a unit of the currency in a given year.***

As *no* direct *publication of the general price index is found* in Hungarian statistics, I determined it as the ratio of national income computed at current (or sales) prices and that computed at constant (or comparative) prices. In literature, this ratio is called the *implicit price index*.*** Of course, the fact must be observed that the indicator received as its reciprocal value, i.e. the purchasing power of a unit of the currency *does not decrease* in the long run to such extent—as is shown by the rise of the price index, not only because of the computation method, but often in reality, either. This is explained by the fact that in the course of the last decades the range of products and services to be had for money has expanded to a very great extent, and the range of choice thus increased assures, in principle, a rational use of money for all money holders. Thus the exchange value of money depends not only on the change shown by the price index, but on the structure of the price index and on the objective of using the money as well.

Thus, from the aspect of changes in the purchasing power of money, changes in prices are an important, but not an exclusive, factor. As I shall demonstrate in detail in the following, it would make no sense to directly compare the existing exchange value of the forint—because of the underlying economic development level, supply and the range of choice—with its unit purchasing power attached to the 1946 or 1951 consumption pattern, for today more complex needs and higher quality requirements can be satisfied.

The history of changes in the purchasing power of a unit of the forint is the history of the inflation of the forint. The changes in the exchange value of money are inseparable from the overall course of economic life, its favourable and unfavourable phases of development. Within the four decades under examination, I separated the periods in which the purchasing power of the forint was decreasing to a considerable extent (i.e. the price level was rising considerably) from those in which the exchange value of money was not badly deteriorating (the price level was stagnating). The dates and periods coincide, as a matter of fact, with the problems and events of Hungarian

* The independent analysis of producer, export and import, investment, and consumer prices is, of course, justified. For example, export and import prices are important for the terms of trade, and consumer prices for living standards. As wrong it would be to neglect the analysis of these, so much it would be a mistake to judge the inflationary process on the basis of changes in the prices of one or another partial field. These changes in prices add up in the general price level, expressing the pressure weighing on the exchange value of money in all fields of economy.

** For example, if the price index rises by 10 percent from one year to the next, it corresponds to a 9.1 percent decrease in the purchasing power of a unit of the currency [as $(100:110) \times 100 = 90.9$]. Quite often this indicator is also called the rate of inflation. To distinguish them, I shall call rate of inflation the change in the yearly price level, and its reciprocal value the purchasing power of a unit of the currency.

*** The price index computed from the data of the domestic utilization of the national income is the only, relatively homogeneous, time series available which allows an analysing starting with 1946.

economy, well-known from experience and from a great number of publications (the problems of post-war reconstruction, the price and wage settlement of December 1951, the tension following the events of 1956, the producer price settlement of 1959–1960, and a similar measure taken in 1969. In 1972, 1976 and 1978 over-heated investment, in 1973 the first sudden rise in oil prices, and the second one in 1979, effects of the restrictive measures related to shifting to a new path of economic growth, etc.).

In the inflationary process of the forint currency five phases may be distinguished. Table 1 shows the changes in the purchasing power of the forint separately measured in each phase. The separation of the phases from each other is somewhat arbitrary, mainly attributable to the fact that I tried to examine, also for its own sake, periods which I judged as homogenous from the aspect of changes in the general price level. It is justified to ask the question, why I do not consider phases four and five, from 1968 to 1984, to be homogeneous, since in the case of the earlier phases there exists by far not such close causal relationship as between those two: *the domestic and foreign price events of the fourth phase necessarily led to the change in the value of money fund in the fifth phase*. Thus 1979, the year of changing the growth path, presents itself as the obvious dividing line.

Phase one: from the 1st of August, 1946 till the end of 1952

Although the Hungarian government took a number of economic policy measures through the issuing bank, the state budget, and other instruments affecting the domestic economic and international fields with a view to protecting the exchange value of the money right from the moment of introducing the new currency,* these could attain no more but slow down the process of rising prices. Already in the first half of 1947 the price level was rising, under the impact of external and internal causes, more than what would have been justified. The Hungarian economy, in its feverish activity of reconstruction, could not escape the effects of the considerable price increase that took place on the world market and in the leading capitalist countries. Also, it soon turned out that the relative prices hastily formed in 1946 were unrealistic and, on the part of agriculture, strong efforts were made to raise prices. As a result of the official interventions into prices, and of the spontaneous changes in market prices, a considerable shift to the benefit of agricultural prices followed in less than a year after the stabilization. This ought to have eliminated the wide gap between the relative prices of agricultural and industrial products created at the time of stabilization, but could do no more than reduce it to some extent. This happened because the fixed agricultural prices were made free. Though they were rising more than the industrial prices, they were pulling the latter, too, so that a "price competition" started between the two

* Bank note circulation ceiling of 1 thousand million, selective credit policy, loans granted so as to maintain the balance of the state budget, rationing to regulate consumption, etc.

Table 1

Changes in the purchasing power of one forint on the basis of the reciprocal value of the implicit price level relating to the domestic utilization of the national income, in the main phases under examination

Year	1946–1952	1952–1960	1960–1967	1967–1978	1979–1984
1946	100.0				
1947	84.4				
1948	71.2				
1949	60.0				
1950	60.0				
1951	42.0				
1952	42.0	100.0			
1953		99.0			
1954		91.7			
1955		88.4			
1956		90.2			
1957		88.0			
1958		91.7			
1959		83.1			
1960		79.8	100.0		
1961			99.2		
1962			100.0		
1963			100.4		
1964			100.0		
1965			102.0		
1966			99.2		
1967			98.2	100.0	
1968				97.8	
1969				93.5	
1970				92.0	
1971				90.7	
1972				88.1	
1973				84.9	
1974				82.5	
1975				79.4	
1976				75.9	
1977				73.1	
1978				70.7	100.0
1979					93.3
1980					88.6
1981					83.1
1982					76.7
1983					71.4
1984					66.7

major national economic sectors. As a consequence, wholesale prices rose by 50 percent in a year, and the cost of living by 35 percent. Beside economic necessities, political considerations and efforts also played an increasingly important role in the significant rise of the general price level.* Basically, this was made possible by the socialist social transformation that had taken place.

Hungary changed over to planned economy on the first anniversary of the new currency: during the period of the first three-year plan (1948–50), a political change occurred that fundamentally transformed the nature and economic policy of the Hungarian economy. Meanwhile, as a consequence of the changes in price level and its structure, by the end of 1949 the forint had lost much of its value in comparison with its purchasing power of the 1st August, 1946. According to certain statistical sources, the purchasing power of the forint fell by 40 percent from the stabilization to 1949 (computed on the basis of prices of commodities sold in [state-owned] trade and on the free market). A similar rise in prices took place in industry and agriculture. Only the services were left practically unaffected by the rise. [1]

The first five-year plan was to assure a smooth development in the period after 1949. After the results of the first year, the favourable process was broken by the suddenly raised plan targets. A generally sharp imbalance was created between supply and demand. Especially bad tensions came about on the market of consumer goods. In 1950 the general price level was rising slowly, but in 1951 it rose by nearly 40 percent. Thus the rate of inflation once again became a pull-back of economic growth, and the due conclusions had to be also drawn on the consumer market. The price and wage adjustment of the 2nd December, 1951 expressed this necessity: it mainly affected basic commodities (staples) and, through a nearly 40 percent raising of retail trade prices, it again considerably reduced the purchasing power of a unit of the currency. As wages were raised by not quite 20 percent, this was concomitant with a significant decrease in personal real incomes. Economic tensions, however, did not ease, as the price and wage adjustment did not bring about equilibrium by increasing supply but, on the contrary, by strongly curbing demand, i.e. on a lower level and for a short and transitory period, thus preparing the ground for the inflationary processes of the next period.

In the first period of the changes in its purchasing power, the forint currency suffered the heaviest "blows" in all its history: by the end of 1952 its value was only 42 percent of the original.

Phase two: from the beginning of 1953 till the end of 1960

In this phase, the purchasing power of the forint was "attacked" from all sides. A further rise in the general price level was determined by the following factors:

* On the basis of the conception that "the working class bears the burden of reconstruction", cheap food had to be supplied to the cities, national income was restructured with a view to socialist industrialization, etc. In all this, the price system played a role as one of the instruments applied.

— it was at the beginning of this period that nearly all the price increasing effects owing to the modification of the first five-year plan were felt;
— in the years from 1953 to 1956 the lack of an integrated economic policy conception was manifest in price increases concomitant with economic stagnation because of frequent changes in direction, giving preference now to that of the heavy industry;
— the period of the counter-revolution and the following consolidation had mixed impacts on prices and caused considerable damage to the national economy;
— the correction process of the economic mechanism began: it included a significant producer price reform, and several wage increases.

In two-thirds of the period solvent demand by far surpassing supply was prevailing. This became manifest in suction now in the field of investment, now in that of consumer goods, or, not infrequently, in both, because of the totally different economic policy conceptions. The economic conditions of increased investment activities, and of raising the living standards were, namely, missing. Tensions were further increased by the upset equilibrium between suddenly grown incomes, following the events of 1956, and the fast shrinking commodity stocks. As a consequence, the price level of means of production, as well as that of consumer goods were rising.

In comparing the purchasing power of the currency with that in 1946, only an 8.5 percentage-point loss of exchange value is found in this phase. On examination of the period in itself, however, i.e. from 1952, inflation must be judged as high, causing a 20.2 percent fall in the purchasing power of the forint. As a result of the "price competition" mentioned above, the prices of agricultural products grew to such extent as caused—for the first time since the turn of the century—the gap between the prices of agricultural and industrial products to change to the debit of the latter, and this situation remained practically the same until 1955. (That is, the agricultural price scissors changed into industrial price scissors.) With a view to avoiding an even higher rise in the general price level, industrial prices were strictly limited so as to counterbalance the gradual but systematical growth of the state purchase and procurement prices in agriculture. This was done in the knowledge that, otherwise, the stagnating industrial production would have caused a fast rise in the price level. The 1953 and 1958 reductions of the consumer prices also helped to prevent the price level from rising. These reductions were considered, in accordance with the prevailing conception, as important means of raising living standards.

The counter-revolutionary events of 1956 had an adverse effect mainly on the price developments of 1956; while in 1958 the general price level went down a little. In 1959–1960 a considerably increased investment programme, and the financial means spent on the reorganization of agriculture as well as on the stabilization of its socialist sector overdrew the resources of the national economy. As a consequence, and because of the significant producer price adjustment of 1959, the purchasing power of the currency was further decreasing. In consequence of the adjustment, the producer price level of industry grew by 53.8 percent on average. [2] The raising of producer prices, however, affected consumer prices to a small extent, since only in exceptional cases was it allowed to increase consumer prices because of corrections in producer prices. All this became manifest in a 10.4 percent rise of the general price level in 1959.

After the producer price adjustment of 1959, further price increases became necessary already in 1960. This means that central price regulation alone failed to ease the above-mentioned tension between demand and supply, as they were continuously reproduced in consequence of the still taut growth, accumulation, and distribution processes.

Thus, *because of inflation the currency again lost some of its purchasing power, though at a lower rate than in the first phase: at the end of 1960 it amounted to 33.5 percent of its stabilization value.*

Phase three: from the beginning of 1961 till the end of 1967

As for price developments, this phase is a veritable "riddle". At first sight, it is quite impossible to understand why, under the combined impact of the prevailing economic processes, the price level did not noticeably rise, but even fell in some years.

*Namely, in the early 1960s a permanent imbalance was prevailing in the national economy, showing most clearly in the deteriorating foreign economic equilibrium.**

From 1960 till the end of 1967 domestic consumption exceeded the national income produced at a gradually increasing rate and, with the exception of 1966, the Hungarian balance of trade closed with a deficit. In certain periods, through the greatly increased supply, this had a favourable effect on prices, as is shown by the falling general price level in the years 1961, 1964, and 1966–1967.

Yet the results expected from increased domestic consumption did not come about; too many resources were absorbed by the accumulation of stocks and unfinished investment projects, the fast rise in production costs, and the insufficient rise of labour productivity. That all this did not lead to a high rise of the general price level can be explained by the "preparations" made for changing over to the new system of economic control and management. Fixed prices were meant to assure that no significant price increases or changes in relative prices should come before the fundamental changes.

In this phase, *the inflationary process was practically stagnating: the purchasing power of the forint only fell by 0.6 percent in comparison with its value of the stabilization, and within the phase under discussion by only 1.8 percent, i.e. it represented in the end 32.9 percent of its 1946 value.*

* In 1960 the debt stock amounted to Ft 2.2 thousand million, in 1963 it was nearly the double: Ft 4.1 thousand million in convertible currency, which already surpassed the amount of the yearly exports to those markets. (2, pp. 416–417.)

Phase four: from the beginning of 1968 till the end of 1978

The new economic mechanism brought about a fundamental change in most fields of the economic life, while it left the earlier established financial (fiscal and monetary) system more or less intact. It has to be noted, besides, that the "transitory" nature and fixed characteristics of the preceding phase did not leave the first years of the phase under discussion intact, as mostly those investment projects affected economic growth which had been started in the years between 1963–1967. It is thus not surprising that the high tensions prevailing on the investment market were not easing, stocks were growing fast, and the balance of trade continued to deteriorate.

The economic growth rate remained uneven. Beside a few undoubtedly favourable tendencies, domestic consumption now always tended to surpass the national income created, even if some years changes of the opposite sign could also be found. In the first five years of the phase, foreign resources were not used to an extreme extent; the foreign trade deficit accumulated from the beginning of 1968 till the end of 1973 was no more than Ft 4.6 thousand million.

The growth of domestic (productive and personal) consumption is to be explained first of all by the overheated investment process. In this period, imbalance was not yet an overall phenomenon, it showed rather in some of the partial markets. The equilibrium disturbances and structural tensions became intensive and general later on, with some delay.

As regards the price system and price regulation, extremely important measures were taken from the aspect of the inflationary process. The earlier domination of fixed prices was broken: they were replaced partly by prices moving between the officially prescribed limits, and partly by free prices. The financial bridges (customs, duties, government refunds, etc.) integrated into the price system were meant not only to assure that the domestic price level should adjust itself to the world market prices, but also they were hoped to set a limit to an accelerated inflationary process which, according to prevailing views, was to be expected, in any case. This is how, the fast spreading of free prices notwithstanding, the general price level could be kept under control. This is meant, of course, in the sense that the abolition of a part of fixed prices necessarily led to freer changes in prices, and changes of a rising tendency at that. It is characteristic of this period that, within the framework of the established rules of the game, not only wages were "rigid downwards", but prices as well. Within the gradually rising price level, higher-than-the-average changes showed in 1969, probably as a consequence of the overheated investment activities.

The initially very slowly rising trend—by international comparison—of the general price index gave rise to the idea that, through the differentiated system of government reimbursements, Hungary could be made independent of the inflation observable in the capitalist world. This seemed to be justified by the fact that, up to the end of 1978, the highest yearly rise of the general price level still remained below 5 percent, even though revolutionary changes had in the meantime taken place in the world economic processes and in the development of prices.

After 1968 it was suggested, though, that actual domestic inputs must be taken for basis to find out, how Hungarian prices ought to be approximated to world market prices, but the "actual" inputs contained "manipulated" import prices and thus countermined real orientation. Thus, in formulating the economic policy conception, and in drawing up the national economic plans, the central place was necessarily given to the protection of the domestic price level.

The 1973 world market price explosion exerted such pressure through the import prices as ought to have enforced a modification both of the domestic price level and of relative prices. But Hungary assumed the attitude of an "introvert" and did not change its economic policy: planners continued to envisage a relatively high growth rate, though the country suffered from badly deteriorating terms of trade, and the demand for Hungarian products was decreasing. To counterbalance this, more and more loans were raised, which were not always successfully invested. Revaluation of the forint currency made exports, and the emergence of an import substitution process more difficult. Hungary made no efforts to improve the quality parameters on the limited domestic market, though the opportunity was given. All this led, later on, to drastic and socially painful changes in respect of both growth rate and domestic distribution relations.

Thus the process of "adjustment" to world market prices started slowly and with a delay, and its carrying into effect had mixed consequences. Because of the country's open economy, it had finally to be admitted that it was impossible to escape external inflationary effects. The consequence of the theoretical hypothesis made itself felt even in this period that only the rate of inflation measured on the consumer market must be registered. Meanwhile, in the background, on the market of investment and producer goods, such rise in individual prices and the price level took place which markedly reduced the purchasing power of the forint. It was thus only a matter of time, when this would break the barriers raised in protection of the market of consumer goods. Finally, this occurred in 1979, at the beginning of the following phase. After 1968, namely, it was only in the middle of 1979, that an extensive raising of consumer prices was effectuated, causing no little surprise to the population with its unusual extent.

Therefore, the "multigrade protective system" could in fact do no more than delay the infiltration of inflation into the consumer market. The choreography of the "breakthrough" process was, strongly simplified, the following. *The first grade was revaluation of the forint relative to the major convertible currencies.* The revaluation was, however, a "relative" one also in the sense that it expressed the different rates of rise in the different countries' price level, and not the improvement of Hungarian economic efficiency. In fact, Hungary suffered from a considerable deterioration of its terms of trade at the time, which added to the worsening of the equilibrium situation. Under such conditions, a higher revaluation would have further impaired Hungary's ability to export, whereas a lower revaluation would have entailed a higher rise in the domestic price level.

Since the relative revaluation "covered" the rise of the domestic price level rooted in the deteriorating terms of trade rather than prevent the rise in import prices, *the second grade of the protective system, the price subsidies, had to be established.* In the beginning, this was to serve as a protection against the rise in import prices, and later on mainly against that of consumer prices.

Inflation, however, makes its way in any case once the inflationary tendencies have established themselves in an economy, whether they are given free way, or are suppressed. *The third grade of the protective system consisted of the open admittance of the inflationary pressure, and of a series of "price adjustments" effectuated step by step on the market of producer goods.* Though, with some delay, inflation became increasingly obvious and open on the market of producer, investment, and consumer goods.

Thus, till 1976 inflation mainly affected markets other than the consumer market (the general price index was regularly higher than the consumer price index), and after 1976 first gradually, and from 1979 on quite clearly, the price increase on the consumer market was well above the general rise in prices. The "breakthrough" took place in a relatively short time, and a high rate of inflation became prevailing also on the consumer market.

The inflationary process visibly accelerated in this phase, so that the purchasing power of the forint fell by 9.6 percent in comparison with the stabilization, and within the phase examined by 29.2 percent, thus representing 23.3 percent of its 1946 value.

Phase five: from the beginning of 1979 till the end of 1984

Thus, parallel to the growing deterioration of economic equilibrium, the creeping inflation was speeding up, which, however, still meant a one-digit rate of inflation and has remained so in our days, too. The deterioration of economic equilibrium reached its trough in 1978, so that radical measures became necessary from 1979, directly or indirectly affecting nearly all fields of economy. *The Hungarian economy was thus compelled—the country now becoming an "extrovert"—to considerably lower the growth rate, and even more the domestic investment and consumption, in order to counterbalance the losses caused by the deteriorating terms of trade, and to create the sources for the current debt service, and later for the reduction of debts.* This was promoted by a considerable restriction of solvent demand for investment, which markedly reduced the pressure of demand and the concomitant rise in prices on the market of investment goods. Besides, the altogether not too intensive rise in the price level was promoted by the general administrative demand control on other markets, as well by the impoving tendency of the external economic equilibrium, and the fact that the changing relative world market prices continued to be integrated into the domestic price level through several transmissions.

The second world market price explosion in 1979, which had, perhaps, even more serious consequences than the first one in 1973, made it imperative to form prices reflective of the relative world market prices, apt to eliminate transmissions, and to establish a price mechanism that works in this way. *This was aimed, in fact, at establishing a direct connexion between world market and domestic prices,* i.e. the value of the currency. The first step was to establish a uniform rate of exchange.

The series of measures necessary thereto began in 1976, when the drastic change of the growth path that only followed in 1979 was not at all expected yet. With a view to establishing a uniform rate of exchange, between 1979 and 1982 the forint was repeatedly revalued against the dollar and the other convertible currencies in the commercial rate of exchange, and devalued in the non-commercial one. These steps can also be interpreted as anti-inflationary measures, as the rate of exchange did not cause tension in the producer price level, while it raised the consumer price level. Since, however, the non-commercial rate of exchange affected only about 10 percent of the foreign exchange turnover, the combined effect on the average domestic price level was negligible.

Thus, the most important function of the exchange rate policy applied in this phase was to protect the domestic pice level. For lack of this protection, the growth of the solvent (mainly investment) demand of enterprises would have exceeded the capacities of the national economy, whereas the freezing of the price level would have prevented even the most necessary minimum changes in relative prices.

The uniform rate of exchange began functioning in 1982. It not only promoted but also demanded a faster adjustment to the world market processes. This was inevitably related to the raising of the producer price level in the first place, which reached the highest rate in 1982, and then settled on about this level.

Since 1982, the exchange rate policy has increasingly concentrated on restoring a sound balance of payments. In other words, *with a view to the balance of payments, inflationary sacrifices had to be made, in nearly all the major markets (incl. the consumer market).* In the exchange rate policy this came to expression in a systematical depreciation, higher export subsidies, and corresponding import restrictions.

The current Hungarian exchange rate policy is, of course, noticeably affected by the high exchange rate of the dollar (and its strengthening till early 1985), the successful anti-inflationary measures of the advanced capitalist countries demanding great sacrifices (heavy constraint on growth, import restriction, high unemployment), and the deteriorating value of the currency because of accelerated inflation in Hungary. The protection of the domestic price level is, nevertheless, still considered as an important task of the exchange rate policy. This is where the statement made by the Central Statistical Office is to be traced back, establishing that the depreciation of the last years amounted to about a half of what would have been justified by the requirements of international competitiveness.

As a result of the actions outlined above, *inflation in this phase exceeded a little that of the previous one: the forint loss about one third of its purchasing power; at the end of 1984 it amounted to 15.5 percent of its 1946 value.* Figuratively speaking, in 1984 Ft100 had to be paid for as much of goods and services as would have cost Ft15.50 in 1946.

A few conclusions

The forint currency has gradually been depreciating since 1946, as the general price level has nearly always been rising, periodically or continuously, at a lower or higher rate—within the frameworks of either a strict or a loose system of directive plans, in a reformed mechanism or under repeated restrictions, upswings or stagnations, with balanced growth or a drastic imbalance. *Inflation is, therefore, such a persistent symptom of the Hungarian economic life, which should by all means be thoroughly analysed, even though it has in some cases been taken into consideration in forming the economic policy.*

It is a widespread view that the rate of inflation is usually lower in the more advanced countries than in the less advanced or developing ones. This is by and large justified by experience. If, however, the statement is examined within the group of the more advanced countries, it will become clear that, above a certain level, *there is no close link between economic development level and the rate of inflation.*

Similar conclusion may be drawn in respect of the hypothesis concerning the relationship between economic growth and the rate of inflation, saying that fast growth is concomitant with a lower rate of inflation, and a lower growth rate with a high rate of inflation. Statistical data clearly refute this simplifying assumption, as inflation may be a symptom concomitant with both fast and slow growth, or, inflation cannot only promote growth, but just as well restrain it (see stagflation).

It should be obvious from the preceding that inflation in Hungary was not caused and intensified by the medium level of development of the country, and slow economic growth enforced from 1979, but it had already been created and made permanent by the fundamental problems of production, distribution and redistribution, and the resulting equilibrium disturbances.

The "introversion" following the 1973 world market price explosion was a temporary and rather formal "protection" against the effect of world market prices and, especially in the light of subsequent experiences, it clearly did not entail advantageous consequences for domestic price stability, and a relatively moderate rate of inflation.

The establishment of the uniform rate of exchange in 1982 was in fact a significant step, the first one to make the process of monetization of economy open and "socially acceptable". Until then, namely, the process had taken its course as if hidden, almost unnoticed. Although the increasing integration of foreign credits with the sources of credits placed on the domestic market indicated that a certain relationship existed between them, this link was rather loose and indirect. Conflicts have usually been caused by the fact that the "physically" motivated financing expectations needed a given amount of foreign sources, while the amount of the actually available foreign credits allowed, as a rule, a lower amount of credits to be placed on the domestic market.

The cause of this paradoxical situation was that the more realistically the extent of *the use of foreign resources was determined, the more likely it became that they could be obtained as credits.* The increasing importance of monetary resources among production factors was quite a new feature of the Hungarian economic life. As a consequence, the monetary situation was bound to enforce, sooner or later, a physical adjustment to monetary resources. It was, however, a recurring problem that economic policy makers did not always observe the requirements of the restricted pecuniary resources, which ever more frequently compelled the economy to drastic physical adjustments.

In discussing the question of harmony between the external and internal value of the currency, the financial bridges which exert their transmission effect directly or indirectly cannot be ignored. *If the financial bridges cannot regulate according to uniform principles, i.e. they make exceptions and assure massive immunities, not even the most rationally developed exchange rate policy can assert its effect-mechanism.*

As for a practical solution, in the greater part of the period under discussion, the exchange rate policy aimed at protecting the domestic price level. The budget was, of course, a "partner" in that, even if they "did not always speak the same language" and this gave rise to a number of disturbances in price formation.

The struggle against the disadvantageous consequences of the social and economic impacts of inflation began when the depreciation of money had already become significant, which showed even more conspicuously in the consumer prices. Though it is no excuse, in most countries, as it is to be seen, circumstances will force out the not too popular anti-inflationary and equilibrium improving or restoring measures.

In the first two-thirds of the 1960s the price level was rising to a slight, even negligible, extent, and even the somewhat higher rise between 1968 and 1973 could not be called important. This fact and the favourable external conditions together suppressed the measures aimed at creating equilibrium and thereby restricting inflation; from the second third of the 1970s this was made difficult by the extremely unfavourable foreign economic conditions. The Hungarian economy is, by its nature, rather vulnerable, and it is difficult for it to ward off the effect of the disadvantageous external circumstances.

This explains—though it does not justify—the attitude of economic policy that the external inflationary rises were not allowed to make their effect strongly felt on the domestic market. Because the price level was kept at an artificially low level, and because of the insufficient volume of production, supply could not keep pace with the increasing demand and the shortage was usually counterbalanced by high imports. This was financed from foreign credits, in the fields of both consumption and accumulation. *The relatively easily available foreign resources and their initially rather low burden suggested that Hungary was able to grow, accumulate and consume at a higher rate than what proved to be realistic. And the domestic solvent demand for this was in fact created.* The bank of issue provided ample credits directly to producers, and indirectly, in the form of refinancing, to the state and other banks.

By 1978, however, problems had accumulated to such extent—credit sources got blocked, the rate of debt service ran too high, sales on the world market grew more difficult, etc.—that the growth rate and the proportions of domestic distribution and redistribution had to be changed. The change of the growth path necessitated the curbing of solvent demand, first of all through prices: 7 or 8 years of a too slow rise in the price level had to be corrected almost in one step. That is to say, forced by external and internal circumstances, from 1979 on fundamental changes which had been considered earlier as unfeasible had to be implemented.

Starting with 1979, not only the path of economic growth and the proportions of distribution and redistribution have been modified but, simultaneously and in coordination with it, the attitude of isolation from the world market inflation has been replaced by efforts made at a deliberate and planned formation of more realistic producer and consumer price systems. Thereby also *the nature of the inflationary process has changed: price increases have become permanent and the deterioration of the currency was reproduced on an ever lower level.*

Summing up the short historical review: from the changes in the purchasing power of the forint currency a relatively well controlled movement of the general price level can be inferred. Of course, this is not to say that the management of the price changes has been satisfactory on all the major markets and in each phase, nor that there have been no problems. If, however, the inflationary process is considered as a whole, *the annual 5 percent rise in the general price level and the 4.8 percent reduction in the purchasing power of the forint currency in the average of 38 years stand any international comparison*. The measures taken, even if with some delay, to restore the foreign economic equilibrium let the Hungarian economy recover itself a little and, if we can make adequate use of this, the rate of inflation will become controllable within a relatively short time.

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ПОКУПАТЕЛЬНАЯ СПОСОБНОСТЬ ФОРИНТА (1946 — 1984)

Э. ХУСТИ

Автор статьи дает краткий обзор процесса инфляции, измеряемой на базе уровня цен. В статье представлена покупательная способность номинального форинта от периода стабилизации до наших дней, дается характеристика определяющих ее экономических процессов. Рассматривае-

мый относительно продолжительный период разбивается автором на пять этапов, при анализе которых отмечается, что значительное сокращение покупательной способности форинта произошло в период директивного планирования и нормированных цен. Сколь это ни парадоксально, но снятие преград перед инфляционным процессом — вопреки общераспространенному мнению вмерило рост цен и таким образом положительно сказалось на экономике страны. В статье отмечается, что формирование уровня цен находится под контролем. Это, разумеется, не означает, что в важных рыночных секторах цены во все периоды складывались должным образом и не возникало никаких проблем. С учетом этого автор обращает особое внимание на ценообразование после 1979 г. и на вытекающие из этого экономические проблемы.

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THE CHANGING ROLE OF PRIVATE SAVINGS*

M. PETSCHNIG

One of the necessities for the development of the Hungarian economy is an increase in the savings made by the population. The presently low saving propensity is also related to the lack, or rather narrow range, of forms of saving—although there would be sufficient money for such an accumulation. This is indicated by the fact that the stock of saving deposits increased even in the years when real incomes showed an unfavourable development (1979–1984). Then, the additional incomes (from the second and third economies) were the sources of savings which produced significant income differentials. For these differentiated saving attitudes the range of securities should be expanded, instead of creating new forms of deposits. It is not unreasonable to assume that securities improve the propensity to save, and it is fair to say that they may also be evident on the side of capital investment through the disciplining power of the hard conditions of access to money.

The limits to savings

The growth of savings,** be it on a private or society level, is always limited. The *individual* can never fully put aside his income: his savings are necessarily limited by the satisfaction of his requirements as a consumer. (Provided the satisfaction of such requirements is facilitated by a supply of goods of the desired quantity and quality.)

The *social limitation* of savings results from the fact that each and every accumulated Forint influences the process of realization. Replacement of demand shortened by savings is enabled by the credit sphere. The shortfall of demand, however, can be replaced only if this is wanted, which again depends on the business tendencies, expectations and possibilities of the market. The same applies to the terms of foreign credit investments. Savings may collide with the market limitations to regrouping, and from that moment on their increase can by no means be considered as desirable.

Thus *the growth of savings in itself cannot be qualified* either as a positive or a negative value. It becomes a necessary development under given economic circumstances only. Considering the goals of the seventh five-year national economic plan covering the years 1986–1990 (and knowing the normal rules of behaviour of the economy) it seems that, for the time being, the increase of savings can be a stimulus rather than an obstacle to our economic progress.

Savings and investment may also be directly interlinked through the mediation of securities. In this case real and monetary accumulation are actually not separated in

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** For the purposes of this study, "savings" stand for cash savings. (In the wider sense of the term, savings include material accumulation as well.)

time. (Except for bonds issued with the purpose of mediating loans.) Hence it need not be feared that, for instance, in lack of effective demand money piled up in banking institutions cannot be placed out. The limit to saving in bonds is the same as in securities, only that the signal of this limitation is given somewhat earlier: when the desired quantity and quality of bonds fail to be placed on the market. The effective appearance of the social limitation to savings is the carrying of information that plays *a cost-saving role for the society*. As for the encouragement of saving, it enables a flexible way of action.

The connection between savings and the material (physical) investment *directly* established through securities, is beneficial for the efficient re-allocation of material goods in other ways as well. For an examination on the social level the following must be pointed out. It is known that the balanced (internal) growth of the economy postulates harmony between investment and spontaneous savings. In a plan-controlled one-tier banking system, where the central/credit bank has no liquidity limits, the bank is able (actually it is even called upon) to finance the material investment foreseen by the plan. Subsequently, savings come into being without there being an absolute guarantee of their spontaneity. A strive for material investment forces out its own source and results in disproportions and forced savings. (There were times when, in the light of a frantic quest for "socialist industrialization", this was explicitly deemed positive—but this was far from being right. The outflow of incomes must be regulated *ex ante,* instead of confronting the expenditure of incomes with a *fait accompli* afterwards.) Forced savings may take place with private persons as well as in the form of budgetary levies and by freezing reserves of companies.

When capital is raised from the security market, under normal circumstances non-spontaneous savings cannot happen, since those buying securities may decide freely whether to invest.

If forced savings are considered as one of the manifestations of inflationary pressure, then capital flow conducted at the cost of spontaneous savings is one of the causes of inflation. Disproportion and forced savings may, of course, also ensue in the case of capital flow induced by securities, but not as a built-in guarantee for the method of capital allocation.

All these not only seem to indicate that *savings must be encouraged* but also raise the question whether *existing savings-mediating systems* should not be *expanded through other capital allocation patterns* directly expressing the social limitations of savings. If this is so, what should we expect—a regrouping of savings or even additional ones? To these questions I shall attempt to find answers by analyzing the saving behaviour of a typical saver, the private person.

Private savings between 1975–1984

The tendency of private savings in the ten years between 1975 and 1984 offers useful clues for a forecast. The period under survey contains booms and slumps as well as average periods—that is, everything that can be expected in the future too.

Savings include cash savings of private persons on the one hand, and money deposited with the National Savings Bank (OTP for short in Hungarian), with cooperative savings banks and post offices (hereinafter called OTP deposits) on the other. These have (practically since 1983) been supplemented by money spent on bonds.

The yearly increment of savings was Ft 15 billion* in 1974 and nearly 33 billion in 1984. Although the population does not build its savings exclusively from its incremental income for a given year, savings and incremental income can still be compared and even provide interesting results. There were years during the period under survey (1976 and 1978) when the absolute value of surplus savings exceeded the increment of cash income. But, except for the years 1979 and 1980, *surplus savings usually accounted for over 70 percent of the increment of cash income*. This leads to the conclusion that in the years between 1977–1984 the growth rate of savings exceeded that of cash incomes.

OTP deposits provide a pretty good picture of the population's savings, partly because some three-fourths of the annual savings went in that direction, and partly because the relative proportion of cash and deposit savings has been more or less constant, except for the years 1979 and 1980. The volume of OTP deposits nearly trebled in the years between 1975–84 (270 percent), while cash incomes only doubled (205 percent). Differences in the dynamics of their respective annual growth rates are shown in *Table 1*.

From 1975 until 1984 OTP deposits grew by Ft 138.2 billion. This includes, of course, the surplus caused by inflation. Dividing it by the official consumer price index, we will find that *the real level of OTP deposits by the end of 1984 (Ft 124.6 billion) equals the nominal stock of 1978.*

OTP deposits include not only private money but deposits by economic organizations and social funds as well. The latter are, however, not disclosed. Provided their proportion remains unchanged, they do not distort the analysis. If they do change, this may well lead us to false conclusions as to the population's saving behaviour. This may be particularly disturbing for the analysis of recent years which have shown a surprising picture of real incomes and savings.

Interest rates on private deposits are lower than those applied to economic organizations. Locking up money with not too attractive interest rates can still be otherwise advantageous for the sphere outside the population, the chances of which have, in all probability, been improved in recent years by accelerating changes in the regulation of (enterprise) incomes and by frequent siphoning-off of incomes.

* *billion* stands throughout the article for *thousand million*.

Table 1

Cash incomes and OTP deposits in the years between 1975–1984

Year	Growth of		Increase of OTP deposits per 1 Ft growth of cash income
	cash income*	OTP deposits*	
1975	109.7	115.0	1.05
1976	106.1	114.0	1.07
1977	109.8	116.0	1.05
1978	107.9	116.0	1.08
1979	108.6	109.0	1.00
1980	109.2	107.0	0.98
1981	108.1	110.0	1.02
1982	107.3	110.0	1.03
1983	108.4	112.0	1.03
1984	109.2	111.0	1.02

* the year before: 100 percent

Source: A lakosság jövedelme és fogyasztása 1960–83 (Income and consumption of the population 1960–83). Központi Statisztikai Hivatal (Central Statistical Office), Budapest 1984. *Statisztikai Évkönyv 1984* (Statistical yearbook 1984). Központi Statisztikai Hivatal, Budapest 1985.

In addition to the aforementioned one, there are at least four more factors influencing the growth of OTP deposits which must be disregarded when looking into the cash holding behaviour of the population and its changes.

— The stock of OTP deposits is also increased by interests added but this represents a surplus only from the point of view of credit mediation and, eventually, when paying it out, i.e. with the "output" of deposits but not with their "input". The surplus of deposits *ensuing from interest* amounted to Ft 50 billion, or *more than one third* (exactly 36.2 percent) *of the total increment* in the period under survey.

— Another factor to be considered is that, beside money accumulated in the OTP with the expressed purpose of saving, deposits meant to meet the so-called cash-flow requirements are also reported. Such are remittance (current) accounts and cheque account deposits (and, since 1983, the cheque account deposits of partnerships and other companies as well). The growth in the balance of these accounts, too, appears as a saving surplus,* even though such deposits are used by the population to reduce cash dealings, not to save money.

— There are deposits which are not voluntary but created by legal rules. Such are car purchase deposit accounts and flat (dwelling) application deposits. Some of them would no doubt come into being voluntarily as well, but changes in their magnitude are more closely related to the pace of car supplies and flat allocations than to saving habits. Their existence is in no way the result of free decisions by individuals: in fact they are a very simple central method of tying up the purchasing power of the

* Sums accumulated in these deposits, too, show a steady growth which is due partly to the widening of their scope of application and partly to the growing size of items to be paid.

population (car purchase accounts bear interest at a mere 2 percent p.a. and even this only since 1983).

— We must disregard money accumulated in the so-called foreign exchange accounts since these were not opened from domestic money outflow.

If we deduct from the stock of OTP deposits the interests and the increments of remittance and cheque accounts, car purchase deposit accounts, flat application deposits and that of foreign exchange accounts, we arrive at a net stock of savings that may be considered as a *quasi-voluntary saving*. *Quasi*, because this remainder can still contain lots of savings of forced nature, but the percentage of the latter cannot be established. If we deduct the aforementioned items from the stock of *OTP deposits as per the end of 1984, it will be Ft 177.6 billion* as against the gross stock of Ft 219.5 billion.

The proportion of quasi-spontaneous and gross savings is changing and also declining as against 1975; while quasi-spontaneous savings then accounted for 91.3 percent of the stock of gross savings, by 1984 this percentage was down to 80.8. This may indicate that non-spontaneous, non-domestic and non-saving-minded deposits were rising more quickly, along with interests, than quasi-spontaneous ones. *As compared to a 170.0 percent increment of the gross stock, that of quasi-spontaneous ones only registered a 140 percent rise*. As for the difference in the annual growth rates, the last three years are remarkable also because *the gap* between the growth rates of the two kinds of stock *has been growing since 1982: from 0.2 percent it soared to 3.2 percent*. Deposited savings thus show a much less spectacular dynamics if one separates quasi-spontaneous savings from the total gross stock.

Annual cash savings are the incomes less consumption, OTP savings and dwelling-related investment expenditures. The remainder can, however, not fully be considered as cash saving, and this is for two reasons. The Central Statistical Office lists under the heading "income spending" only sums spent on building and/or purchasing homes as private investments. It disregards capital investments by private enterprises and bonds purchased by private persons. As a matter of fact, neither of these items was so sizeable that it might cause a difference of any great consequence between reported and actual cash savings (the stock of bonds sold to the population was, for instance, no more than Ft 500 million by December 31, 1984). Disregarding money tied up as capital for small enterprises may at best distort the forecast of the tendency of cash-flow.

As banking techniques are advancing, the cash reserves of families may shrink to a minimum. However, this was not yet the case in the period under survey, so the causes of changes in cash accumulation must be found in other factors.

The literature considers cash savings as the least rewarding method of saving since it does not bring in any revenue for its owner; moreover, it is very easy to steal, though no doubt it is the easiest to mobilize. A high proportion of cash savings are usually explained with an underdeveloped "saving consciousness", distrust of banks ("straw mattress" syndrome) and/or by weak savings-bank services.

The overall truth of these arguments can hardly be challenged. Nevertheless, it scarcely fits the actual domestic situation of the period under survey. Owing to an expansive network of cooperative savings banks and the advanced motorization, it has become easy to deposit savings at banking institutions. On the other hand, soaring prices from the mid-1970s onwards rendered cash savings a bigger luxury than ever before and this accelerated the emergence of consciousness of banking institutions as instruments of saving. As for distrust in banking institutions, it would not make too much sense to discuss this now, some 30 years after the consolidation started in the wake of 1956. Yet the share of such savings is solidly between 24 and 42 percent, spreading around an average 30 percent. (It is remarkable that about the same percentage was already prevalent in the 1960s.)

Such a high proportion of cash holdings is not justified either by the state of development of Hungary's banking institutions or by the people's saving consciousness. What does make it justified is the chronic although alternating shortages on the consumer's market of industrial good. This is why one always has to have cash near at hand. Fluctuations in the amount of cash held at home are mostly tied to the population's price and supply expectations, and keeping liquid cash at hand enables quick action. During the period between 1975–84 the proportion of such savings was particularly high in 1979 (34.3 percent), in 1980 (42.3 percent) and again in 1981 (33.6 percent). The consumer price index reached, for the first time since 1968, 110 percent and in preparation for further price rises, people pilled up more cash than before. The impact of price expectations on cash reserves can be seen in other years as well. Such was the case in 1967, when it soared to 42.9 percent from 26.9 percent in the previous year—but this was also caused by the anticipation of the introduction of a new system of economic control and management.

In the three "years of peace" preceding the 1979–81 period, with its high cash reserves, the share of cash savings was around 25 percent. The sixth five-year plan promised a moderate annual 5 percent increase of consumer prices and in the first year of the plan (1981) this was in fact accomplished. The proportion of cash savings fell to the level registered in the second half of the 1970s but this did not occur earlier than 1982. From 1983 onward this proportion was rising again and reached 32.1 percent by 1984. This was in all probability caused by the fact that, owing to the rapidly growing "second" and "third" (illegal) economies, the regrouping of money among the population was getting more intensive.

Thus, it can be said that in years expected to be critical for prices and the supply of commodities, people are prone to keep more of what they accumulate in cash form, even if this involves obvious financial losses. This calls attention to at least two things. Firstly, that the *liquidity of the form of savings is of particular importance* owing to the many shortages in supply, and it is much more demanded here than in a demand-constrained economy. On the other hand, the criteria of the population's "portfolio-analysis" are unlike those in a capitalist market economy. The gains of a higher grade of liquidity are not compared with the lower proceeds of the liquid form of savings or with the loss in the amount accumulated, but with the extra income that may result from the stock-piling from before the price increase and/or with the pleasure of acquiring goods. Consequently, the population's cash reserves may be reduced by improving banking techniques as well as by expanding possibilities to mobilize savings and by mitigating the intensity of shortage and shortage psychosis, resp.

Changes in liquid savings other than cash could not be traced from available OTP reports. Such are deposits with a 2 percent interest rate p.a. or none, and remittance accounts. Their breakdown was included in the 1984 status report only and it showed that 30 percent of the annual stock of deposits was payable at sight.

The *propensity to save* means in principle the amount the owner is ready to save in monetary form from his cash income earned in the given period of time. Should we strictly insist on the contents of this concept and could it be traced, then the ratio of savings to income would certainly be even lower. Assuming the average rate of interest, since 1979 this has not been enough even to preserve the real value of money tied up at banking institutions. Under such conditions, it would be more honest to speak of results of saving instead of propensity to save and of the share of incomes allotted for savings, i.e. it would be better to create a category without value judgement.

The propensity to save is measured with the ratio of the given year's increment of OTP deposits to cash incomes. The index will be more telling if total cash savings are compared to disposable cash incomes. Disposable cash incomes include, in addition to cash incomes, credit-drawing surplus and other non-income revenues (source of expenditures for a fixed purpose). It is open to question if this is a suitable base of comparison, for its surplus over incomes contains wherewithals from which hardly if any savings can be put aside. It is therefore more reasonable to compare savings with cash incomes. The resulting figure will show the volume of resources available for regrouping created from the outflow of incomes at a given time.

Comparing the figures of quasi-voluntary savings to annual cash incomes, it will approximately indicate how much from every 100 Forint the population is likely to voluntarily place with banking institutions.

Table 2 shows changes in "saving propensity" in the period under survey.

It indicates that Hungary's *population puts aside 5 to 6 from every 100 Ft of cash income* (or Ft 7.50 at the highest), thus putting it according to Iván *Illés* [1], among the average or less sparing European nations. (To tell the truth, he interprets housing accumulation, too, as a kind of saving; without this the picture is even more gloomy.) *Quasi-voluntary savings* deposited *represent about half of this,* which most probably puts Hungary very low on the list. This low result of savings can no doubt be explained with factors other than those applicable to Sweden. The high level of social security in Sweden does not require a high proportion of savings, as, for instance, is the case with Italy. However, in Hungary incomes which are not even enough to cover the reproduction costs of labour do not allow a significantly higher proportion of savings, not to mention the lack of attractive forms of savings which would be needed because of the depreciation of accumulated money.

Table 2

Propensity to save in Hungary between 1975 and 1984

Year	Cash savings / Cash income	Previous year = 100 percent	Quasi-voluntary savings / Cash income	Previous year = 100 percent
1975	6.2	–	3.7	—
1976	5.8	93.5	3.8	102.7
1977	6.8	117.2	3.3	86.8
1978	7.5	153.1	3.5	106.1
1979	4.9	65.3	2.3	65.7
1980	4.5	91.8	3.0	130.4
1981	5.6	124.4	3.2	106.7
1982	4.9	87.5	3.2	100.0
1983	6.5	132.7	2.8	87.5
1984	6.5	100.0	2.5	89.3

Source: A lakosság jövedelme és fogyasztása 1960–1983 (The population's income and consumption 1960–1983). Központi Statisztikai Hivatal, Budapest 1984. *Statisztikai Évkönyv 1984* (Statistical yearbook 1984). Központi Statisztikai Hivatal, Budapest 1985. OTP reports.

The tendencies shown in *Table 2* indicate a synchronous state in all but three years (and in the "critical" ones at that) and this evidences the striking power of changes in savings over the period under survey. 1978 was one of those years when, as a result of rising incomes (in spite of a deteriorating economic situation) savings showed a rapid upsurge. It is remarkable that in that year quasi-voluntary savings were not as spectacular as those computed for full cash savings. The propensity to save dramatically weakened in 1979—evidently owing to a drastic price increase which also affected staples in mid-1979—and this was followed in 1980 by a hoarding spree among the population. The extent by which the OTP was taken surprise was proved by their 1979 annual report, stating that the increment of deposits in that year fell 34 percent behind the plan.

The low rate of savings also continued in 1980, although it showed some improvement if computed on the basis of quasi-voluntary savings. This was exclusively due to the fact that, as against a steady growth in the years before, now money on car purchase accounts suddenly fell by about Ft 3 billion.

1981 shows an improvement, as already mentioned, in all probability because of the decline, by about a half, of the inflation rate in the previous two years. A reading of *Table 2* from that year onwards deserves special attention. *The rate of total savings indicates an improvement from 1982*. Moreover, it appears to have remained steady throughout 1983 and 1984 to an extent unprecedented (except for 1978) in the Hungarian economy. On the other hand, *if computed on the basis of quasi-voluntary savings, the rate declined* and by 1984 it was nearing the trough of 1979. Thus the gap between the full ration of savings and voluntary ones has been widening in the later years, which may lead to the conclusion that people do have money to save but they increasingly tend to keep it in cash. Yet, it might also indicate that the growing propensity to save is getting less and less voluntary.

In the following we will seek reasonable answers to the cause/causes of the year-by-year increase of private savings deposits.

In principle, savings deposited at the OTP should have decreased in the years of the slow-down of economic growth, i.e. *between 1979–1984,** for the following reasons:

— Domestic market supply narrowed down because of the external debt service liability. (Shortages in the supply add to current reserves.)

— The increase of consumer prices had a sizeable impact on goods and services with rigid demand and along with its established pace, real wages were falling.

— The average rate of interest of 4 to 5 percent was not able to valorize deposits; saving cash was tantamount to real losses.

— Prices of homes were soaring and became unrealistically high, so that to save for a home was just about hopeless and this lessened the pulling power of savings.

— It happened just then that legal rules gave way to the emergence of small enterprises and operation under contract—that is, to investing private money for purposes other than home building and/or purchase. This implied a certain regrouping of a part of the money accumulated so far into the new small enterprises.

— More auctions were held to tie up the discretionary share of incomes, and prices of foreign trips were substantially raised (in addition to several revaluations of the US dollar) and such trips were organized to places outside Europe as well.

The above-mentioned factors resulted in an "attack" against OTP deposits, so much so that according to textbook rules it was safe to expect a reduction in their stock. Yet in the rather critical years between 1979–84 deposits behaved, surprisingly, as *Table 3* shows they did. (As background information it was thought useful to include the consumer price index as well as the indices of the per capita real income.)

It appears from *Table 3* that, with virtually stagnating real incomes, the growth rate of the stock of deposits failed to keep pace with the increase of consumer prices only in the years 1979 and 1980; otherwise it exceeded the latter. Comparing it with growth rates registered between 1974–78, it was found that *in 1979–80 it was only the pace that slowed down.* Looking into the cause behind the symptom may bring us closer to finding an answer to the question of the likely tendencies of private savings in the rest of the decade.

When setting out to search for the causes, I first examined the available data *globally*. Accepting the statement that savings from incomes not turned into capital are accumulated on the basis of the remainder principle, I set up the following four hypotheses:

* In a capitalist economy, at times of depression, savings tend to rise, because a part of "m_c" and "m_v" (in the Marxian sense) are, because of poor business prospects, not reinvested. It is obvious that, under Hungary's circumstances, this phenomenon could not be considered in the period under survey.

Table 3

Consumer's prices, incomes and deposits in Hungary between 1979 and 1984

Year	Consumer price index*	Per capita real income*	OTP deposits*	Quasi-voluntary savings*	Increment of the stock of OTP deposits in million Forints
1979	108.9	99.4	108.7	107.4	10 919
1980	109.1	100.4	106.9	109.8	9 469
1981	104.6	103.4	110.2	110.0	14 809
1982	106.9	100.6	109.8	109.8	15 655
1983	107.3	100.8	112.2	108.7	21 407
1984	108.3	100.7	111.3	107.8	22 348

* previous year = 100 percent

Source: Statistical yearbooks, Central Statistical Office, Budapest
OTP reports

1) The population's cash incomes earned in the first economy were higher than those reported by the CSO.*

2) The consumer price index was actually lower than the one officially computed and this resulted in a bigger increment of real incomes.

3) The population maintained its consumption level by increasingly drawing on its own production and own funds, by illegally importing goods from abroad and through the physical "appropriation" of social property.

4) The population financed the rising costs of living (supplemented its shrinking real income) by using up its current savings (or part of it).

For the purposes of the first hypothesis cash incomes illegally appropriated from the first economy plus incomes allotted by companies to employees illegally can be taken into account. As for its magnitude, there are no known, or even estimated, figures available. By counting down I arrived at the assumption that between 1979 and 1984 there must have been a yearly 24 to 25 billion Forints of extra income trickling down from the first economy to the population and this might have been the basis of the annual 10 percent growth of OTP deposits over the period.** The resulting sum seems, however, too big to be a satisfactory explanation in itself. It would imply that in the six years between 1979 and 1984 the population misappropriated a further 140 to 150 billion Forints from the national income it produced. (In the 1980s this would have been equal to the net accumulation of one year's national income.)

* Abbreviation for Hungarian Central Statistical Office.

** For my calculations I set out from the tendencies of 1968–1978 and assumed they would prevail. I established the annual growth of savings belonging to 1 percent growth of real incomes and taking everything else as unchanged, computed the surplus of nominal income the actual rise of savings would have caused. The starting point of my calculations may not have been adequately well-established. Nevertheless, it was sufficient to estimate the magnitude (that is, if it is in the hundred thousands, millions or billions) of the nominal extra income pertaining to the first hypothesis.

Although this hypothesis cannot be fully dismissed, it is certain that illegal and semi-illegal incomes from the first economy did not play an exclusive, or even decisive role in the increase of OTP deposits between 1979–84.

The second hypothesis was totally refuted by a survey done by the author herself in 1982–83. The survey proved that the published consumer price index only expressed a part of the increase of expenditures by the population. [2] In this light the increase of cash savings in the period under survey seems all the more conspicuous.

The third hypothesis might have mentioned that, in theory, the increase of social allocations (benefits) in kind also contributed to having preserved the level of consumption. (Their share within the population's total consumption rose by about 1 percent in the period under survey, as against that of the previous years.) Thiskind of consumption is, however, in no substituting relationship with the items of purchased consumption. Therefore, it would be difficult to accept that the population was able to increase its savings in the 1980s by adding to the proportion of social allocations in kind within its consumption—over and above the fact that this is the sort of consumption the population has the least influence on.

While the increased supplementing of consumption from abroad (private import) and that of (physical) offences against social property cannot be excluded, they cannot play as big a role in the trio of income (consumption) savings that would satisfactorily explain the increase of cash savings.

The fourth hypothesis assumes that the population used up its current reserves to cover rising costs of living in the period under survey and some of these scarce resources went into OTP deposits. Yet, instead of dropping, the ratio of cash reserves formed as current savings grew in the critical years between 1979 and 1981.

From the global approach to the relationships among cash income (consumption) savings it can be eventually concluded that even if some assumptions stand their ground, none of the hypotheses offers a plausible explanation for the question concerning the cause of the unexpected increase of OTP deposits. Consequently, a different approach is needed, one that takes the population not globally but *differentiates it by groups or strata*. On this basis, and as will be proved later on, it can be seen that *personal incomes have become largely differentiated since 1979*. As a result, Hungarian society more and more resembles a sand-glass, indicating that while certain strata are getting poorer, there is a growing number of people with big incomes. It is the latter who cause the growth of savings, while some middle layers, formerly capable of accumulating money, have now become unable to do so. This phenomenon is not immediately obvious from the public statistical data—but there are facts that confirm this hypothesis.

1) From *the number of depositor's books and from the sums they contain* the following tendencies can be observed:

— As against 1975, *the ratio of the so-called small deposits has become significantly reduced*. This remains true even if for 1975 savings under Ft 5 000, and for 1984 those under Ft 25 000 are considered as small deposits. (There was, of course, no

Table 4

The growth rate of the stock of deposits between 1974–78

Year	Stock of OTP deposits*	Quasi-voluntary savings*
1974	14.2	14.2
1975	14.8	13.9
1976	14.3	10.2
1977	15.8	13.6
1978	16.1	11.3

* previous year = 100 percent
Source: OTP reports

such drastic deterioration in the value of the currency.) The absolute number of depositor's books with less than Ft 5 000 is also on the decline.

— *A growing proportion of all deposits is concentrated in savings of over Ft 100 000:* their share grew from 20 percent in 1975 to 40.6 percent by 1984.

— *The bigger the deposit, the higher the growth of rate of the sums deposited.* Savings under Ft 5 000 each fell 4 percent from 1975 to 1984 but those with Ft 50 000 to 100 000 doubled, those from 100 to 500 thousand more than quadrupled and the sum of those with savings of Ft 500 000 and more rose as many as twelve times.

Changes in the proportions of depositor's books with small and big amounts are shown in *Table 5*.

Figures in that table are only an indication of the tendency of deposit concentration because the evaluation of data had to take certain distorting facts into account. Distortions were caused partly by the rules of the game of deposit

Table 5

Breakdown of deposits according to sums

Deposit in Ft	Percentage of such deposits		Change in proportions 1984/1975 percent
	1975	1984	
1– 4 999	4.0	1.4	35.0
5 000– 10 000	15.0	10.0	66.7
10 001– 25 000	17.0	11.0	64.7
25 001– 50 000	21.0	16.0	76.2
50 001–100 000	23.0	21.0	91.3
100 001–500 000	19.0	36.0	189.4
over 500 000	1.0	4.6	460.0

Source: OTP reports

constructions and partly by the fact* that many people with large deposits keep their savings in more than one book in order to keep their riches secret. If, however, the extent of distortion did not change significantly over the period under survey, then the strengthening of deposit concentration can be read from *Table 5,* too. It may also be concluded that small depositors used up their savings (or part of them) to supplement their relatively stagnating income and/or that deposits under Ft 5 000 were opened less frequently. At the same time, *a significant change* can be observed *with savings over Ft 100 000:* their number soared from 91 thousand in 1975 to 377 thousand by 1984.

There are two inseparable phenomena behind the growing concentration. One is the amount of money piling up as a result of inflation and the other is signalling the emergence of a wealthier group of people.

2) *It is remarkable that the per capita average deposit is twice as big in Budapest as in the countryside* and the gap has only widened since 1975. In the period under survey the growth rate of average deposits in the capital exceeded that in the countryside by nearly 20 percent. The difference can nowadays hardly be explained with traditions and/or with the insufficient development of the savings-bank network outside the capital. The per capita average deposit of Ft 35 074 in Budapest and of Ft 16 702 in the country (1984 figures) also express differences of incomes in the capital and the provinces. These figures imply not only that incomes from the first economy are higher in Budapest than in the countryside but also the chances to make extra money are the bigger in the capital. (For instance, prices of building sites, tips and "conscience money" are the highest here and craftsmen's tariffs, too, are about twice as high as in the provinces.)

3) Growing incomes from the second and third economies in the 1980s created a new structure of incomes not traceable from official statistics. As against the more or less evenly distributed incomes from the first economy, *extra incomes,* concerning 70 to 75 percent of all families [3] *are distributed highly disproportionately*. Such incomes tend to concentrate among those engaged in small-scale agrarian production, handicrafts, retail trade and certain free-lancers. The strengthening of income concentration, mostly due to a regrouping of incomes among the population,** has its origins in the growing number of those making extra incomes in the faster increase of prices and tariffs in the second and third economies.***

* The following may distort the picture:
- car lottery saving-books can be opened in amounts of Ft 5 000 and Ft 10 000 only;
- the upper limit of money prizes is Ft 50 000, therefore it is not reasonable to keep more in one single book;
- savings certificates, too, are restricted to sums of 5, 10, 20 and 50 thousand Forints (they are issued in these denominations). They bear interest, depending on the time they are running, up to 9 percent p.a.

** The growth of redistribution among the population can, to some extent, be seen from data published by the CSO. According to money circulation balances of the population money circulation among the population accounted for 8.7 percent of total incomes/expenditures in 1983, against 7.1 percent back in 1975.

*** I proved this in detail in my studies [2, 4].

Referring to foreign experiences, Tamás *Bácskai* mentions that the so-called "non-constant incomes" precipitate in 4 to 5-year cycles as savings. [5] A domestic survey conducted by Péter Galasi in 1983 showed that "...the volume of savings deposits by groups with a higher amount of extra earnings exceeds that of groups with less extra earnings, ... the size of deposits is the least related to the size of wages (rank correlation coefficient: 0.27); it is somewhat more influenced by the income of the households (0.65) but is most strongly related to the extra income (0.90). Similarly, it can be observed that the saving propensity of households with more extra income is also higher: they regularly save bigger sums in comparison to the income they have. From all these it can be concluded that extra incomes are used by the households first of all for laying the foundations of future investments, and they are less important for the family's current spending of income and for the level of actual supply. [6]

All these may lead us to believe that *the basis of "deviant" saving attitudes between 1979 and 1984 were provided by officially unregistrable incomes,* resulting in such differences between incomes that while certain strata were left without any income to lay aside, others realized a growing discretionary share of income.

Looking into the personal savings attitudes displayed between 1975 and 1984, available figures allow us the following conclusions:

1) Among the causes of a characteristically low saving propensity is the weak, and with the negative rates of interest, increasingly *weakening, interest in saving.* There is no denial of the statement that the population does not save for the sake of interest, yet it must be added that the extent to which the value of the currency is preserved (or even lost) does matter. Observations prompt me to risk the hypothesis that a positive real rate of interest does not stimulate saving as much as a negative one retards it. The interest rates could encourage the propensity to save as measured through deposits.

The much lower propensity to save registered in the 1950s and 1960s was mainly caused by the then depressed living standards. But, along with the improvement of living standards, the discretionary share of income (a potential source of savings) is growing and rising consumption levels, too, move towards increased savings. Yet a discouragement of savings leaves much less chance for potentionally accumulative incomes to be turned into actual savings than would positive encouragement. Right now, less stimulating factors, and much weaker ones for that matter, can be cited than even a decade ago, because 1) interest rates, being negative in real terms, have completely lost the message that it is worth saving, if only for getting an income; 2) the range of goods and service to be had on credit has become much wider.

At the current level of welfare, *provided there was a suitable stimulation, the propensity to save would* in all probability *be palpably higher* than it is now.

2) Because of negative real interest rates, a growing share of savings will be a forced one. Forced savings indirectly show also that there is money available for saving. The forced nature of many a saving is indicated by the slackening growth computed on the basis of quasi-voluntary savings as against a rise of total cash savings.

If savings are "motivated" by force, then it is safe to assume that money accumulation is smaller than it would be if people were interested in saving.

3) The preference for liquid savings is so strong that the population rather swallows losses in terms of value. Consequently, forms of saving with a high liquidity and promising an extra income are very much in demand (see, for instance, bonds) and if adequate opportunities were provided, they could be even more popular. Savings constructions allowing quick mobilization reduce the population's safety reserves.

4) In the 1980—in the wake of the emergence of the second and third economies—substantial changes have taken place in the proportion of incomes and property among the population, and *the relevant conclusions must be drawn* with regard to the scope of application of various forms of savings. At present, people with largely different incomes and financial situations are living in Hungary (and the differences are likely to grow). They have different possibilities to accumulate money and their motives, too, are widely different. One part of the population has reached living standards such that it could be more than a simple consumer, i.e., it has the necessary extra income to turn it into capital and would very much like to do so. At the same time, this is just the stratum that is most irritated by the erosion of its capital deposited with the OTP. Ideas have already emerged about devising possible ways to spend large incomes but not about providing ways to accumulate and invest them.

Among the motives of savings nowadays there is already a wish to make extra incomes, but existing forms of savings are hardly up to this requirement. Therefore, different saving attitudes resulting *from different property/income status call for new forms of cash savings*. It is not that more deposit constructions should be created to widen the options of forced savings, but there should be methods of accumulation for monetary claims adapted to the terms of enterprising groups. This would mean widening the field of application of a growing range of securities. Such stop-gap securities may give a new sense to money accumulation through motivating income expectations.

Economic necessity and the possibility of privately-owned securities

A wider spreading of securities would not only help express a certain specific interest of those saving but, from the side of capital users, it would also be in line with the interest of the national economy. In a global way, the seventh five-year national economic plan (1986–1990) does consider drawing private resources into the sphere of production as one of the ways to ease the shortage of capital. Yet private money collected through securities may generally help reduce the shortage of capital to be spent on development projects *if they result in extra savings* by improving the propensity to save.

This is a rather realistic expectation.

— The current low level of the propensity to save is to no small extent due to the lack of attractive forms of savings. Providing for such forms would curb wasteful consumption and the depressing drive to use up everything as soon as possible.

— It would rekindle the enterprising spirit of the population, i.e. things that are for the time being restricted both in the field of acquiring immovables or setting up private ventures (in small-scale industry and trade). Not everyone with the necessary means would join the real estate trade or any other productive or commercial venture, but could successfully participate in securities transactions involving much less work, trouble and capital. The income securities promise would also make small savings attractive again.

— With the necessary establishment of the market of securities, the population's high liquidity requirement towards savings would be satisfied in such a way that the users of money could count on resources in the long run. *The amount of cash savings that might flow into securities is fairly impressive*. As from December 31, 1984 cash enough for 71 days' expenditure was in the hands of the population. Even if we reckon with a requirement of 40 days, the amount of cash that might have been converted into securities at that time may be estimated at Ft 40 billion. Similarly, by granting a cash reserve enough for 40 days, twice as much could be "released" if, besides cash, sight deposits are also considered. (As of December 31, 1984 the stock of remittance accounts and those bearing 0 to 2 percent interest was Ft 39.4 billion.)

Many fear that a spreading of securities might endanger OTP deposits and credits. If we consider the liquidity reserves of the OTP as the difference between deposits and credits, this developed as follows: in 1975 on every one Forint of reserves there fell Ft 2.78 of deposits; by 1984 this almost doubled by rising to Ft 5.48; *thus liquidity reserves nearly halved in 10 years* (from 0.36 down to 0.18). This happened in a period when the amount of money flowing from OTP deposits into securities was still negligible. If the OTP had, in 1984, insisted on the liquidity coverage it used to have in 1975, it could have placed only 64 percent of the stock of deposits as against the 82 percent it actually did. This would have implied Ft 39 billion less OTP credits by the end of 1984 than it had actually been. Measured against 1975, this Ft 39 billion was a "risky" sum. Nevertheless it did not mean a real liquidity risk for the OTP. With these thoughts I only want to point out that with a state-owned banking institution operating in a relaxed economic and political atmosphere the growth of credits and deposits need not necessarily be identical.

Provided that with the introduction of securities, the volume of which is controllable anyway, the growth rate of OTP deposits would slow down slightly, this still would not endanger the liquidity of the OTP even with an unchanged pace of granting credits. Alternatively, the OTP itself may control the development of its deposit/credit ratio through its presence on the market of securities.

As regards the concerns about the assumed impact of securities on OTP deposits, they are only acceptable with the *now prevailing conditions of returns on saving*. In this respect the information to be derived from the growth in savings certificates and in the bonds issued for the public since 1982, or the growing demand for the latter are essentially desinformative. The savings certificate is not a qualitatively new kind of deposit, it could not aim at increasing the volume of savings. With its introduction the composition by liquidity of OTP deposits has changed—through a regrouping within the stock of deposits.

Even the bond issued at per value with government guaranty only differs from the deposit constructions hitherto used in respect of interest. It does not express the risk of enterprise and thus it started with unfair conditions of competition against OTP deposits.The government guaranty is, under our conditions, the price of rehabilitating bonds as a form of security and, obviously, it cannot be maintained in its present form. Nor can the non-uniform system of interest rates in which the making of personal resources into sources of capital for firms means an unjustified advantage.

The securities mutually expressing the interests of savers and of those investing capital and the other modes of saving have to be *combined in such a uniform system* in which the promised or undertaken *return is in proportion to the risk involved by the saving construction in question*. With such conditions there is no reason to fear that securities will endanger the sources of OTP deposits. Let alone that credits can be made available to the public not only from OTP deposits.

This study has so far taken for granted that by spreading securities-constructions additional savings may be achieved. However, securities also offer more advantages than this, *on the side of capital investment*.

Capital acquired through issuing securities cannot be assigned to the so-called extensive possibilities of acquiring resources. On the one hand, it provides a bigger scope for intensifying the income-creating ability of production, and on the other, it imposes tougher terms on the enforcement of this requirement than do development funds allocated centrally or through state-owned banks. Companies can, for instance, permanently reckon with capital acquired through share issues: their rate of credit would not be weakened (*ceteris paribus* it would even improve) and enterprising activity could be expanded. It is evident that only companies with a well-established and sound reputation will be able to get hold of extra resources offered by private persons. Creating and maintaining "goodwill" is a relevant motivation in this respect, too. It is safe to assume that this may enhance the moral and financial responsibility companies feeling for a profitable investment of private money. A private person is notably someone who advances capital but cannot be forced to re-schedule debts or to renounce interest on the debt itself. *Tough terms set for acquiring money exert an internal disciplinary influence on the management.*

Savings by private persons enter the bloodstream of the economy at certain points and through mediating interests such that the company guarantees of the realization of income invested are probably stronger than the assumptions and promises of a re-distribution *via* the central budget are.

Interest realized through money investment not only brings the ownership's interest closer to the object of property but also creates several poles for this interest inasmuch as the owner of securities becomes, for example, interested in the successful operation of the capital and not only as an employee. The various possibilities to accumulate and selection of those possibilities calls for the supply of more economic information to the population, and for relevant education, which will facilitate as well as necessitate the strengthening of the social nature of property.

Weighing up the afore mentioned advantageous effects of securities, it seems that their introduction would be desirable even if they did not result in extra savings. The *importance* of applying forms of private savings of an enterprising nature *has actually gone beyond the volume of the flowing capital,* since this is hidden in the value of *qualitatively novel relationships* borne by it.

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ИЗМЕНЕНИЕ РОЛИ СБЕРЕЖЕНИЙ НАСЕЛЕНИЯ

М. ПЕТШНИГ

Обеспечение внутренних ресурсов развития венгерской экономики делает необходимым и стимулирование добровольных сбережений населений. Часть сбережений вызывается необходимостью и — если подходить в международном масштабе — готовность делать сбережения низка. Хотя зрения реальных доходов годы суммы вкладов в сберегательные кассы не снизились. В 1979—82 г. зрения реальных доходов годы суммы вкладов в сберегательные кассы не снизились. В 1979/82 г. снизились лишь темпы роста сбережений. Однако с 1983 г. годовой рост вкладов вновь превысил 10%, как и в благоприятные с точки зрения реальных доходов 1960-е годы, нотя реальные доходы на душу населения не возрастают и средние процентные ставки по вкладам не обеспечивает валоризации вкладов. В то же время часть денег населения была перегруппирована в новые мелкие предпринимательства и возросло число аукционов, предназначенных для вложения определенной доли доходов, стали дороже заграничные путешествия, а в следствие быстрого повышения цен жилья сократилась притягательная сила накоплений с целью покупки жилья. Несмотря на все это прирост денежных сбережений достигался за счет работы сверх 8-часового рабочего дня и побочных доходов. Различия в доходах ощущались и в усилении концентрации вкладов. По-видимому,

процесс дифференциации будет продолжаться, что ставит проблему целесообразного общественного использования т. н. свободной доли доходов вместо бесполезного расточительства. Наиболее подходящим способом этого было бы накопление денег в ценных бумагах, что, с одной стороны, удовлетворило бы характерной для условий дефицитной экономики потребности населения в достаточно высокой степени ликвидности сбережений, а с другой стороны, благодаря высоким доходам способствовало бы повышению желания делать сбережения. Из дифференциации имущественного и доходного положения населения вытекают и дифференцированные потребности в помещении сбережений, а служащие их удовлетворению конструкции с использованием ценных бумаг — как можно предположить — привели бы к образованию дополиительных накоплений. Однако значение применения методов денежных сбережений населения предпринимательского типа, состоящие в выпуске ценных бумаг, заключается не только в оживлении перетока капитала, но и в том, что он вольется в кровообращение народного хозяйства там и посредством такой заинтересованности, где гарантии в повышении стоимости вложенных средств предприятиями будут сильнее, чем в случае перераспределения средств через государственный бюджет. Ведь с помощью ценных бумаг деньги получены на более твердых условиях и поэтому они оказывают дисциплинирующее воздействие. Предпринимательская заинтересованность населения, которой можно достичь с помощью ценных бумаг, приблизит к формированию заинтересованности в собственности в той степени, в какой владелец ценных бумаг заинтересован в результативном функционировании капитала не только в рамках отношений занятости.

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MARX ON THE RATE OF PROFIT, THE RATE OF PROFIT OF ENTERPRISE AND THE RATE OF INTEREST

T. P. LIANOS

The author proves that, with a certain condition, if the rate of entrepreneurial profit is zero, the rate of interest exceeds the rate of profit. That is, it is not necessarily true that the rate of profit is the upper limit to the rate of interest. He also examines the development of the rate of profit, the rate of entrepreneurial profit and the rate of interest in the course of the business cycle.

One area of importance in modern Marxist literature is that of monetary economics and, in particular, the determination of the rate of interest and its role in the phases of the business cycle. This is a relatively unexplored area, although *Marx* devoted the largest part in the third volume of *Capital* to monetary phenomena. Part of the difficulty in dealing with these problems is the state in which Marx left the notes from which *Engels* constructed the third volume.

It is well-known from Engels' preface to this volume that Marx left "no finished draft, not even a scheme whose outlines may have been filled out, but only the beginning of an elaboration—often just a disorderly mass of notes, comments and extracts" [1].

It is interesting to note that Engels thought that part 5 of the third volume, which deals with interest and money capital, was "the most complicated subject in the entire volume".

The Marxist literature on this subject contains a number of studies that provide a systematic and illuminating exposition on Marx's ideas on monetary issues and also form the basis for modern developments in the area of Marxist monetary theory. In this regard, one should mention the early studies by *Hilferding, Alexander* and *Fan-Hung* [2, 3, 4], and the recent studies by *Fine, Harris, Mátyás, Panico* and *Weeks* [5, 6, 7, 8, 9, 10], among others.

One aspect of Marx's ideas on the rate of interest is its relationship with the rate of profit and the rate of profit of enterprise. This relationship is unexplored and the purpose of this paper is to provide an attempt to formalize the relationship between these three variables.

The analysis of this relationship may start from the following statement. "The profit of every capital, and consequently also the average profit established by the equalization of capitals, splits or is separated, into two qualitatively different, mutually independent and separately individualised parts, to wit—interest and profit of enterprise—both of which are determined by separate laws. The capitalist operating on his own capital, like the one operating on borrowed capital, divides the gross profit *into interest* due to himself as owner, as his own lender, and *into profit* of enterprise due to him as to an active capitalist performing his function." [11]

This passage established that, independently of the identity of the recipients, for the economy as a whole (and also for every individual capital) we can write that

$$R = P + In \tag{1}$$

which is simply an identity where R = profit, P = profit of enterprise and In = interest. From this identity follows Marx's earlier statement (in the original text) that "... one might consider as the maximum limit of interest the total profit..." [12]

Clearly, when the profit of enterprise is zero, interest is equal to profit. From the above identity it is also clear that the maximum limit of P is R when In = 0. However, Marx says that "the minimum limit of interest is altogether indeterminable. It may fall to any low. Yet, in that case there will always be counteracting influences to raise it again above this relative minimum." [13]

Interest is the product of an amount of money capital and the rate of interest, and since borrowed money capital cannot be zero as long as we retain the division of the capitalist class into money-capitalists and industrial capitalists, one may argue that when Marx speaks of the minimum limit of interest, he has in mind the rate of interest.*

The identity (1) can easily be transformed from a relationship between absolute magnitudes to one between rates. The constant and variable capital expressed in monetary terms is $C+V$. It is this magnitude that generates the total amount of profit R. Dividing both sides of identity (1) by $C+V$ gives

$$\frac{R}{C+V} = \frac{P}{C+V} + \frac{In}{C+V} \tag{2}$$

where now the rate of profit is $\varrho = \frac{R}{C+V}$. The production process is partly financed by industrial-capitalists themselves and partly by money-capitalists. The amount of money-capital lent and borrowed is M. Thus, industrial-capitalists finance $C+V-M$ of total money-capital and the remaining M is obtained from the money-capitalists through the money-capital market. Equation (2) can now be expressed as

$$\frac{R}{C+V} = \frac{P}{C+V} \cdot \frac{C+V-M}{C+V-M} + \frac{In}{C+V} \cdot \frac{M}{M} \tag{4}$$

Now the rate of profit is $\varrho = \frac{R}{C+V}$, the rate of profit of enterprise is $r = \frac{P}{C+V-M}$ and

* Panico, [14], attributes the characteristic of being "altogether indeterminable" without reservations to the *rate of interest* rather than to interest, as Marx does.

the rate of interest is $i=\frac{In}{M}$. Thus, equation (3) is written as

$$\varrho=r\frac{C+V-M}{C+M}+i\frac{M}{C+V} \tag{4}$$

The ratio $\frac{C+V-M}{C+V}$ shows the proportion of total capital which is financed by industrial-capitalists and the ratio $\frac{M}{C+V}$ shows the proportion financed by money-capitalists. Defining $\frac{M}{C+V}=k$ and, consequently, $\frac{C+V-M}{C+V}=1-k$ equation (4) now becomes

$$\varrho=r(1-k)+ik \qquad k<1 \tag{5}$$

Assuming a constant rate of profit we can clearly see the maximum and minimum values of the rate of interest, by writing the above equations as:

$$r=\frac{\varrho}{1-k}-\frac{i\ k}{1-k} \tag{6}$$

from which it follows that the maximum value of the rate of interest is $i=\frac{\varrho}{k}$ and it occurs when $r=0$. The minimum value of the rate of interest is zero and then the rate of profit of enterprise is at the maximum which is $r=\frac{\varrho}{1-k}$. It should be noted that for a given ϱ the maximum values of i and r depend on the proportion of money-capital borrowed and lent to the total money-capital advanced to the production process. Relationship (6) above provides support to L. Harris' suggestion that Marx's statement about the limit of interest payments "... does not delimit the interest *rate* unless the amount of interest-bearing capital on loan is given". [15]

Figure 1 gives the geometric picture of equation (6) for a given level of the rate of profit. For $\varrho=\varrho_1$ equation (6) appears as a straight line with a negative slope. As ϱ increases to ϱ_2 the line shifts upward in a parallel way.

Two interesting things may be noted. First, the rate of interest can be greater than the rate of profit, since $k<1$. Second, if $i=r$ then they both are equal to ϱ. This occurs at the points of intersection with the 45° line, such as A in *Fig. 1*. Also, if $i>r$ then $i>\varrho$. This last statement can be proved by letting $r=\lambda i$ where $\lambda<1$ and working on expression (6).

These results hold for a given level of the rate of profit. However, the rate of profit is not constant. It changes with the business cycle. Suppose that the minimum and

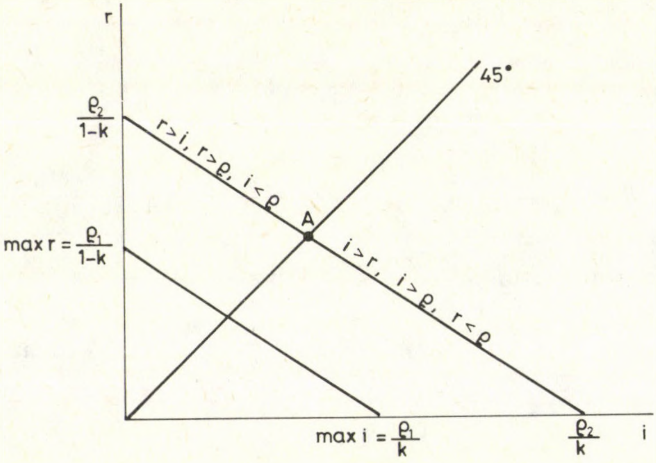

Fig. 1

maximum values of the rate of profit over the business cycle are ϱ_1 and ϱ_2, respectively. In terms of *Fig. 1* this means that the line connecting r and i is shifting upward to the right. For the sake of simplicity, it may be assumed that the ratio of the amount of money capital lent to the total money capital, i.e. the value of k, remains constant during the business cycle. In this case the shift will be parallel, as on *Fig. 2*. The rate of profit of enterprise and the rate of interest are related to the rate of profit. The change in ϱ will be accompanied by changes in r and i. Typically, the simultaneous changes of three variables over the course of the business cycle are shown on *Fig. 2*. Suppose that the rate of profit is at its minimum level ϱ_1 and at this level the rate of profit of enterprise is equal to the rate of interest. The relevant point on *Fig. 2* is A. Now, the rate

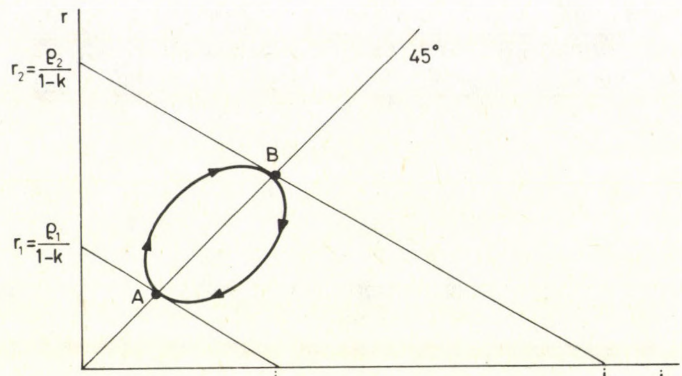

Fig. 2

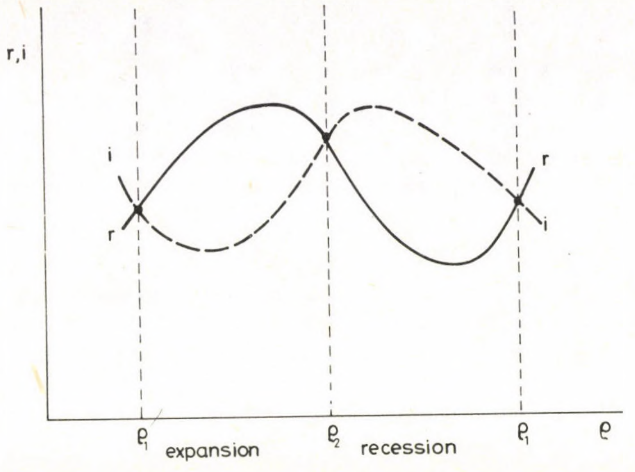

Fig. 3

of profit increases as the economic recovery takes place and the r_1i_1 line shifts in a parallel way. The simultaneous changes of r and i are shown by the circle and follow the direction of the arrows. The rate of profit of enterprise increases while the rate of interest falls slightly. Later on, both increase (at different rates) until r reaches its maximum. At point B the rate of profit is at its highest level, the rate of profit of enterprise continues to fall and the interest rate continues to increase. At B the economy enters the phase of recession and the line r_2i_2 shifts to the left. For a while the interest rate continues to increase and, at the same time, the rate of profit of enterprise declines drastically. After a point both r and i decline until i reaches its minimum point, and so on.

The relationship between r and i, as the rate of profit is changing, is shown more *clearly in Fig 3*. During the period of expansion the rate of profit of enterprise is generally higher than the rate of interest, and *vice versa* for the period of recession. Also, the rate of interest reaches its minimum before the rate of profit of enterprise reaches its maximum and, correspondingly, the former reaches its maximum before the latter reaches its minimum. Of course, the relationships of *Fig. 3* are derived from the exact position of the cyclical shape of *Fig. 2* that shows the combined movement of r and i. The exact relationship between r, i and ϱ cannot be decided *a priori*, without the evidence of statistical data and analysis. On theoretical grounds, one would expect the relationship between the rate of profit of enterprise and the interest rate to follow, in general, the pattern indicated in *Fig. 1* and *Fig. 2*. This is a hypothesis to be tested on the basis of statistical data.

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МАРКС О НОРМЕ ПРИБЫЛИ, О НОРМЕ ПРИБЫЛИ ПРЕДПРИЯТИЙ И О ПРОЦЕНТНОЙ СТАВКЕ

Т. П. ЛИАНОС

Автор доказывает, что при определенных условиях, если прибыль предпринимателя равняется нулю, процентная ставка превышает норму прибыли, то есть не обязательно верхним пределом процентной ставки является норма прибыли. Автор исследует также, как складывается норма прибыли, норма прибыли предпринимателей и процентная ставка в делового цикла.

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REVIEWS

CHANGES IN THE STRUCTURE OF HUNGARIAN INDUSTRIAL FOREIGN TRADE

B. BOTOS

In the middle of the seventies the economic literature and the documents concerning economic policy stressed that a new strategy was essential for the future of Hungarian economy. Yet now this strategy should interpret the participation of the country in the world economy in a wider context and in a more diversified way than it did at that earlier period. If the level of participation in the international division of labour is regarded decisive from the point of view of the Hungarian economy, this holds *a fortiori* for the industry. The share of industry in the foreign trade of the country, the rapidly accelerating technological development, the rearrangements in the international division of labour and several other factors confirm that an inward turn cannot be the direction to be followed by industry. Thus it is unambiguously right that in the eighties the requirements for "adjustment to international changes and improvement of the efficiency of participation in the international industrial division of labour have to stand in the centre of strategy of industrial development". ([4], p. 253.) Regarding the characteristics and possibilities of adjustment of the Hungarian industry to external conditions, our survey* forming the basis of this study proved that the lag in the structural modernization of Hungarian industry is a grave burden from the point of view of adaptation to the world economy.

Vulnerable points in the structure of the Hungarian foreign trade

One of the key issues of economic policy in the 6th Five-Year plan-period (terminated in 1985) was the restoration and maintenance of the foreign trade equilibrium. For this reason the contribution to equilibrium was given priority in judging the different branches of the economy. Considering the end result, Hungarian industry seems to have met this requirement because the balance of foreign trade in manufactures has gradually improved during recent years. However, it becomes clear from a more detailed analysis that the improvement is due not only to the results of industry but to the slower growth of the import of manufactures than that of exports.

* Lili *Berkó*, Márta *Kiefer*, Éva *Nádor* and Imre *Németh* took part in this survey of the Research Institute of Industrial Economics of the Hungarian Academy of Sciences, under the direction of the author. The most important results of the work are included in the study [2].

(In any case it is true that imports of manufactures for convertible currencies increased by 19 percent, exports by 38 percent, while the terms of trade improved by about 4 percentage points.)

"Adjustment" tendencies, which cannot be regarded as favourable in the long term, were, of course, not unique to the Hungarian economy. There were signs (gradually becoming stronger from the second half of the seventies and the eighties) which indicated that the positions of socialist countries in the international trade of industrial products weakened in spite of the fact that their share in world production of manufactures continued to increase.

The share of the socialist countries in world exports declined from 13.3 percent in 1963 to 8.8 percent in 1983. The ground lost was mainly in the developed capitalist countries—both in the quantity of sales and in market shares. The export of manufactures of socialist countries into developed capitalist countries was (at current prices) $ 17.2 billion in 1980 but had decreased to $ 17 billion in 1982. The exports of developing countries increased in the same years from $ 57.7 billion to $ 65 billion. Thus the loss of ground of socialist countries was accompanied by the gaining of ground by developing countries—that is, the latter started ousting the former. It is typical that the share of the export of machines to OECD markets is much bigger in the case of newly industrialized developing countries than the share of such exports coming from the socialist countries [8].

Sharpening of structural problems in the capitalist world economy, business fluctuations, changes in the relative prices of natural resources, unfavourable changes in the international political atmosphere and (not independent from the above) different trade policy effects equally contribute to the weakening world trade position of Hungary. Nevertheless, we think that it is possible to prove (and our survey wished to contribute to that end) that our troubles are fuelled mainly by internal factors.

Analysing the structure of foreign trade in manufactures on the basis of data concerning the years 1976–1984 and according to manufacturing branches, the most important structural tensions can be summarized as follows:

1. The share of fixed capital-, energy- and raw material-intensive branches is quite big in the export for convertible currencies. In 1976, one third of exports were already coming from these basic branches (metallurgy, chemical and building materials industries) and in 1984 their share was even larger (see *Table 1*).

With the exception of light industry, there are significant differences between the shares of different branches when comparing the two markets. The structure of rouble exports is clearly more favourable: the share of the engineering industry is about 60 percent and, corresponding to that, the shares of basic branches and of the food-processing and light industries, are comparatively small.

The share of engineering in the dollar trade is less than half of that in the other markets. At the same time, the basic branches, having the largest trade in this market, have more than double share (the food industry being 2.5 times bigger) observed in rouble exports. This does not demonstrate a modern structure of exports because the

Table 1
Division of Hungarian industrial exports in 1976 and 1984 (percent)

Branches	Settled in Roubles		Settled in convertible currencies	
	1976	1984	1976	1984
Extractive industry and energetics	1	1	1	—
Basic branches[a]	15	16	34	39
Engineering industry	60	61	26	22
Light industry	14	11	19	14
Food-processing industry	10	11	20	25
Total	100	100	100	100

[a] We place among basic branches—following the international practice—metallurgy, the chemical industry and the building materials industry.

Source: Own computations, on the basis of data of the Central Statistical Office (CSO).

basic branches export mainly raw materials and low-processed products, as well as being energy-intensive. The conditions of access to the markets are extremely difficult for food exports.

It is not only the proportions that cause concern. The data also show that up to now traditional products and vehicles have been determinant among the exported engineering products, thus contradicting world tendencies. The direction and balance of trade in really up-to-date, strategic products is particularly disadvantageous from the Hungarian point of view, e.g. changes in the pattern of foreign trade involving electronic products. The import surplus of Hungarian foreign trade with developed capitalist countries approximately doubled within the examined period, while exports grew significantly to developing and socialist markets.

Table 2
Branch division of net exports of Hungarian foreign trade in industrial products in 1984 (million forints)

Branches	Settled in Roubles	Settled in convertible currencies	Total
Extractive industry and energetics	− 51 823	− 1 785	− 53 608
Basic branches	− 15 275	754	− 14 521
Engineering industry	39 110	− 13 601	25 509
Light industry	3 466	− 3 572	− 1 106
Food-processing industry	15 954	26 203	42 157

Source: Own computations, on the basis of data of the Central Statistical Office.

A comparison of export and import data also allows presentation of the net exports of branch groups (see *Table 2*). The data convincingly support the fundamentally different export structure of markets. The food processing industry reached a decisive export surplus in the non-rouble trade in 1984, the basic branches also had some surplus, while all other banches were net importers. In the rouble trade the food industry also had a positive balance but the biggest exporter in this relation was the engineering industry. The food-processing industry as a whole is, of course, also a net exporter but the surplus of the engineering industry definitely comes from the rouble trade.

2. Distinction by progressiveness of branch groups is a practice that has been applied for long in structural analyses. Because this is not a totally accurate measurement one should understand that groupings according to different criteria are to be found. We chose from these the categorization applied by the UNIDO, which contains the following grouping: raw material-based, traditional, up-to-date and progressive industries.

Raw material-based industries include the extractive branches, the food-processing industry, some branches of the chemical industry (organic and inorganic chemical industry, production of fertilizers) and the wood and paper industries. Traditional industry includes the light industries (except for the wood industry), up-to-date industry includes a significant part of engineering and the light chemical industry. Progressive industries are the electronic industries, some other branches of engineering and biotechnology.

The composition of Hungarian industrial exports is as follows:

Table 3

Division of Hungarian industrial exports according to progressiveness

Branch group	Trade settled in Roubles		Settled in convertible currencies	
	1976	1984	1976	1984
Resource-based	14	16	33	36
Traditional	40	33	46	38
Up-to-date	29	28	11	17
Progressive	17	23	10	9

Source: Own computations, on the basis of data of the Central Statistical Office,

The raw material-based and traditional products dominate the Hungarian non-rouble exports. The share of products from the light and food industries is highly significant within this latter category. Although the lack of a suitable index of efficiency means the progressiveness of exports presents a lop-sided picture, it is probable that the re-export of imported raw materials often tries to replace the missing modernization of the export structure.

Our research has also confirmed the image formed earlier according to which the structure of Hungarian industrial exports into rouble markets can be regarded as formally up-to-date, but that into dollar markets reflects a traditionally-structured industrial background. While the combined export of up-to-date and progressive branches amount to more than 50 percent of the total export against roubles, the same ratio is only 26 percent in the trade settled in dollars.

There is even a possibility to make some comparison using international data [6]. In the following we compare the composition of Hungarian exports against dollars and roubles according to the up-to-dateness of products with the structure of exports of three typified country groups (developed capitalist countries, newly industrialized and other developing countries). (The last two members of the categorization shown in *Table 3* above—up-to-date and progressive industries—are included in one group as "new industries".)

Analyses of a more detailed nature, along with the import data of capitalist countries, prove that for Hungary an unfavourable polarization process has accelerated in recent years. Thus, the temporal deviation of the two data bases can be very important in the present case. In spite of the fact that, in addition to the date, the units of classification are not the same either, attention should still be called to some important tendencies illustrated by the table.

One of these is the structure of rouble exports which can be regarded "up-to-date" in a breakdown of such depth. The ratio of export for dollars of raw material-based industries is, however, remarkably high. This cannot be regarded as favourable.

Though the Hungarian export against dollars seems to have an up-to-date structure (on the basis of data in *Table 4*) like that of the newly industrialized developing countries, the picture changes considerably if we analyse the foreign trade structure on the basis of data broken down according to SITC. According to SITC nomenclature, raw material-based industries are the main industries [51, 52] along with wooden and cork-wood goods—except for furniture [63]—and categories of non-ferrous metals [68].

Table 4

Division of exports according to branch characteristics[a] *(percent)*

Branch group	Developed capitalist countries	Newly industrialized countries	Other developing countries	Hungary Rouble settlement	Hungary non-Rouble settlement
Resource-based industries	29	33	76	15	36
Traditional industries	30	46	18	34	40
New industries	41	21	6	51	24
Total	100	100	100	100	100

[a] Foreign data refer to 1976–1978, Hungarian data refer to 1982

Source: Changing patterns of trade in world industry, United Nations, New York 1982. p. 15 and for Hungarian data Central Statistical Office, Budapest.

Table 5

Division of Hungarian manufacture exports between markets according to branch characteristics in 1982 (percent)

Industry group	Export	
	Rouble settlements	Non-rouble settlements
Resource-based	20	49
Non-resource-based	80	51

Source: Own calculations, on the basis of data of the Central Statistical Office.

Table 5 contains export to the two main markets in that break-down.

A substantial difference is apparent between the two markets regarding the division of branch characteristics in exports. Trade against roubles indicates a more developed* industrial structure since the bigger share of raw material-based industries in exports is mainly a characteristic of developing countries. *Table 6,* computed by UNIDO, shows the former data for four county groups [10].

It is apparent that the share of the export of non-raw material-based industries grows almost proportionally to the level of industrial development. Comparing the above with data of *Tables 4* and *5,* it becomes clear that while the division of rouble exports in such a break-down presents the typical mark of exports by the most developed countries, the structure of non-rouble exports is characteristic of the second line of developing countries. All these only confirm the result of researches published

Table 6

Division of industrial exports of four country groups according to branch characteristics in 1980 (percent)

Branch group	74 Developing countries	Newly industrialized countries[a]	Some selected developing countries[b]	Some developed countries
Resource-based industries	62	37	60	30
Non-resource-based industries	38	63	40	70
Altogether	100	100	100	100

[a] Argentina, Brasil, South-Korea, Hong-Kong, Mexico, Singapore, Turkey

[b] Egypt, Ivory Coast, the Philippines, India, Cameroon, Columbia, Nicaragua, Sri Lanka, Thailand, Tunisia

[c] Greece, Israel, Yugoslavia, Portugal, Spain

Source: [10] pp. 71–72.

* Using the term of Ferenc *Jánossy* [11] "quasi-developed" ("quasi-entwickelt"). Ed. note.

earlier by the Institute for World Economics of the HAS, and first of all by Béla *Kádár* [3]. According to these, Hungary will be pressed in the eighties less and less by the OECD countries and much more by the newly industrialized countries and the countries becoming industrialized in the second and third line.

3. The effectiveness of Hungarian exports may be strongly influenced by its level of processing. International comparisons demonstrate that the share of more complicated, complex final products is very small in Hungarian exports for convertible currencies, considering the development level of the Hungarian industry. At the same time the share of processed raw materials is large. This obviously reflects the competitiveness of Hungarian products at this level of processing (see *Table 7*).

Table 7

Division of exports according to the level of processing

Level of processing	Developed capitalist countries	Developing countries	Hungary settled in Roubles	Hungary convertible currencies
Raw materials	11.8	39.2	1.4	0.1
Processed raw materials	6.7	11.9	10.7	39.9
Semifinished products	9.0	10.4	12.5	16.3
Simple finished products	22.7	17.5	24.6	21.3
Complex finished products	49.8	21.0	50.8	22.4
Total	100.0	100.0	100.0	100.0

Source: [9] p. 188. Hungarian data concerning 1982 come from the Central Statistical Office, Budapest.

The situation has further deteriorated in the recent years, since the share of products representing the highest level of processing was still 22.4 percent in 1982 and only 18.7 percent in 1984. The share of processed raw materials jumped from 40 to 46.9 percent during the same period. It becomes clear from more detailed data that the bulk of exported Hungarian final products is turned out not by progressive branch groups but by traditional and, in particular, light industrial branches.

4. Having analyzed the structure of Hungarian foreign trade from several aspects, our results positively confirm that the transformation of industrial structure during a large part of the past decade fell behind the extent which seems to be indispensable for the acceleration of adaptation to world economy and for the realization of *the related central government conception.*

The structural differences between the two markets and the growing divergence reflect the structural rigidity and lack of changes needed for further economic progress. Exports to non-rouble markets show a very unfavourable image from the aspects of branch characteristics, level of processing and other indicators. Though this judgement cannot be independent of the level of requirements raised by the given markets, it does draw attention to the consequences of this "Janus-faced" nature and the related tasks of industrial policy.

Changes in the rouble trade between 1976 and 1984 were not extremely significant considering the branch characteristics of exports. One can mention first of all the slight growth in the share of engineering and the approximately 3 percent loss of share of the light industries. Non-rouble exports are characterized by more substantial changes, but these are far from being regarded as favourable. For instance, the shares of basic banches and the food-processing industry grew further while that of engineering exports declined. One can consider the continued advance of raw material-based industries as the most unfavourable fact of the period under survey. The growth of the weight of products regarded as up-to-date is the only hopeful sign.

The consequence of our analysis is grave but many other researches confirm it. *The present structure is not suitable for stimulating industry and the economy* for fast growth. A large share of output and that of exports consists of products which do not suit the world market demand and they have an unfavourable price. They also meet with keen competition in developed and developing countries. Some of them are hit by protectionist measures. It is possible—in fact, it is necessary—to produce within the present structure products of a better quality and better suited to market requirements, to manage more efficiently and to make more successful deals. The scope of measures serving these ends is, however, limited. To face the realities of the task of structural transformation seems to be an unavoidable truth which is very painful but the only expedient way.

Hungarian industrial policy and internationalization

What are the conclusions to be drawn from the structural analysis of Hungarian industrial foreign trade and thus used for devising a long-term strategy of industrial development? It is not only closing-up with more advanced countries that becomes more and more difficult with the present rhythm of structural changes but also the chances of a successful follow-up policy are diminishing.

The rate of change of the industrial structure is, of course, influenced not only by intentions but also by objective conditions. The structure of production generally cannot be modified so quickly as market requirements and other targets of economic policy demand. Several examples prove that structural changes even more dynamic than those required by Hungary are not unachievable. *Figure 1* presents for example the measure and rate of structural changes in Japanese foreign trade [5].

Figure 2 indicates the structural change in the non-rouble exports of Hungarian industry between 1976 and 1984.

The diagram presenting the structure in 1976 reflects the high demand for Hungarian exports of raw materials and the preponderance in exports of traditional products. The structure of 1984 shows that there has hardly been any change since 1976.

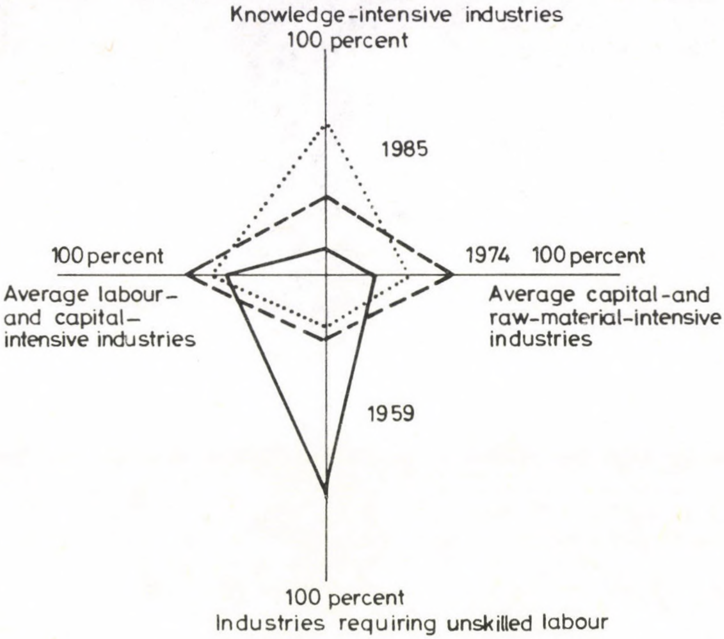

Fig. 1
Structural change in the industrial exports of Japan

Note: Though the figure shows the structure of 1985 according to planned data, the prognosis of the Japanese Economic Planning Agency proved to be correct [7]; according to statistical data the present structure shows the above picture.

Source : [5] p. 9.

It would not be fair to draw far-reaching conclusions from the comparison of the two figures because of different data bases and different periods. It is also evident that a reproduction of the Japanese example is not possible and cannot be a target. However, it is evident (and I wished to draw attention to that with the figures) that there is a possibility to realize a determined and conscious structural policy. The most important condition of that is the elaboration of a long-term industrial development policy which considers the increase of competitiveness on the world market in the broadest sense as the basic criterion of development.

In order to give priority to internationalization it will be necessary to clarify how this process is defined. It is, first of all, a *target*. This target is based on the realization that a more active participation in the international division of labour is indispensable for the Hungarian economy. The industrial policy-makers were unanimous in taking a positive stand from this point of view. This is reflected by all authoritative documents concerning economic policy, which formulate the necessity of strengthening adjustment to the world economy and the need to increase the international competitiveness of industry. This is, however, not enough in itself.

During our research we surveyed the most important and relevant documents

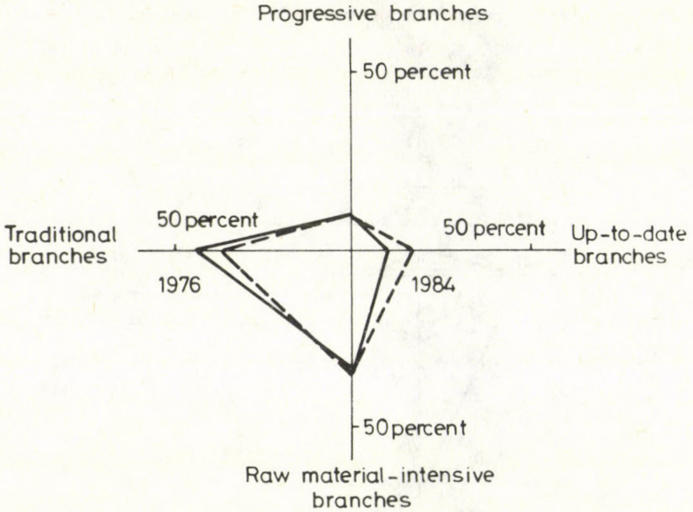

Fig. 2
Structural change in Hungarian industrial exports
Source: Own calculations, on the basis of data of the Central Statistical Office, Budapest

which were published between 1977–1984. It became clear from the analysis that the earlier Hungarian industrial policy only set a few targets and had few specific and typical methods serving internationalization. Of course, there were and there are plans (and not small in number) for making the system of relations with foreign markets more effective. The economic regulators and other instruments endeavour to promote the realization of these ideas. The main trouble is that these targets and instruments exist and work *beside* those of industrial, financial and structural policies, not in an organic unity with them. This also contributed to the fact that the changes in industrial structure were unable to create a really favourable background for internationalization. Though there are economic schools (for example the Cambridge Economic Policy Group) which believe that increasing international competitiveness can guarantee the achievement of other targets in economic policy (growth, employment, etc.), it seems the problem can only be solved with the building of these requirements into the hierarchy of targets.

Internationalization also means the process of *implementation of the tasks* outlined in the preceding section—in the course of which the system of relations between the domestic economy and the external environment (world economy) continuously changes. The trade between the Hungarian economy (industry) and other economies (industries) is the most frequently mentioned element among this system of relations. This trade is generally based on contracts among one or more domestic and one or foreign enterprises. However, internationalization also contains elements which cannot always be linked to transactions between national organizations (e.g.

management cultures, technological know-how, the movements and exchange of enterprise capacities, etc.).

The relation of Hungarian industry with foreign economies is best characterized by the form of internationalization materializing in the *flow of goods*. Thus this may be called a "market" form. Although many efforts have recently been made to increase the scope and weight of other forms, the lag is evident in this field, too. The "productive" type of internationalization, which means the use of factors of production abroad (direct investment, cooperation, joint venture, flow of manpower), is not significant even in the division of labour among the socialist countries. Yet, it is fully evident that the optimal form of internationalization for small countries, with the actual rate of technological development, is the parallel development of productive relations.

The industrial development conception of the 7th Five-Year plan-period (1986–1990) also stressed the significance of "productive" internationalization, declaring that a growing direct participation of foreign capital and technologies was indispensable. As selectivity is a question of vital importance, disinvestment is hampered by grave economic and other factors. Thus the direct participation of foreign capital can provide the additional source which makes a dynamic development possible in some fields.

It is less recognized that certain *possibilities* are inherent in internationalization on the levels of both economic policy and enterprise management. On the national economy level it makes possible for industry to formulate a new industrial policy (it makes that even necessary). On the enterprise level it can promote the increase of productivity, a more effective exploitation of available resources, and utilization of the economies of scale etc.

Examining Hungarian industrial policy from the point of view of tasks deriving from the latter approach of internationalization, the picture is far from comforting. For example, many experts have expressed the opinion, that not even the industrial development conception of the 7th Five-year Plan could give a clear answer to the questions of how the targets could be realized and what the real dimensions of the scope of movement in the world economy are.

The discussion of possibilities also demonstrates that internationalization, similarly to many other categories of economics, may be interpreted both on macro- and microeconomic levels. It is, however, also evident that the processes going on on different levels are closely interlinked, but the role of relations among enterprises is determinant.

What connections can be observed in Hungary between industrial policy and internationalization on the enterprise level? In one respect the interdependence is fully evident: there is no possibility for shaping a feasible industrial policy if it does not put the promotion of internationalization of enterprises at the centre of efforts. Yet, an environment made by an industrial policy which supports and stimulates the extension of international relations is of vital importance for the enterprises.

At the same time, it is undeniable that the two aspects of internationalization may in certain aspects be contradictory. Exports or imports favourable for the national economy or the whole industry may be uneconomical for enterprises and *vice-versa*. It is evident that this contradiction can only be solved by a suitable transformation of the incentive system.

Unfortunately, the requirement that international competitiveness be increased has spread through Hungarian economic and industrial policy in such a manner that the connections and differences between the international competitiveness of enterprises and of the industry as a whole have remained unexplained. The international competitiveness of a country is not simply determined by some kind of average competitiveness of enterprises. The effectiveness, flexibility and cohesion of the whole industry (even the economy) as a productive system is at least as important as the results of individual enterprises. Though the conditions, capability and possibility of a country to participate in the international division of labour are reflected in foreign trade data, yet it is inaccurate to judge its openness purely on the basis of foreign trade tendencies. This is why industrial policy has an outstanding role in internationalization.

The Hungarian industrial management is trying, to a certain extent out of necessity, to channel the real processes into a planned direction—with several actions having immediate effects. Yet, the ensemble of *ad hoc* interventions cannot be regarded as industrial strategy or policy, largely because the effect of short-term measures very often contradicts long-term, strategic targets. This contradiction is also characteristic in the field of internationalization (for example the effect of simultaneously stimulating exports and restricting imports).

One of the central questions discussed among experts of industrial development is: which targets should industrial policy formulate and what form should they take? According to some opinions, in a small and open economy like that of Hungary, industrial policy has to endeavour to shape the operational conditions and to produce an economic environment which stimulates enterprises to search for efficiency. Such an environment makes later possible, it even enforces the advantages for the producers of competitive products and pushes back non-competitive production. According to others central industrial management should even have a role in deciding on the directions of selection. They argue that, lacking a real market selection and a real competitive situation, the industrial development strategy can only be successful if central industrial management is able to contribute to identifying a minimal number of development targets. The importance of this role is not only underlined by the lack of adequate market orientation but it also has other reasons. Many international experiences demonstrate that the role of the state's central intervention is perspicuous even in those economies where market regulation is dominant. This is why I agree with the assertion that "a bigger market interest of enterprises and far-sighted central planning can, together, create an armoury of instruments more suitable than the actual one, thus promoting both te discovery of breakthrough points and the realization of plans for breaking out'". [1].

In my opinion there is an obvious need for an industrial policy in which the priority is to find the points towards which the main efforts should be directed and to devise a complex strategy which stresses and supports the internationally competitive sectors of the Hungarian industry. The strategy has to identify, beside the main targets of development, the activities to be suppressed, since a major modernization of structure cannot be realized without the latter action.

What points would the main efforts be directed towards? Only in exceptional cases can selection be directed to creating productive capacities and to concrete decisions on investments. Initially, there is a need for central support for technological development directions, and within these developments to find parts which are suitable for shaping (or maintaining) the internationally competitive activities of Hungarian industry. The choosing and selective support of these are, of course, not unknown in Hungary. However, experience with programmes of computerization and the production of electronic parts suggests that two of the fundamental conditions of success are missing: continuity and consistency.

The outlined industrial policy and the increasing of enterprise autonomy are not contradictory, and thus these categories do not esclude each other. There will also be a need for industrial policy when the regulating role of the market can direct enterprise management more efficiently than today. It is even more indispensable now when central industrial management endeavours to simulate market forces by planning, regulators, transformation of organization and other instruments. This is also true *vice versa:* a successful industrial policy is, in the long run, inconceivable with a lack of market incentives and a genuinely orienting scale of values. This is why it seems indispensable to shape an exigent internal market for the successful orientation towards export.

A consistent realization of selection and a gradual increase of enterprise autonomy can be helped by increasing the role of market-conform instruments and monetary tools in industrial management. The growing role of the contract system in supporting research and development, state orders, and investment competitions can help to ensure that scarce resources are not devoted to conserving the present economic structure but to creating the structural conditions of growing competitiveness.

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Acta Oeconomica, Vol. 37 (1—2), pp. 143–151 (1986)

BOOK REVIEWS

KORNAI, J.: *Contradictions and dilemmas*. Corvina, Budapest 1985. 165 p.

Social sciences underwent a significant transformation during the past ten to twelve years: the postulation of a professional approach has become dominating. The hegemony of specialized, part-disciplinary approach has developed over the comprehensive social scientific and philosophical one. Such a structural change, however, does not entail the total decay of the ideological and philosophical elements. Even if a book fully satisfies the demand for "disantropomorphization" and "valuelessness", it will still show numerous ideological features. On the occasion of its publishing it will by necessity get involved in practical routine processes and systems of relations, and, consequently, it will represent an attitude towards some points just at issue, irrespectively of the intentions of the author. It will inevitably "contribute" to current discussions, interfere with science-political and socio-political confrontations and decisions: it will have "socio-pedagogical" impacts, inasmuch as it will influence the social thinking of the readers—that is, it will play a remarkable practical and ideological role.

The majority of social science publications, however, immanently imply disguised ideological presuppositions, despite their endeavour toward "valuelessness", i.e. toward being free from value judgements. It is indeed difficult for the research worker to put in brackets the daily events going on around him and arousing emotions and passions. It is thus not surprising if the most consistent scientists *ab ovo* do not challenge the impossible, do not try to fully eliminate the ideological aspects, and they deliberately accept the philosophical premisses on which their work (theoretical and social work) is based. The book *Contradictions and dilemmas* by János *Kornai* is an especially absorbing reading, among others because the author's basic concept of economics and social philosophy are exposed together.

The book as a whole is a selection of previous publications. Beside the chapter "Degrees of paternalism" (actually a chapter from "Economics of shortage") and the article "Efficiency and the principles of socialist ethics" which became included in curricula of university instruction, papers are contained about the prospects of the economic reform, about the mechanism of the reproduction of shortage, about the diseases of national economies, etc. With all this broad scale of subjects the book still is in a conceptional unity. As the author specially emphasizes, the collected papers are linked by the identity of approach. In this way the papers of comprehensive social theory and social philosophy give great help also in the interpretation of the studies which first appear to belong rather to professional economics.

Kornai has found a fortunate solution to unifying scientific as well as philosophical-ideological aspects: he concentrates on the task of positive description but does not refrain from making statements either. His analysis is therefore often completed with normative and evaluating discourses. He makes a distinction between the unscientific version of normativity and an other version of it, that he calls "healthy". The first one sets out from some fictitious ideal derived from speculative postulates and refers that to reality. The healthy normative endeavour is restricted, the author says, to the elimination of actual troubles or at least to the mitigation of their impacts. As a research worker, Kornai exposes the basic phenomena and relationships and, as a politically committed scientist, he qualifies the same in many cases either directly or through the way they are formulated. It is in this sense that he writes about the diseases of national economies, about begging for state donations, harmful inequalities, central dictates, extreme paternalism, overprotected economy, lobbying, illusory profit motivation, administrative decimation instead of natural market selection, the lack of personal responsibility, exploitation, corruption, the simulation of competition construed at the desk, the factitious system of regulations, the levelling subsidies, the economic pathology, the unhealthy slow or disproportionate, forced growth, etc. Moreover, his central notion, namely, shortage, is a normative category backed up by definite value premisses and not a simple descriptive term. But this last statement requires a brief explanation.

The term shortage concerns symptoms reflecting in a formal approach—some disequilibrium. Equilibrium (as well as the lack of equilibrium) shows the relationship between two factors, and thus it can be illustrated by setting out from two opposite poles. Its upsetting becomes simultaneously manifest as the surplus of one factor relative to its proportional ratio and as the deficit of the other one. That is, in principle, it is equally justified or unjustified to present it as surplus or shortage each approach stressing one aspect of the objective relationship. Abundance and shortage are relative categories and they are only meaningful relative to one another. Therefore, they are mutually inseparable: they are conceptually identical.

Let us have a well-known example: buyers must queue for years to get a new car. There is a disequilibrium between solvent demand and commodity supply. This symptom may be described as commodity shortage, or excess demand, or as an ensemble of commodity shortage and excess demand. Logically, there are three basic types of the way how equilibrium can be restored: 1) Upper equilibrium on the level corresponding to demand; 2) Lower equilibrium on the level corresponding to supply; 3) Equilibrium on some intermediate level.

Thus, the same symptom is manifest in different ways. Objectively it may be qualified as: 1) Shortage (according to one of the general definitions of shortage, "inputs are not available to carry out some serious intention [to spend the money saved on buying a car]"). 2 Surplus (serious intentions have been in excess of available inputs [availability of cars]). 3) Coexisting shortage and surplus (e.g. when the need-motivated and income-motivated versions of solvent demand are distinguished. As the generation of individual incomes is not proportional to needs (the length of working time is not necessarily determined by volume of needs), earnings partly remain below and partly exceed personal needs. Consequently, it is not impossible that such buyers enter the market who occasionally spend money for the sheer reason that their incomes are higher than their actual needs. There exists a point of view in which this symptom is considered to be excess demand from the theoretical aspect. The distinction between forms of consumption called need-motivated and income-motivated is washed away in market liquidity. To decide which is the level where disequilibrium must be eliminated is already beyond the "positive" scientific query.

Summarizing the aforesaid: from the point of view of the descriptive approach, the same magnitude of "surplus" or "shortage" amounts to the same degree of violation of equilibrium. The resulting disproportion may be qualified as abundance or as shortage only in the normative approach, as a function of some basis of reference (value premisses, preferred political objectives, distinguished system of theory, etc.). That is, it amounts to taking a definite stand when this symptom is given the name shortage. It is an important methodological merit of this evaluating attitude absolutely irrespectively of our consent or reservations if any that it radically transcends the methods merely recording facts.

The host of problems related to shortage leads us to the second, cardinal and positive feature of Kornai's approach: his interest is not limited to the narrow field of professional economics but treats the complexity of social relationships. He believes that specialization on the study of partial systems is not satisfactory and even discards the purely economic approach. Economic-political, socio-political, social philosophical, etc. problems are regularly included in the spectrum. For example, he mentions among the diseases of nations the vulnerability of individuals, their feeling at risk, their unfairly disadvantageous situations, the humiliation of human dignity because of unemployment, the various processes inflicting physical and mental suffering, and the inequality offending the sense of justice.

The author defines the general method of his research work in the following: he tries to trace back contradictions appearing on the surface to their ultimate basis (to the deeper antagonisms). He stresses that the systems-specific inconsistencies of socialism are based on the selection of values (power structure, ownership, relations, institutional pattern). It is a fascinating statement of his that the basic structure of society can be illustrated as an inorganic symbiosis of two different systems of principles and systems of values. He describes its functioning by the confrontations, dilemmas and compromises between political and ideological and immediate economic considerations referring to human aspects. He states the following on the level of high philosophical abstraction: "It is impossible to create a closed and consistent socio-economic normative theory which would assert, without contradiction, a politico-ethical value system and would, at the same time, provide for the efficiency of the economy." The two spheres cannot function but at the cost of mutually violating and denying the logic of each other.

Kornai finds it impossible in a modern civilization to allow the hegemony of either the monetarized economy or of political paternalism and thus to eliminate either the market or the negative implications of bureaucratism. What he finds to be realistic possibilities are: to ponder when and which "disease" should be chosen and when and which therapy should be applied and to what extent. His more comprehensive recommendations are less paternalism, bureaucratism, redistribution, administrative-statutory regulation, with more decentralization, higher efficiency and harder budget constraints for enterprises: it is necessary to expand the non-state sector, to refrain from harmful inequalities and to learn to live with the healthy inequalities. Except for unique cases, the disease can be kept mild by mild therapy.

The striking force of the author's argumentation is somewhat diminished because there is no adequate relationship between the philosophical heights of treating problems and his recommendations listed. The desired, moreover, politically probably actually justified, measures are not backed up by a general social theory with a historical perspective. When he emphasizes the impossibility of reconciling the two value systems he must be blamed for breach of methodical discipline. To put it sharply: 1) He denies in principle the probability of an economic system in which the economic and human objectives are not necessarily asserted at each other's expense. 2) He consents to the existing state of affairs: in spite of his intentions he provides a philosophical justification for the given structure, as his socio-philosophical discourses are kept within the bounds of a model of the mutually conditional existence of bureaucratism and market.

L. TÜTŐ

CSIZMADIA, E.–SZÉKELY, M.: *Food economy in Hungary*. Akadémiai Kiadó, Budapest 1986. 218 p.

The late Ernő *Csizmadia* and Magda *Székely* were eminent professors of agroeconomics. They could not see this book published. The book, consisting of eight chapters and dealing with the Hungarian food economy, is an impressive undertaking as it gives a summary idea and an evaluation of Hungarian agrarian development in the decades after World War II.

Chapter one is a review of the Hungarian agrarian development during the first half of the 20th century, moreover, it occasionally covers the development of the entire economy. The authors present a few important characteristics of development by relying on long time series. The powerful shift in proportions between industry and agriculture can be thus traced. As it is noted on p. 9 of the book, in 1925–26 industry contributed 27.5 percent and agriculture 44.2 percent of the national income, by 1937–38 these proportions changed into 34.4 percent and 38 percent, resp. The authors present the yields of the major products between 1913 and 1938, and also make international comparisons. With respect to agricultural commodity production it is indicated that in the interwar period commodity production showed some decrease (computed at unchanged prices). The authors also discuss the level of Hungarian per capita food consumption in an international comparison. The distribution of landed property in the years 1895 and 1935 is also presented.

World War II inflicted enormous damage on Hungarian economy, including agriculture. Only the damage in agricultural products reached the value of a year's crop on arable land of 4 million hectares. In 1946 the cattle stock was 43 percent smaller than in 1938, pigs 79 percent and sheep 80 percent. The surviving stock, too, was in very poor condition after the war.

The authors dwell on the Hungarian land reform and the qualitative change in the structure of states. The numerical data are clear indications of the enormous socio-political importance of the land reform. Also the main stages of the Hungarian agricultural cooperative movement are reviewed, distinguishing 4 stages of development. The authors discuss the events of 1957–58, whereafter the massive collectivization of the Hungarian agriculture was carried out, resulting in the dominance of the cooperative farms in the structure of agriculture.

Chapter two, entitled "Hungarian economy and food production", gives a summary of the main trends of development and structural changes in the Hungarian economy as a whole and in the food economy,* in particular for the period 1945–1980. The part discussing the role and importance of food economy is perhaps the most interesting one in this chapter. Thus, for example, in 1980 food economy employed 23.4 percent of active earners, implemented 16 percent of total investment in the national economy, turned out nearly 27 percent of gross production value—and produced 20.4 percent of the net production value.

The authors note the important role of the Hungarian food economy in the domestic market and in its being regarded an important political stabilizer in Hungary. The contrasting of export and import data indicates that through its foreign trade surplus Hungarian food economy has made important contributions to achieving external economic equilibrium.

Chapter three of the book gives a more detailed analysis of the production of food economy and it discusses the factors of production as well. In the postwar period, till about the mid-sixties, the annual average growth rate of agricultural production amounted to about 1–1.5 percent. Its real acceleration began in the second half of the 1960s, to reach the peak in the first half of the 1970s with an about 4.6 percent average annual increase. Subsequently this growth rate decreased to 2.2 percent a year between 1976 and 1979. The authors also present the growth in the volumes of the major agricultural produces.

* In Hungarian terminology this covers agriculture plus food processing.—Ed. note.

In this chapter also the conditions of land use and land ownership are discussed. It may be learned from this part that in 1980 the state sector used 30.9 percent of the total land area, while 63.7 percent of it was used by the cooperative sector (including household-plot farms). The remaining 5.4 percent was used by auxiliary farms (of people with full-time jobs in other branches of the economy) and the private sector. From another aspect, it may also be stated that of the total land area in Hungary 50.4 percent is arable land and 89 percent is cultivated area. Concerning the labour force, the authors analyse the decrease in the number of agricultural labour and the drop of its share in the national economy. They devote special treatment to the structure of agricultural labour according to professional qualification. This chapter is closed with a discussion of the fixed and current assets of agriculture. At this point the authors present the financial and technical basis of agriculture and the postwar development in this respect.

Chapter four, in close relation with *Chapter three*, gives a detailed analysis of the pattern of production. First, the changes in time in the production pattern of food economy are presented and, secondly, the shares and main characteristics of some major and product categories in food economy are scrutinized. For example, bread grain production, the milling and banking industries are discussed in detail. This is followed by the discussion of the vertical stages of fruit production and canning industry. Similarly detailed treatments are included about the vertical lines of beef an dairy, pork, poultry and egg production and, last but not least, the problems of fodder production and the manufacturing of fodder mix. This chapter of the book provides a large amount of information and gives a close look at some important characteristics and production level of Hungarian food production.

Chapter five discusses the enterprise structure of the Hungarian food economy and its main features of development. This chapter, too, must be appreciated for its conciseness and for the abundance of information contained. The characteristics of the cooperative sector of agriculture are scrutinized, underlining the important feature of the Hungarian agrarian policy that state and cooperative property are two equivalent forms of socialist ownership. The authors write the following about this on p. 122:

"The following important principle is based on a theoretical grounding: in the age of advanced socialism, social progress does not require the radical change of property relations, but the strengthening of both state and cooperative property, the enriching of their common features, and a close collaboration between state and cooperative enterprises. Therefore, any impatient effort to nationalize cooperatives is as much unfounded as its opposite, i.e. the cherishing of cooperative illusions, or the exaggeration of their role."

From this strategic characteristic of the Hungarian agrarian policy two further important economic political principles are derived: the first one is the equal validity of enterprise autonomy for both state enterprises and cooperatives; the second one says that relations between state enterprises and cooperatives are maintained in practice on the basis of equal rights. These are important fundamental principles of the Hungarian agrarian policy. This chapter also deals in detail with the role of state farms in agriculture. It discusses the problems of industrialization of the Hungarian agriculture in principle and in practice. In this context I should only like to note one point, namely, that the authors follow up the process of the emergence and development of industrial activities or, more accurately, non-agricultural activities in the Hungarian cooperative farms, specialized cooperatives and state farms. The point is, namely, that in Hungary the supply function and the manufacturing of agricultural products partly also belong to the agricultural establishments. It is characteristic of the internal structure of this so-called non-agricultural activity that the share of food processing was nearly 32 percent in state farms in 1980 whereas this figure was below 11 percent in the farming cooperatives (p. 145).

The data also indicate the importance in agriculture of metallurgical, engineering and other heavy industrial activities as well as manufacturing activities in the service of light industry. The share of this kind of activity is nearly 64 percent in the Hungarian specialized cooperatives. On p. 147 further important structural characteristics are revealed about non-agricultural activities. It is shown, for example, that in 1979 the share of the so-called agricultural activity (or basic activity) amounted to 57 percent, while the remaining 43 percent was non-agricultural activity. In this latter one there are at least two kinds. 75 percent is directly attached to agricultural activity and about 25 percent is actually independent of that. The magnitude of this latter figure is negligible in the case of state farms. This indicates that the so-called non-agricultural activities pursued in large-scale farms may be regarded as belonging decisively to the sphere of the Hungarian food production.

Chapter six deals with the problems of small-scale production in the Hungarian agriculture. The household-plot farming of cooperative members and the so-called auxiliary farms are scrutinized. In this chapter another essential strategic characteristic of the Hungarian agrarian policy is studied. Namely, agrarian policy in Hungary has for long pursued a combination or synthesis of large-scale and small-scale production. The authors discuss the main characteristics of Hungarian small-scale production in detail. It is stated that, e.g. in 1981, there were about 1 000 500 small producers in this country (p. 155). The authors analyse the development of small scale production, its important role in the structure of agricultural production, and they present the main trends of development. Another highly essential characteristic is the one to be read on p. 161, i.e. that these 1 500 000 small producers are people belonging to all the strata, thus workers, cooperative peasants, intellectuals, pensioners, etc. Also the analysis of small-scale production in the formation of personal incomes is given at this point. For example, in the care of all small producers, in 1975 11 percent of total personal incomes was earned in small-scale production. However, there are substantial differences by categories. For example, the share of income from small-scale production was 32 percent in the case of the cooperative peasantry but only 4 percent in the case of intellectuals. In this same chapter the authors give a detailed presentation of the activities of large-scale farms aimed at the integration of small-scale production.

Chapter seven of the book treats the problems of inter-farm cooperation and integration. It studies in detail the problems of agrarian and industrial cooperation in the Hungarian practice, starting from simple cooperation to joint ventures. From this chapter I note the part dealing with the "production systems". The structure of the Hungarian agriculture integrated the production systems with high speed in the 1970s. These systems have greatly contributed to restoring the grain balance and to turning this country more and more into a net grain exporter. The authors briefly sum up the main lessons of the functioning of production systems and note that in production systems average yields are, as a rule, 10 to 30 percent higher than without systems. By applying new know-hows and technologies the production systems have considerably added to the development of the financial-technical basis of the Hungarian agriculture and have contributed to its achieving fast economic growth. The other point to be noted in this chapter is the review of the agroindustrial associations. Such associations are cast decisive role in the food production of several socialist countries. In Hungary this is not so, there are only 4 active agroindustrial associations set up on grounds of the regional principle. In these unions the agricultural large-scale farms are dominating, but they also contain service enterprises and those engaged in processing and sales. It is a very important feature of the Hungarian agroindustrial associations that the member enterprises have preserved their economic and legal autonomy.

Chapter eight of the book studies the main characteristics and factors of the system of economic control and management in the Hungarian food economy. The reader is given a brief, concise idea about the main characteristics of the planning system, of the whole of the system of economic regulations, and the main elements of the latter. Thus, for example, the authors discuss the agricultural price and subvention system in detail, together with the credit system as well as the tax system and the questions of personal income regulation. I suppose that each of the said points may duly claim international attention.

*

Summing up, it may be stated that the posthumous book of the Csizmadia couple has filled a gap, as it gives brief and concise synthesis and analysis of the major characteristics of Hungarian food economy and the functions it discharges in Hungarian economy. The most important statements of the book are condensed in the summary part in about 4 pages. The entire book must be appreciated because this is the most concise and high-standard treatise so far published about Hungarian food economy and because this book gives access to the main trends of the postwar development of Hungarian food production. The reader is thus made acquainted with the real position of food economy in Hungarian national economy. Profiting from the historical analysis, the authors take a glance ahead at several points and so the reader is enabled to foretell certain trends that are likely to be typical of the 1980s.

This book is suitable to satisfy interest towards the entire agriculture of Hungary. The book might be of interest not only for European readers but also for those in the Third World.

I. BENET

AMANN, R.–COOPER, J. (Eds): *Technical progress and Soviet economic development*. Basil Blackwell, Oxford 1986. 214. p.

Technical progress and its effects on Soviet economic development are a very important and long standing research field of Western scientists. The editors/authors of this book are among the best known Western scholars who contributed on a high level to the comprehensive, but also detailed research of this subject with their two thick volumes published in 1977 and in 1982 (for a review of the latter see *Acta Oeconomica*, Vol. 32. (1984), Nos 1–2. pp. 190–194).

This volume contains 9 studies by different experts. The first study by Ronald *Amann* aims to set the scene. It presents the development of the characteristics of the Soviet economy from the 70ies up to now. According to Western analysts the technological inertia experienced in the Soviet Union crucially constrains the economic development, but in many cases this view is shared by Soviet experts, too.

Assessing technological performance one can choose between aggregated or more direct indicators. The most general aggregated indicator is the rate of economic growth. According to Western estimates the growth rate of Soviet GNP was depressed from 6–7 percent in the 1950s to about 2 percent in the 1980s. At the same time, the annual growth rate of labour productivity is now only about half of that measured in the 1970s—according to official Soviet data. A more exact indicator, which can adequately measure technical progress, is the total factor productivity. According to US analysts its growth rate "...after 1973 declined at an average rate of 0.8 percent per annum and it ... picked up slightly in the last few years, but is still either negative or negligible." (p. 8)

The more direct indicators were taken from the annual Soviet Statistical Handbook. It emerges from these figures that the rate of diffusion continues to be the most problematic part of the R and D cycle in the Soviet economy. Compared with successes in sciences (invention, innovation) diffusion and incremental improvement are the phases where the Soviet performance is relatively weak. It is striking that while the Soviet Union was the first or among the first in introducing new ideas into industrial practice, how "consistently" it lagged behind in widely diffusing them. But the data conceal many individual performances, therefore the authors are, as earlier in their books, concentrating on case-studies, thus avoiding unnecessary simplification.

Opposing J. *Cooper*'s and others' point of view, Amann clings to his opinion on Soviet technological backwardness. He states: "Taking into account the whole spectrum of indicators of technical progress, a consistent picture of inertia emerges which must be (and in fact is) a matter of serious concern to the Soviet political leadership." (p. 16) Moreover, the R and D system, despite previous attempts to reform it, is still not fully apt to contribute to the birth of patents and innovations and much less to promote their diffusion. According to his opinion, three major themes continue to occupy a central place in discussions:

"1. The economic system is permeated with departmental barriers which impede cooperation between different industrial ministries and tend to isolate scientific activity from manufacturing activity...

2. There is a systemic tendency on the part of industrial enterprises and their ministries to maximize output at the expense of the quality and novelty of products and, thus, to attach a relatively low priority to industrial innovation.

3. The inadequacy of pilot plant and large-scale testing facilities creates an imbalance between resources devoted to R and D." (p. 16)

The slowdown of technological (and) economic development result in a kind of vicious circle, which would be very difficult to break out of. According to Amann, the options facing Soviet political and economic leadership are the following: a Hungarian-type economic reform; a technocratic reform; enhanced discipline (a kind of neo-Stalinism); increased CMEA cooperation; increasing West–East technology transfer. At the time of writing, the author considered the starting of a new reform process the most probable.

In the second chapter Julian Cooper analyses the civilian production of the Soviet defence industry. In his interpretation, beside the Ministry of the Defence Industry, three ministries of machine-building, moreover the Ministry of Aviation, Shipbuilding, Electronics, Radio, Communication Equipments, respectively, the enterprises under their direction fall under this category.

Some statements by Soviet politicians and publications of economists referred several times to the civilian production of the defence industry claiming it to be as high as about 40 percent of the total output of these industries. Analysing this still not well researched problem some new information can be obtained on the general and relative development level of the Soviet defence industries and on the possibilities and problems of conversion from military to civilian production and *vice versa*. The relevance of this question is supported by the fact that both before and after the Revolution the civilian production of defence industries was and has remained a characteristic feature (see the famous Tula samovar produced by an ammunitions plant).

The range of civilian products manufactured by the defence industry is extremely diverse. Beside the obvious aircrafts and ships, these industries produce a wide range of transportation equipment as for example personal cars, bicycles, motocycles, wagons, tramcars etc. The range of agricultural equipment extends from tractors through fertilizers to irrigation installations, while that of industrial equipment from excavators through food industry machinery to NC machine tools and industrial robots. But the defence industry plays a similarly important role in the manufacturing of various plastics, metallurgical products and also of computers, communication equipment, medical equipment and the most diverse consumer goods (washing machines, vacuum cleaners, radios, TVs, cameras, etc). The share of defence industry enterprises in total civilian production can extend from a few percent to 100 percent in some special cases.

The author analyses the quality and the technological level of products manufactured by defence industries based on comments and complaints in the Soviet press, the share of products bearing the state mark of quality and the share of export quality products. He states that "... the average level of quality of the civilian products of the defence sector is somewhat higher than the average level characteristic of the rest of Soviet industry." (p. 45)

In the next study Paul *Snell* examines the development level of Soviet microprocessor and microcomputer manufacturing. A rather simplified opinion of the level of these industries is in use in the West, speaking about a lag extending from 2–3 years to 10 years, or about copies of older American devices. Many Western scholars claim that the Soviets have no more than an 8-bit microprocessor. But according to Shell this picture is partly misleading.

On the basis of relatively few available information it can be established that the Soviet Union produces about 15 families of microprocessors (4-, 8-, and 16-bit single-chip devices, and 2-, 4-, and 8-bit, bit-sliceable devices to increase word-length). There are some types among them which are proved to be original Soviet developments and some pieces are said to be patented even in the West. The situation is more or less the same in microcomputer manufacturing. Contrary to Western claims, this industry is thought to be able to develop independently microcomputers of a standard not to be underrated. There is, however, no information available about the scale of mass production, if any.

Among Soviet personal computers the best known Agat is software-compatible with the Apple–II computer. It has apparently been available for hire, but not for sale in Moscow. The main difficulty also in this field seems to be more the adaptation and diffusion of high technology than in development itself.

Anthony Rimmington treats the case of biotechnology, in a narrower sense the process of single cell protein (SCP). SCP "... is the name given to the protein-rich microbial cells which are produced when bacteria, algae, fungi or yeasts are grown on a variety of feedstocks." The aim is "... the provision of an adequate supply of desperately needed protein to the livestock sector of agriculture." (p. 75)

This technology has run into more and more political and environmental opposition in the West, thus it is of considerable interest to see how SCP has fared in the Soviet economic system. The first large-scale production of SCP occurred during the second World War in the Soviet Union. After a long break, the first experimental production of SCP from petroleum fractions was carried out in 1960. Based on successful trials and after removing some technical hitches, large-scale production was started in the 70ies with the construction of more and more plants with a capacity of 100 000 tonnes per annum.

Nowadays, a partial shortage of raw material (n-paraffin) imposes severe restraints on the expansion of this branch. In the future, utilizing more extensively the by-products of the pulp and paper industry a vast increase over current capabilities could emerge. An also promising method is using natural gas via methanol. "Indeed, there are reports that the USSR has been negotiating with ICI (of UK) for the purchase of their 'Pruteen' technology (which utilizes methanol from natural gas)." (p. 89) Nevertheless, biotechnology has a long way to go before it can claim to be "feeding the Russians" in spite of significant advances—writes the author. (p. 39)

In the next chapter, Malcolm R. *Hill* and Richard *McKay* examine the connections between Soviet product quality, state standards and technical progress. They dispute the simplified Western opinions which claim that the quality level of Soviet equipment, machinery is generally lower than of their Western counterparts as a result of lower demands. The authors disagree with these views and try to proved their opinion describing the system of Soviet standard specifications and some comparative case-studies. From the results it is apparent that the Soviet and British standards for machine tools and for some types of electric motors are generally the same. Therefore, it would be appropriate to reconsider some Western views held on Soviet product quality.

In Chapter 6 Gary K. *Bertsch* deals with the question of West–East technology transfer and Western technology controls. He describes the most important types of technology transfer, the legal and illegal channels and possibilities, from scientific cooperation agreements to industrial cooperations, and the share of Soviet high-tech imports in the 80ies. It is noteworthy that still relatively few studies analyzing the assimilation of Western technology in the socialist countries are available. There has been disagreement over the alternatives of Western technology controls: tightening or not COCOM procedures.

There are not only East–West, but West–West (USA versus Western Europe and Japan) divergences in technology controls. Because of many uncertainties the author rightly states: "... the issues of West–East technology transfer and Western controls will require continued attention in both academic and government communities." (p. 134)

Vladimir *Sobell* analyses technology flows within the CMEA in the next chapter. According to Western opinions "... Comecon has become a region of high cost, low variety and low quality." (p. 136) With the exhaustion of the potential for extensive growth, there is no other possibility beside reform experiments than to utilize the gains of West–East and intra-CMEA transfer of technology. However, in the latter case the inefficient functioning of socialist economies affects the whole CMEA cooperation in technology.

Though the intra-CMEA exchange of machinery and equipment has a high share in the total foreign trade of CMEA countries, the development and quality levels of products make it doubtful whether the imports carry technology improvements. It is not accidental that there is an increased pursuit to implement joint R and D programmes, sometimes jointly utilizing imported Western technologies. The results give no cause for too much optimism. In spite of that, the author maintains: "... it is reasonable to expect intra-CMEA technological linkages to expand and perform the modest but vital function for which they were designed." (p. 152)

David A. *Dyker* deals with Soviet planning reforms in the 80ies, more exactly from Andropov to Gorbachov. Since the possibilities of extensive growth had become exhausted in the 70ies, it became inevitable to modify the planning and management system. With the accession of Y. Andropov to the General Secretaryship of the Communist Party, there was a sharp change in the policy-making. A new decree was published in July 1983 setting up an industrial planning experiment.

Compared to the size of the Soviet economy the number of enterprises submitted to this experiment is rather small. The experiment, first introduced operationally in selected sectors in January 1984, abolished or loosened many economic constraints. Planning and investment were partially decentralised; autonomous R and D work is permitted to enterprises; key success-indicators are sales/deliveries, quality, productivity, cost reduction or profit increasing. Wages fund savings accruing through job rationalization can be used by managers more independently. But non-fulfilling the plan results in strict bonus/wage withdrawal for managers and workers alike. "On the face of it, there is some genuine increase in the freedom of manoeuvre of the enterprise. The number of planning indicators imposed by the ministry has been reduced from 30 to 10" says the author. (p. 159) At the same time, the supply side remains an over-centralized and over-bureaucratized system, thus the link to the other parts of the economy is rather contradictory.

There is no clear picture of the effects of leaving a part of R and D to the enterprises themselves. The main problem with this step is that "... as long as directors have to put the main priority on fulfilling delivery plans ..., they may be less than enthusiastic about any innovation which threatens to disrupt continuous production..." (p. 163)

The 1984 decree of fixed capital formation signals the intention to improve on design/construction lead-times and on braking cost escalations. For achieving it, the decree deems it necessary to improve the technical quality of investment planning by computerization. But "there are question marks over the capacity of Soviet or indeed any, computer system to grapple with such complex problems." (p. 166)

In the last chapter, Daniel L. *Bond* writes about the prospects for the Soviet economy. The recent growth trends are unfavourable to support advances in the future. In the 70ies the economy entered a period of serious growth deceleration, mostly because of sectoral imbalances, labour discipline problems, reduced investments and adverse weather. These created numerous bottlenecks (for example in rail transportation, energy production, etc.), which brought growth almost to a standstill.

Recently, there have been changes: the performance of key bottleneck sectors has been improved, worker discipline campaigns have resulted in somewhat better productivity, at least in the short run, and investment is growing more rapidly than planned. Simultaneously, the external economic position of the Soviet Union has remained strong (the dramatic fall in energy prices was not foreseen). The above-mentioned factors could result in a higher growth rate according to the author's somewhat optimistic projections.

The authors of the separate chapters have, in sum, written mostly high level articles on their special subjects. As a whole, the book provides useful information on the problems faced and methods attempted by the Soviet planner, politicians and the R and D establishment. The separate studies often complement each other making it possible to reach more balanced conclusions on the performance and prospects of the Soviet economy and, more specifically, of its technical progress.

A. TÓTHFALUSI

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Journal of Consumer Policy

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Journal of Consumer Policy is an international scholarly journal which encompasses a diverse range of issues to do with consumer affairs. It analyses the consumer's dependence upon existing social and economic structures, it seeks to define the consumer's interest, and to discuss the ways in which this interest can be fostered – or restrained – through actions and policies of consumers, industry, organisations, government, educational institutions, and mass media.

The journal publishes empirical research on consumer and producer conduct, such research being chiefly committed to the consumer's perspective. However, the producer's perspective is far from neglected in the *Journal of Consumer Policy*, with its pages being open to contributions on controversial issues that explain the producer's viewpoint. One of the aims of the journal is to increase communication between the parties in the marketplace.

Here, too, the scope of the journal is consciously broad: not only consumer problems with private producers are scrutinised but also problems to do with the handling of goods and services in the public sector. Public policy in the consumer sphere and its social and economic consequences are regularly examined. Also studies on the interaction between consumption and associated forms of behaviour such as work and leisure are encouraged.

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CONTENTS

REVIEWS

BOOK REVIEWS

BOOKS RECEIVED

Acta Oeconomica is abstracted/indexed in Geological Abstracts, Journal of Economic Literature, Key to Economic Science, Public Affairs Information Service, Social Citation Index, Referativni Zhurnal, Rural Recreation and Tourism Abstracts, World Agricultural Recreation and Tourism Abstracts, World Agricultural Economics and Rural Sociology Abstracts.

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THE SOCIO-ECONOMIC ISSUES OF GROWTH-ORIENTED STRATEGIC ADJUSTMENT PROGRAMS

M. SIMAI

In a flexible economic system adjustment is a permanent and integral part of economic policies. Medium term strategic adjustment programs and policies imply different material and human costs. A fundamental question in the implementation of these programs is how to minimize the costs, especially the human costs. The possibilities of the countries greatly differ, but there are some more general lessons. State intervention and market forces must be properly harmonized. Public administration should be united around the programs. The speed of the adjustment process should be coordinated with the character of the given economy and the magnitude of the tasks. Social implications and the incidence of the costs must be carefully analysed in advance and certain groups must be better protected. The international organizations involved in adjustment programs should pay appropriate attention to the social programs and problems.

Introductory remarks on the concept

Adjustment, together with many other categories applied in economic sciences, has different meanings. It is used in many different ways. Basically it means the process of restoring correct relationships. In the vocabulary of the international economic life in recent decades, the concept of adjustment was closely related to external imbalances and to indebtedness, and the conditions established by IMF and the policies of the World Bank. The meaning of adjustment, however, is not confined to the given notion.

Adjustment as a set of policy measures is also used in cases when the difficulties are of internal origin. Rapid growth of government expenditures may result in a budgetary deficit, leading to domestic cost and price increases, inflation, declining competitiveness, in the final analysis, balance of payment difficulties.

The restoration of a national equilibrium between supply and demand often requires drastic stabilization measures even without pressure from an international organization. Technological change also requires far-reaching adjustment measures. In order to survive, countries have to adjust.

In the framework of the OECD the concept of "positive adjustment" was developed as the one which facilitates shifts from declining sectors to the growing ones and from the less efficient branches to the more efficient ones. According to their definition, adjustment policies can be regarded as positive if they facilitate such shifts or if they are directed to achieving other governmental objectives, such as will improve the social and physical environment, the distribution of income or the fair sharing of the burdens. Adjustment is an integral and necessary phase of the economic growth process.

In a flexible economic system adjustment is not an alien "host"—it is more or less a permanent requirement in economic policies. Since the domestic and external environment is constantly changing, economic policies have to accommodate in the changes sooner or later. Depending on the intensity and the nature of the changes, adjustment requirements may differ greatly.

In this paper I define strategic adjustment as a comprehensive set of policy measures which is taking place in a macroeconomic framework and includes: not only external measures but also internal changes in development policies and priorities, structural shifts in output and consumption. Also, it may intend to influence the role of the given country in the international division of labour. Short-term adjustment policies and measures, mostly to external shocks, may be parts or beginnings of strategic adjustment. The interrelation between short-term adjustment measures and strategic changes may be especially strong in those cases when the factors requiring adjustments are of major importance and of a lasting nature. Short-term steps must be followed by longer-term policies. These requirements seem to be especially strong in the contemporary world economy. The new technological revolution, the long-term imbalances in international finances, the structural changes in world output and trade indicate that *short-term imbalances reflect long-term development problems. Therefore, adjustment policies must be implemented with a longer-term view and with a new development horizon.* The changes which took place in the last decade, altered the operating mechanism of the world economy. Competition increased in an interdependent world in the make of the ongoing rapid international transmission of economic disturbances and structural changes in the industrial countries. In an increasingly hierarchical structure of the world economy, global distributive mechanisms and pressures are reproducing and strengthening inequalities without any clear sign of increase in international economic solidarity. Technological progress makes the achievements of earlier industrialization increasingly obsolete in the global division of labour. Some sectors of the world economy are in a condition of deep structural crisis.

The failures and the partial successes of short-term adjustment policies proved the necessity of planning the process in a long-term framework. Due to the complex nature of the process, the human implications—even of shorter-term adjustment policies and measures—must also be considered in this context.

From among the recent national and international debates and practices concerning the problems of medium-term adjustment, this paper concentrates on the following issues on the economic policy level:

— the best ways to minimize the costs of adjustment, especially the human costs,
— how to improve the adjustment capacity of individual countries,
— how to increase the efficiency of public administration, especially in that branch which is responsible for the elaboration and implementation of adjustment programs,
— the best ways of international institutional support of the national adjustment policies.

All these issues have important human implications.

While adjustments of policies are, of course, necessary steps in every country, the different external and domestic changes may require completely different measures in the individual countries and their demand concerning international policies of support may also greatly vary. There are great differences in the capabilities of countries to adjust their policies to the changes. The potential and actual costs and benefits of the adjustment process may depend on factors which can be controlled by one country better then another. This could depend on the economic and political power, the structure of the economy, the achieved level of economic and social development, etc. There are important systemic factors influencing the concrete policies of adjustment. In the centrally planned economies the problems of output, consumption and trade are already receiving greater attention. In spite of the great differences, there are also important similarities in the tasks, in the causes of successes and failures, in the factors determining the costs and also in social conditions and consequences. The similarities are especially strong among the developing countries. It is their experience which this paper wanted to analyse first. Some of the lessons of the centrally planned economies and of industrial western countries are also taken into account.

Who will bear the costs?

Adjustment in a national economy becomes a necessary task when there are difficulties. These difficulties may be limited to one country or to a group of countries, and they may be of general, global nature. When only a couple of countries are facing serious problems requiring major adjustment measures, the external environment can offer more support, than in the case of widespread and long-term difficulties. In such circumstances, for many countries the "world economy" may represent a hostile environment. External forces may undermine and destabilize national economic structures, or they may force countries to give up social priorities and change the dominant system of values. The weaker the countries, the more limited the role of international efforts to help them, and thus the greater the shocks will be.

During the *Great Depression* in the interwar period the "beggar-my-neighbour" concept characterized policies by which the different countries wanted to shift the burden of adjustment on to their partners. The main burden was thrown on the debtor countries. Adjustments according to the formulation of Keynes forced the countries "in the direction most disruptive of social order, and to throw the burden on the countries least able to support it, making the poor poorer". [1]

The experiences of the last decade were not completely satisfactory and the social costs of adjustment were high in most countries—especially in the developing world. The poorer and more dependent the countries were, the higher were the costs and the more domestic problems they had. In the developed market economies it has been emphasized in policies (and often implemented in practical terms) that adjustment presupposes an alleviation of the burdens of those directly affected by compensation payments, unemployment benefits, training programmes, assistance for moving, etc. Such facilities were hardly available in the developing countries, where the costs of adjustment were relatively higher. The acceleration of inflation reduced real wages, their decline was sometimes 30–40 percent. Import restrictions and the declining demand resulted in major losses in output and employment. Under-employment also increased and the informal sector grew rapidly. There was a general deterioration of social conditions. Public expenditure for the extension and maintenance of social infrastructure declined sharply. Health and education expenditures were cut in real terms in many countries—sometimes by 50–60 percent. Few countries were able to "defend" their social programmes, in spite of strong efforts to do so.

According to the estimates of the author, calculating the differences between the actual and potential output during 1975–1985 and taking into account the losses in terms of trade and the higher interest rates, the combined total loss of the developing countries was equal to their *total* GNP for 1980. These were, of course, not the cost of the adjustment programmes but the result of cumulative losses suffered by the countries. A part of the losses were, however, connected with the adjustment policies.

Experiences proved that it is very difficult to develop a cost minimizing adjustment strategy, especially for a single country alone. Costs are often not even calculated by the countries. Some lessons, however, could still be learned from the experiences of recent decades.

a) Adjustment policies became especially costly for the countries when, in an international environment, the economic policies of the larger western industrial countries were dominated by neo-conservative ideologies which accepted the idea of "global belt-tightening" and emphasized the need for economic policy autonomy in an interdependent world. The developing countries were not able to build efficient defence lines against the burden-switching effects of those policies.

b) It is correct to state, that adjustment proved to be more difficult in countries where prices and exchange rates were greatly distorted, adopted, import-substituting policies were of low efficiency, where too much money was borrowed and not enough was exported in relation to their external obligations. Adjustment policies in basically outward-oriented economies were, in many cases, faster. As for the costs and benefits concerned, the division is not on the line of the world market orientation but depends on the ability to develop and implement proper and comprehensive policy packages. Changes in development strategies (shifts from import substitution to export orientation) as adjustment policies, go beyond the short or even the medium-term horizon. This is due to the different structural, skill, managerial and marketing requirements of such policies in comparison to the earlier strategies. The transition from one strategy to another demands coordinated macro- and micro-economic changes, different marketing orientation, etc.

c) There are, of course, great differences between small countries as far as their external position and internal structure are concerned. However, it is difficult to generalize since smaller countries are more exposed to external shocks as a result of the high trade intensity which often accompanies a relatively weak structural position in the world economy. It is better to plan for prevention of the worst problems by exposing the country to the external changes. Also, in those countries the growth process must be organized in a more flexible way. When the shocks do occur, it is much more difficult for small, highly protected countries to act effectively. Economic adjustment in small countries is much more difficult amidst major international socio-economic problems, stagnation and tensions. In certain cases, in small countries which only specialize in one or two products, adjustment may cause disastrous domestic consequences if there is no proper international support.

d) When external shocks or inappropriate domestic measures create disequilibrium, the necessary corrective actions should be taken as quickly as possible. External financial sources should be used to speed up adjustment and not to postpone it.

It is of course true, that certain economies do not respond rapidly to sudden changes in policies or in regulations. Usually, it is easier for the more developed and flexible economies to implement rapid shifts in policies. As far as political implications are concerned in case of economic feasibility there are strong political arguments for shock-treatment. The sacrifices are brief, there is less time for the build-up of opposition against the programmes and with some early results they can even generate considerable support. The impact of the adjustment programme on the different strata of the population will create less social tension and it is more manageable. Gradualism, in principle, facilitates more flexibility in the implementation of the programme and in the distribution of the burdens. It may create, however, a long period of austerity with very little concrete changes, diminishing popular support and increasing discontent.

e) Since the abilities of any given country to develop and implement such adjustment programmes which minimize the costs and mitigate the burdens of adjustment and do not lead to political tensions depend to a great extent on the efficiency of the public administration. The strenghtening of its capacity is a major task of a long-term nature of course, there must be strong executive leadership and the staff of the economic or development administration must be motivated. The economic and social goals of the adjustment process must also be well and clearly defined. Priorities in the adjustment process should be properly selected. In the government agencies there must be clear responsibilities for the given areas of adjustment policies. The tasks must be well coordinated and separated with minimum overlapping. The issues of "centralization or decentralization" and during the adjustment process must be treated flexibly and in a pragmatic way.

Adjustment tasks and their implementation usually cause tensions within the administration. Such issues as the necessary cuts in the state budget and the reallocation of resources increase the existing differences. The weaknesses of the administrative structure and the inconsistencies may also become more conspicuous. An administrative reform may also become indispensable. While it is not easy to implement administrative reforms during the adjustment process, in certain cases this may become a fundamental condition of success.

In difficult adjustment periods it is even more important than under normal circumstances of the growth process, to achieve a popular consensus and to ensure that the participation of the population should be encouraged in the development dialogue as well as in the implementation of the programme.

The stability of societies depends not only on the economic successes or adverse consequences of the adjustment process. If the priorities are correctly selected and the political structure facilitates broad popular participation, even the difficulties are better tolerated.

f) The proper choice of partners in economic relations can be a vitally important asset, especially in the adjustment process. The complementarity of economic structures, the character and norms of relations, the mutuality of advantages, their reliability and readiness to provide assistance if it was required, proved to be especially relevant issues in this respect. Owing to the fact that the main partners of any country are determined by historical, geo-economic, political and structural factors, the freedom of a small country to make sudden shifts is very limited in the short term. Sudden shifts are only possible between marginal partners. Of course, there can be exceptions when a larger country is ready to help the smaller partners through deliberate actions such as providing special facilities for them in the market. This practice (which is not completely unknown in the world economy) usually has strong political motivations.

g) Developing countries are especially interested in those forms of multilateral cooperation which could strengthen their economic position by collective measures, taking into account the interests of all partners involved, and in which the partners share responsibilities. The present international institutions, like the IMF, IBRD or regional bodies—even with the positive changes which took place in the last decade—were unable to fulfil properly the functions of a growth-oriented, collective economic adjustment-supporting system.

Human implications of sectoral adjustment efforts

From the point of view of direct human implications, sectoral adjustment problems represent a particularly important issue. They also indicate the limitations of many developing countries in this respect.

The task of adjustment emerges in most cases as a structural problem: to change the role and place of the given sectors in the economy, or to introduce adjustment measures within the given sectors which will increase exports and thus achieve the required increase in import capacity—as well as producing an environment of domestic scarcities and consequently improving supplies to the domestic market and increasing employment. In this paper we look at three major sectors:

a) Adjustment tasks in agriculture differ in the developing countries. In certain cases, due to the declining ability of food imports, adjustment tasks aim at the increase of domestic production. In other cases, traditional export products can be replaced by new, competitive goods. For both aims different incentives can be introduced. While the measures, in principle, should have a moderately favourable impact on the agricultural sector, in practice this is sometimes neutralized by the declining prices of traditional agricultural export products.

Agricultural incomes in general do not increase and, even in the case of larger farms, purchases of tractors and other agricultural machinery are deferred as a result of the relatively high costs.

The medium-term adjustment assistance, like institutionalized credits, help the larger farms and estates. The small farmers as well as the landless agricultural workers have great difficulties. Agricultural poverty is on the increase and the shrinking purchasing power of the agricultural population adversely influences other sectors.

In the agricultural sector of many developing countries there are of course major, long-term structural problems, like the forms of ownership, the low level of the agro-technological base, the lack of institutional infrastructure for marketing, financing, etc. All these and other problems limit the possibilities of efficient adjustment. The solution of such problems, however, goes beyond adjustment tasks and requires major agricultural reforms.

b) In the mining sector (other than fuel) the long-term impact of the world economic changes require major steps in adjustment to the reduced demand and declining prices by: reducing output, introducing processing and diversifying the production of extractive industries and of the economy in general. Another area of adjustment is rationalization. Even in the case of some expected price increases (if recovery becomes stronger and more widespread) it will be necessary to consolidate and rationalize the existing operations, to increase the efficiency of investments, to rely on smaller activities more, and to increase the value added by expanding vertical integration. It is also important to find areas where the mining sector could efficiently increase its relations with the domestic economy, through different inputs. Since the mining sector is often the most important source of external earnings and non-agricultural employment, the success of adjustment measures influences the general economic situation in many countries and regions. If deterioration continues, the already adverse effects on incomes and public expenditures will be increasingly felt.

The problems with the mining sector, as well as the potential success or failure of adjustment policies, bring up another important issue, the possibility of price stabilization. The experiences of the price explosion of the 1970s and the decline of raw material prices in the 1980s proved that price changes, if they are allowed to fluctuate to the extent which characterized the last 15 years, can cause major instability. At the same time, relatively stable prices are more conductive to global welfare than unstable ones. Price stabilization provides a net gain to producers and consumers together, if it is done properly and allows sufficient flexibility.

c) Due to the "not so bright" outlook in agriculture and the mining sector, the problems and tasks of adjustment in manufacturing are especially important for the majority of the developing countries.

The manufacturing sector has been affected by the world economic problems and their domestic consequences in many ways. The obsolescence of the earlier established production capacities increased as a result of postponed investments. Upgrading of machinery and equipment were deferred and technology imports were reduced. Industrial infrastructural projects were postponed or completely abandoned. Expenditures on domestic research and development and technical education were reduced. Industrial infrastructural projects were postponed or completely abandoned. Industrial unemployment increased in many countries.

The adjustment measures include the increase of productivity and efficiency, and changes in the structure of output in order to promote international competitiveness and to increase exports. There are new efforts to strengthen import substitution and make it more efficient—especially in the field of capital goods. The human implications of these tasks include such important issues as the availability of skills and managerial capabilities at the scale and in the structure required. While there is an oversupply in certain skills, it is more the shortage of highly qualified persons which hinders changes.

Export promotion activities are often combined with efforts to re-examine the possible role of foreign investments and the different ways to attract more foreign capital. The encouragement of private sector activities is often accompanied by reductions in the size and role of public enterprises in manufacturing—often disregarding the social role of the public sector in certain important areas like creating jobs or skills-training.

The harmonization of the above strategies with exchange rates and trade policies is also a part of the adjustment process. It is a fundamental question, from the human point of view, that the planned adjustment measures will be instrumental in recouping the severe reduction of real wages and the deterioration in the distribution of income which have taken place in the last several years. It seems more or less inevitable that real wages, especially of unskilled labour, will continue to be low owing to high unemployment and under-employment. Under these conditions, an increase of social discontent can be expected, because a disproportionately large incidence of the costs of adjustment will fall upon the low income groups and the unemployed.

There is another very important human problem connected with the adjustment tasks. Since it is highly improbable (under the conditions of the expected technological development and investment constraints), that the autonomous job-generating capacity of industrial development will be sufficient, it will be necessary to develop special job-generating strategies, especially in certain highly urbanized regions of the Third World.

The employment problems are going to increase because of the continuing rapid urbanization in the developing world. According to U.N. estimates, in addition to the presently 840 million urban population, by the turn of the century another 1.0–1.2

billion people will have to be absorbed by the cities of the Third World. Most of them will be poor and unskilled. About 50 percent of them will come as a consequence of population growth, the rest will migrate from the agricultural regions.

Adjustment measures must include, therefore, job-creating programmes at low capital investment costs. Projects which are labour intensive, are at the same time justified on economic terms and must also be developed in the industrial sector. Most of the possibilities which are open in manufacturing and which satisfy the above needs are concentrated in the small-scale industrial sector. (In urban services there are, of course, such facilities, too.)

As in the case of agriculture, the adjustment process in manufacturing is also influenced adversely by external protectionist measures employed in a discriminatory manner—in particular against the developing countries. Protectionism is especially strong in those areas where the developing countries have a comparative advantage, or where there are structural adjustment problems in the developed market economies.

d) The role and especially the potential role of the transnational corporations (TNC) in the strategic adjustment process is often discussed by experts. It also has important human implications.

Their possible positive role is mentioned in such important areas as:

— bringing in, reallocating and investing capital—thus helping the alleviation of the debt problem;
— innovating, adopting, perfecting and transferring technology, which may help the upgrading of technological capabilities;
— bringing in new and useful knowledge about organization and management, which are important in the domestic structural changes;
— facilitating international marketing;
— providing new job facilities for the local labour force;
— educating and upgrading workers, professionals and managerial staff;
— through the international vertical organizations they can promote a more effective progression of goods from one stage to another (outside the free market) which may imply a greater stability of export earnings;
— to a given extent, they may stimulate local services and output.

There are, of course, great differences between the actual and potential role of TNC-s, since their activities are not guided by altruistic motivation or public interest but profit motives.

The above potentials may help adjustment efforts, especially export increases. The subordination of a large segment of the national strategies or interests may, of course, hamper such aims in the adjustment process as:

— increasing the export surplus and saving imports;
— maximizing external earning potentials;
— creating new jobs for the masses by labour intensive operations;
— increasing international competitiveness in those areas which are not in the interest of the given TNC-s.

The outflow of resources through the price mechanism, in the form of profit remittances, royalties, etc., was in many cases excessively high. Transnationals have also promoted the outflow of highly-skilled professionals ("brain-drain"). The experiences in connection with the policies of the transnationals prove that in the adjustment period they often reduce operations or completely withdraw activities. Of course, there were also opposite examples in some cases: when the reduced real wages, devalued currencies and different direct incentives provided especially favourable conditions.

The politics of the adjustment process and their human implication

Adjustment programmes, especially strategic ones, require strong involvement of the state. Even in the developed industrial countries, proper government policies are the basic condition of the success of any major adjustment programme. It cannot be expected that national or international market forces alone can correct the imbalances rapidly and without disastrous social consequences and high economic cost. Adjustment is a complex process which calls for the most efficient mobilization of national resources through state intervention and planning, harmonized with the market forces and with the participation of public and private sectors. All these require good entrepreneurs and well-trained, efficient civil servants.

Corrupt public administration, inefficient bureaucracy, governments which are weak and politically divided are unable to develop and implement successful adjustment programmes.

The characteristics of the economic policy formation and implementation process in every country are major factors in adjustment programmes. The national differences in successes and failures are not only explained by the different political capabilities and influences: the nature of adjustment measures is also closely tied to political decisions.

a) The decisions governments make on the level of economic policies reflect prevailing political preferences.

b) The policies implemented in a given social environment reflect the nature and degree of compromises in the given power structure.

c) Economic considerations are also subordinated to the political value judgement of the decision-makers of given countries, and they influence such important issues as the timing and incidence of the costs of adjustment on different groups in the society.

d) The domestic consequences of the adjustment process often cause major political tensions, leading to changes in political regimes. The readiness of the masses to accept the costs and sacrificies reflect the degree of political cohesion and confidence in a given regime and also the ability of the leadership of a given country to develop and implement such adjustment programmes which are successful and which do not lead to unrest and tension.

e) It is, however, not just the domestic political life which has a strong, often decisive influence on the adjustment process, but also international politics. It is a well-known fact that in a politically divided world there are always countries which are disfavoured by the major centres of economic and political power, and the use of economic instruments for political destabilization can hamper economic adjustment. Much less attention is devoted, however, to the different political philosophies which may adversely influence the position of the weaker countries by denying the necessary international, institutional support and/or completely disregard the socio-economic implications by maximizing the expectations towards the role of market forces. In this scenario, according to a well-known specialist, the developing countries "have very little scope of action to resist economic and political domination. The prevailing pattern of consumption would continue to spread to the social groups that have adequate incomes... It seems inevitable that this scenario would produce more inequalities and imbalances among the countries of the Third World and, within each country, among sectors incorporated in the world market and those left outside it". [2]

The international distribution of the adjustment burdens is also an important political issue of international character. This is a more or less permanent problem in those cases when the changes demanding adjustments from a developing country are caused by the policies of the developed industrial countries. The lack of symmetry in sharing the costs of adjustment and the fact that the poorer countries carry unproportionally high costs, has especially serious consequencences for those countries in the world economy.

Conclusions

1. Strategic adjustment is a special phase of economic growth. It is necessary to recognize the inevitable character of adjustment policies in every country at this stage of global economic development. It is also a fact which must be generally recognized, *that every adjustment measure involves economic and social costs and benefits. These costs were distributed in an extremely unequal way during the past 10–15 years.* The human costs of the adjustment programmes were too high and their long-term consequences may be extremely harmful.

2. The development of adjustment programmes with lower costs was not possible in most of the countries, owing to the character of the problems, the prevailing economic philosophy, the weakness of the world economy and the lack of economic and political expertise in the decision-making bodies and/or institutions.

3. The accumulated experiences of adjustment policies underlined the strategic importance of prevention, of fast actions (shock treatment) whenever it was feasible, and comprehensive (package) programmes. These programmes were more successful

than isolated measures. The transition from one development strategy to another is a more complex task and goes beyond the framework of medium-term adjustment.

4. The sectoral consequences of adjustment are especially important from the socio-economic point of view. Their effect on employment, incomes, exports and capital movements is very high. The different sectors raise specific problems. The international interrelations are very strong and they may adversely influence the outcome of adjustment efforts.

5. Adjustment should take place in such a way that it does not conserve the given structure of the international division of labour, does not weaken the bargaining position of the given country in the world economy and does not create internal anarchy or a political strait-jacket.

6. Stabilization measures, rescheduling and different efforts to increase external earnings should be well coordinated and harmonized with the domestic requirements—especially with such issues as the satisfaction of the most elementary needs of the population in nutrition, health and education.

7. The distributive effects of adjustment programmes should be analysed, in advance so that there is a more symmetrical sharing in the inevitable burden.

8. The 'marginalization' of the people and the further growth of unemployment, under-employment and the dangers of further expansion of the informal sectors should be avoided. Therefore, together with the structural changes, special social programmes should be developed.

9. Unavoidable cuts in health, education or cultural expenditures should be made with extreme caution and with a long-term policy view, since the losses in these areas cannot be easily recouped and the long-term damages, even of shorter-term measures, may be excessively high.

10. It was not the task of this paper to discuss the role of external support in assisting the adjustment policies of the given countries. The economic and social experiences of the adjustment strategies raised several issues. For example, about the role of stabilization assistance and the structural adjustment loans. The consequences of conditions were especially important issues, in the centre of which the main question was whether the solution of an economic problem, if it creates several new economic and social troubles, is a feasible approach or not. Another broadly shared experience was the necessity of making the burdens of national adjustment more sustainable through well conceived common efforts promoting economic growth and trade. All the countries could gain if the goals of strengthening national and global economic security could be the guideline for the policies of the international agencies in connection with the adjustment programmes. Their members would thus accept the responsibilities for guaranteeing global economic stability and act accordingly.

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СОЦИАЛЬНО-ЭКОНОМИЧЕСКИЕ АСПЕКТЫ ПРОГРАММЫ ПЕРЕСТРОЙКИ ЭКОНОМИЧЕСКОЙ СТРАТЕГИИ, ОРИЕНТИРОВАННОЙ НА РОСТ

М. ШИМАИ

Мироэкономические изменения особенно усилили необходимость приспособления, перестройки. Эта проблематика стала важным элементом экономической политики всех стран, в особенности небольших и находящихся на более низкой ступени развития. Современное и правильное определение задач программ приспособления и перестройки является важным на всех временных горизонтах, но особенно существенно это для среднесрочных, имеющих стратегическое или структурное значение программ. Международный опыт свидетельствует о слабостях стран в этой области. Чрезвычайно важный вопрос представляет человеческая сторона программ приспособления и перестройки. Это, с одной стороны, означает способности принимающих решения и силы, влияющие на политику, а с другой стороны, распределение убытков, «издержек» в данных странах. В 1980-е годы особенно тяжелыми были социальные последствия программ перестройки. Существует целый ряд условий смягчения их. Указанные страны платят тяжелую цену за пренебрежение человеческим фактором в процессе перестройки.

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ADJUSTMENT PROCESSES IN HUNGARY, 1973–1983
Policy options, intentions, facts

ZS. BEKKER

The article examines the size and the components of the external shocks suffered and the adjustment process realized by the Hungarian economy, taking also into account the differences according to the main markets.

It is stated that beyond the belated policy response, the path of development was characterized mainly by passive elements of adjustment. The turn in economic policy in 1978 could only gradually introduce changes due to the accumulated burden and the two-faced structural propensities of the economy to adjust.

The changes in the world economy which came to pass in the 1970s, and the reactions to them, are today one of the most frequent topics of conversation among economic policy makers, economic analysts and among common people—their real victims. In the evaluation of the effects, especially in selecting the possible and desirable responses, various phases of economic and economic policy thinking can be distinguished. What is more, to a certain extent polarized opinions, identical and different, have surfaced and coexisted for a long time.

This paper is a contribution to the clarification of a well-defined cross-section of the above-mentioned problems and the joint dilemmas: it makes attempts to explore the magnitude and constituent factors of the external shock which afflicted the Hungarian economy and tries to reveal the components of the accomplished adjustment path and the degree the former were effective in Hungary between 1973 and 1983. [1] In addition, the evaluation compares the theoretically possible policy options and the recently developed policy intentions with the realized development path. The quantification is based on the Balassa method*, for this has been used—with some modification—by the study [4] serving as a background to this paper.

The method, employing relatively simple assumptions, defines and summarizes, with the aid of the development of the most important foreign trade indicators, the size of the external effects suffered by the economy; then breaks it down to such components that can be considered as quantitative manifestations of certain characteristic policy responses. Since the structural links of the Hungarian economy are different with the socialist and the non-socialist markets, it is an important element of the overall picture to show, also from this angle, the respective breakdown of the

* This paper and the study serving for its background [4] are parts of a more comprehensive research. Observation, comparative international analysis and typology of the adjustment strategies developed to answer the changes of external and domestic conditions are the tasks of the broader research.

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adjustment burden and path in the wake of the shock caused by the changes in the world economy. Therefore, the analysis has also observed and interpreted the tendencies according to the two main directions of the foreign trade of Hungary.

Accepting some consequences stemming from the logic of certain hypotheses and taking the risk of a sometimes overemphatic presentation (which is unavoidably brought about by simplifying assumptions) the paper finally approaches a synthesis from two directions. One of them is an empirical approach built-up by using the main findings of the data analysis. The other one is a qualitative—more evaluative—exploration of the problem: the path is weighed more generally from the viewpoint of the theoretical alternatives of policy actions.

Cognition of the problem

For a long time after 1973, Hungarian economic literature concentrated mainly on the price changes, when investigating the influences of the world economy. Following the almost continuous and gradual deterioration of the terms of trade, after a certain time the issue turned into a phenomenon which began to tempt the economy like a fetish. In the analyses preparatory to the decision-making process it grew into one of the primary causes and explanatory reasons of the economic troubles. The analyses treated the recession and crisis signals as transitory phenomena and believed in overcoming them. They turned towards the volume effects and the questions related to the growth process only after some delay.

As regards the response to the external changes, the decision-makers on economic policy—though their reasoning was more sophisticated at the professional level than is shown by the following summary—gave two different evaluations of the situation. In the period between 1973–1978 they claimed that the Hungarian economy, on the basis of the economic relations with the socialist countries—and following its earlier growth path—could essentially avoid the shock situation caused by the price explosion; then, between 1979–1983, admitting the inevitable need for adjustment, the restoration and stabilization of foreign economic equilibrium was assigned as task number one.

The above evaluation of the sub-periods requires from the economy different behaviour and presupposes opposite characteristics of the adjustment propensity. It can be seen at the same time that in both periods growth and policy variants demanding highly active interference—and those attainable with relatively passive behaviour—may equally be assigned to the selected main policy line. It is self-evident at the same time, however, that whether the economy adopts active, or passive behaviour, it cannot be taken for granted that the original intention will really be accomplished in the implementation period.

It is striking that in the first period the issue of the equilibrium of the balance of payments was not a dominant element in the evaluation of the situation, and economic action was primarily motivated by the wish to attain continued economic growth. A country which, in an age of radical rearrangements in the world economy, does not treat the equilibrium of the balance of payments and trade as a priority and which is, in addition, poor in raw materials, practically decides to follow the process of becoming indebted. Despite this, two options are available and would presumably be considered.

One of the ways, though it allows the process of indebtedness, brings about the necessary structural adjustment of the economy in the meantime by using additional resources raised through external financing. The other variant, though also creating indebtedness, uses the additional resources not for restructuring, but for bridging gaps or alleviating tensions due to the rigidity of the structure. Taking the policy analysis as given for the Hungarian economy between 1973 and 1978, these two ways provided the possible choice for the country to select one.

The primary task set between 1979–1983, however—the equilibrium-conscious approach—opens up theoretically the following paths for the economy. In the case of the first type of reaction the maintenance of external equilibrium and the reduction of the deficit of the balance of payments is to be achieved by slowing down economic growth, as a result of which imports may decline. An alternative way of action can be export orientation and import substitution in the sphere of production. The latter variant may in principle create the desired external equilibrium, and in addition maintain the dynamism of growth.

The main directions of the two sub-periods and the alternative strategies which may be assigned to them are built up from elements whose presence, identification and testing can be well approached by the Balassa method. Using it as a point of departure, the research made an attempt, within the competence of its tools, to separate the possibilities, intentions and reality from each other.

Empirics: method and computations

The method, as a matter of fact, tests some complex processes and effects with the aid of the development of a few macro-economic categories.* The approach is obviously simplifying, yet its strength is, at the same time, in quantifying simultaneously various effects of the foreign markets shocks in a system relatively easy to treat; finally, it breaks down the reaction to the given size of external shocks into such quantifiable components which can be identified as manifestations of various adjustment strategies.

One part of the external effects is the impact of prices, the other is that of volumes. The method takes the magnitude of the external shock into account as the

* An original description of the method can be found in the article of B. *Balassa* [1]. Study [4] also includes some elements of interpretation and critique and discusses the adaptation questions for the Hungarian case.

sum of these.* Its logic is built on the idea that the effects are interpreted as the difference between the actual situation and that which "would have come about, had the world not changed". The external effect taken into account is composed of three factors: i) the effect of the export volumes, which is practically the consequence of general and relative changes in the world market demand; ii) the net impact of the terms of trade which reflects the loss or gain of the economy caused by the change in prices, assuming a balanced foreign trade, i.e. when there is zero balance between marketable exports and imports; iii) the effect of unbalanced trade which also includes price effects and expresses that, for a mass of products equalling a given trade balance, the payment of an amount other than earlier will be effected owing to the changed prices.

When studying the adjustment responses of the economy four well-defined reaction types, that can be interpreted on their own merit, may be distinguished and measured. All of them carry signals about economic strategies. The character of the actual development path can be traced down on the basis of how, to what extent and in which proportions these four main types of reaction appear: i) drawing in (placing out) additional net resources; ii) export expansion; iii) import substitution and iv) slowdown of growth. Here too, the logic of measurement is based on the comparison of the actual magnitudes with the categories computed by applying the "what would have happened if" principle.

The drawing in (placing out) of net additional resources as a category is the difference between the actual balance of trade and the balance calculated according to the trend values. This means that what the concept covers is not the actual amount of resources drawn in, but the surplus owing to the fact that the world has changed in comparison to the basic period. The size of export expansion equals the quantity of exports attributable to the incremental growth rate over the world exports. It expresses how much more the country has exported than it would have if its export dynamism had only reached the growth rate of world trade. The effect of import substitution shows the volume of import savings stemming from the decreasing import elasticity of the GDP or the national income, as compared with the basic period. On the contrary side, the effect produced by the decelerating growth can be determined on the basis of import savings which can be attributed to the decline of the economic growth rate. Hence, savings in import in case of unchanged import elasticity cannot be considered as import substitution by their nature, they are the effects of decelerating growth.

When studying either effects of the reactions, it is a basic principle that comparison with a selected standard is made and the deviation indicates the burden and the process of adjustment. The standards are numerical and simple but always represent general economic assumptions.

* The original description of the method does not include the effects of the real interests, merely those of the prices and volumes linked to the turnover of commodities.

The present study considers the years between 1963 and 1973 as a basic period in respect of the conditions of growth and demand. When trend values are forecast for the plan period, i.e. when the assumption of "a world with an unchanged system of interrelations" is needed, the indexes of Hungarian dynamics are used.

In respect of the prices two benchmarks have been established: first the price relations of 1972 were the basis of comparison and, later on, those of 1977.* Regarding the second sub-period—i.e. the years between 1979–1983—we thus have two reference points, two different economic situations with which to make comparisons. The selection of both basic years are justified by the domestic as well as the international conditions. Taking into account the different characteristics and specific parameters of the two main markets of the country, distinctions by main markets were applied both in the real processes and in establishing the standards. The measuring standards are not selected a priori, nor are they unchangeable. The measuring tape of Balassa does not lie exactly on the same level** as applied in this paper.

It is also true that external and internal changes are intertwined and difficult to separate. Even the relations of effects and responses, causes and consequences are not always clear-cut and uni-directional. Yet, we accept it as a sensible assumption to examine the adjustment burden of the Hungarian economy through the deviation from its earlier dynamism; furthermore, to consider the average rate of expansion in the world market as a certain type of standard for measuring advancement—even though the existence of a homogenous world market is merely an abstraction.

Empirics: external effects

Since 1973, in the wake of changing conditions in the world market, the Hungarian economy has been continuously under strong external effects which required the taking of certain stands concerning policy reactions.

The findings of the study made it clear that following the first, great and undoubtedly sudden initial shock the adjustment burden increased on the macro-economic level with an almost unchanged intensity. But this is true only if one takes the price and volume effects together into account. The price and volume effects had their own impact on the economy, with different power, varying in time and by markets.

* Owing to the characteristic great fluctuations in the turnover and prices of foreign trade, in the various calculated values the starting data of 1972 are to be understood as the average of the years 1971–1973; similarly, the prices referred to as of 1977 are the average prices of 1976–1978. The export and import data include the total volumes of foreign trade. The concrete process of calculation, forming the constant prices and expressing them in forint values, can be found in detail in the basic study [4].

** Beyond several practical differences (of time horizon and aggregation, which might cause differences in accuracy only)—a special assumption of these measuring standards is that the competing partners of Hungary in the world market are the developing countries. Therefore, the conditions of past and present, consequently the extent of world market shocks and the success in responses, appear in changed dimensions. See [3].

Labelling the sub-periods with a single source of loss would be misleading. The way of appearance and intensity of the losses suggests, of course the simplification that, in the first period, the problems of the terms of trade and, in the second five years, the question of volume effects have to be highlighted.

Table 1 shows the annual development of the size and components of the shock afflicting the economy, as compared with the situation in 1972.

The special attention paid to the terms-of-trade effect can be explained by the fact that the phenomenon was new and sudden; in addition, it caused losses which could be experienced in their direct, physical reality. Despite this straightforwardness, the assumptions concerning its impact from various markets kept being readjusted in

Table 1

Effects of external changes on the Hungarian economy as compared with the 1972 situation

In thousand million Ft (at 1972 price)

Type of effects	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
					Socialist market					
Terms-of-trade effects										
Net terms of trade	2.5	16.3	17.4	25.5	28.9	33.9	30.6	40.8	55.6	68.2
Unbalanced trade effect	—1.1	—2.9	—3.9	—9.2	—5.5	—9.4	—9.0	—17.5	—25.4	—33.2
Export volume effect	6.2	22.2	24.1	34.8	45.1	56.7	68.7	91.0	120.9	144.1
Total	7.6	35.6	37.6	51.1	68.5	81.2	90.3	114.3	151.0	179.1
					Non-socialist market					
Terms-of-trade effects										
Net terms of trade	14.2	17.9	13.3	17.9	16.8	22.1	23.0	20.8	22.5	32.2
Unbalanced trade effect	6,8	5.7	3.4	6.2	11.4	0.9	—0.4	2.5	—3.9	—13.2
Export volume effect	1.9	11.0	10.4	15.3	19.7	24.6	29.1	40.0	55.1	65.2
Total	22.9	34.6	27.1	39.4	47.9	47.6	51.7	63.3	73.7	84.3
					Total					
Terms-of-trade effects										
Net terms of trade	16.7	34.2	30.7	43.4	45.7	56.0	53.4	61.6	78.1	100.5
Unbalanced trade effects	5.7	2.8	—0.5	—3.0	5.9	—8.5	—9.4	—15.0	—29.3	—46.4
Export volume effect	8.1	33.2	34.5	50.1	64.8	81.3	97.8	131.0	175.9	209.3
Total	30.5	70.2	64.7	90.5	116.4	128.8	142.0	177.6	224.7	263.4

several waves. It was only slowly recognized that the main burden generated by this effect comes from trade with the socialist countries.

The fact of Hungary having deteriorating terms of trade on this market can be derived from the weight and special commodity pattern of the turnover, and from the fact that the share of raw materials and fuels in the Hungarian imports has been of great significance. Since, in the first period, these products were directly afflicted by the price explosion, the great deterioration in the terms of trade was logical and can be considered as an external factor at that time.

Still, from the viewpoints of economic policy interpretation and the adjustment problem two elements deserve attention in the movements of the price proportions. One of them is that the terms of trade in Hungary's socialist trade relations had significantly shifted and worsened already at the time of the first price explosion, with a delay of only one year,* predicting in due time the necessity of economic adjustment. Similarly, the price explosion of 1979–1980 in the world market had also heavily worsened the terms-of-trade losses in the socialist foreign trade after one year. This effect, however, compared to the size of actual changes in the world market, imposed a relatively heavier burden on the Hungarian economy than the one in 1973.**

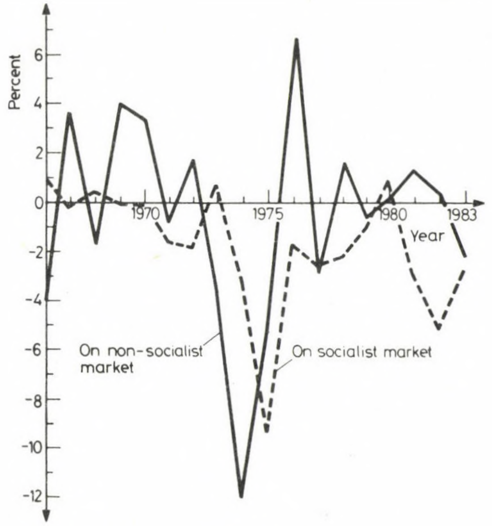

Fig. 1.
Annual changes of the terms of trade, 1966–1983

* In the practice of CMEA trade the five-year average of world market prices is used for setting intra-CMEA prices. This is the so-called Bucharest pricing principle.

** According to the estimations of the World Bank, the real price of oil rose about twofold in 1974 as compared with that of 1972. In 1975–1978 it had already dropped approximately to the real price level of 1972. In 1980 it was about 50 percent higher than in 1972 and, following this, it was again tending downwards to the level of 10 years before.

Figure 1 shows the delayed and somewhat damped movements in the socialist trade relations, but it also highlights a novel movement deserving attention. It concerns the failure of the efforts to improve the terms of trade. If the deterioration of the terms of trade were "only" influenced by the impact of the raw material prices, with the passing of the five-year cycle (generated by the application of the Bucharest pricing principle) after the appropriate adjustment of competitiveness in the manufacturing industries—even if in a damped form and with some delay—a change for the improvement of the terms of trade ought to follow. This wave was, however, completely missing from the development of the prices and we can practically detect only the moderation of a worsening situation. Thus, the delayed deterioration has not been compensated by delayed betterment.

Though only slightly explored, yet important for the adjustment policy, is the fact that the socialist trade relations of Hungary have almost incessantly been characterized by an unfavourable development of the terms of trade for about a decade and a half—and this phenomenon had already been visible prior to the price explosion. Since the early 1970s the facts have shown that in the formation of the price trends of the socialist market—internal factors were also active and one cannot speak exclusively about the spill-over effects of external instability of the world market prices.

The great fluctuations in the non-socialist market are conspicuous, though closely connected with its character. In the terms-of-trade formation of Hungary in connection with this market, a single large rearrangement took place (1973–1975); the preceding and following years were characterized rather by normal, regular oscillations. A part of the Hungarian losses caused by changed prices was the consequence of unbalanced trade, a chronic phenomenon in this market. In the period following the first price explosion one-third of the gross terms-of-trade losses were the consequence of the import surplus, and two-thirds of them can be attributed to the net effect of the changing price levels.

If the need to adjust, stemming from the price problems, was insufficiently conscious, it was even more so in respect of the volume effects, though the necessity of adjustment was already motivated with equal power by volume and price components in the first five years. In neglecting the volume aspect of the changes, a concept of the situation and an image of the character of the economy played a part which was based partly on adequate, partly on erroneous reflection. The main elements supporting opinions about a basically trouble-free development prospect included such facts as the proceeding, uninterrupted growth, the actually existing demand of the socialist market for Hungarian products and the view—which is true in itself—that the world market will always be able to absorb the exports of such a small country.

Plenty of counter-arguments against unchanging expansion could also be heard. The majority of the people advocating slower growth were, however, setting out from the idea that it is the interdependence of the domestic economy which put barriers to a well-founded, rapid economic grow. Of course, the two sorts of ideas, entailing different consequences for growth, do not contradict one another in every point, since any growth with a favourable structure can actually find its opportunity for expansion on the world market. The objective conditions for this type of growth were, however, not existing in the Hungarian economy.

When the past debate about further growth *versus* slowdown was translated into figures, these were devoid of any estimate and quantification as to the effect of an actual external barrier, of how far it was or could be existing, or what inertia had to be overcome in order to keep the Hungarian growth path running.

As a matter of fact, Balassa's idea on determining the consequences of the volume component of the external shocks represents a possible quantitative approach to this relationship.

The export volume effect is a means to estimate the shock which afflicts an economy from the aspect of export opportunities. These are originally dependent on the prevailing demand conditions of the market. Indeed, when examining the

Table 2

Relative magnitude of the external effects between 1974–1983

Component	Socialist market (in percent)	Non-socialist market (in percent)	Total (in percent)
A) Between 1974–1978 — as compared with the situation in 1972			
Total effects/total average trade	22.4	19.3	41.7
Total effects/average trade on the market in question	37.7	47.4	41.7
Terms-of-trade effect/total average trade	7.6	6.5	20.3
Export volume effect/exports	14.8	6.5	21.3
B) Between 1979–1983 — as compared with the situation in 1972			
Total effects/total average trade	55.4	28.9	84.3
Total effects/average trade on the market in question	96.1	68.3	84.3
Terms-of-trade effect/total average trade	12.1	9.6	21.7
Export volume effect/exports	39.9	17.8	57.7
C) Between 1979–1983 — as compared with the situation in 1977			
Total effects/total average trade	23.6	9.3	32.9
Total effects/average trade on the market in question	42.6	20.8	32.9
Terms-of-trade effect/total average trade	3.7	0.5	4.2
Export volume effect/exports	19.9	8.7	28.6

Remark: Five-year totals of the external effects (components of effects) divided by the data of foreign trade turnover of the respective period at constant (1972 and 1977) prices.

adjustment policy of Hungary the impulses coming from the non-socialist external markets must be approached on this basis. In Hungary, however, the separate treatment of different sub-markets plays a determining role and requires the changing of certain hypotheses concerning the socialist market.

The limit to the rational expansion of Hungary's export possibilities towards the socialist countries is to be interpreted as a consequence of the specific structure of the CMEA-market. Owing to the non-convertible accounting of the trade turnover and the specific product structure, the export volume effect can be better expressed by applying the growth rate of the Soviet exports than the rate of expansion of the demand (imports) in the whole sub-region. As a matter of fact, in the period observed the capacity of the Soviet Union to deliver basic and raw materials imposed adjustment barriers on the Hungarian economy. These constraints are easier to interpret for the economist than the somewhat more dynamic expansion of the whole sub-region. Hence, as regards the possibilities of Hungarian exports, the limits on supply side rather than on demand side have to be considered in this market. In the quantitative estimation of the export volume effects and in their evaluation, this relationship has to be taken into account. The relative magnitude of the effects is summarized in *Table 2.* When considering the appearance and intensity of the external shocks, one seems to find deformations in the estimated size and market distribution of the components of the effects used in the assumptions for the decision-making aimed at shaping the adjustment process.

In regard to the socialist countries both the terms-of-trade and the export volume effects had been undervalued. The same holds true for the whole, as well as for the sub-periods. As concerns the non-socialist markets, the effect of the terms of trade was over-emphasized both in economic publications and in the explications of the economic policy-makers. This applies—though to a limited extent and mainly in the first period—even to the volume effects. To sum up, the export volume effect has not received the attention it deserves for its significance in the structural policy either on aggregate level, or according to market distribution.

In the planning practice there has not been developed a quantitative approach, which could give competent estimates about the dimensions of the components of external effects and about their division by countries or regions. The picture was poor, primarily regarding the calculations of the accumulated burdens, and their distribution throughout long periods whether *ex post,* or *ex-ante* estimates are taken into account.

This holds true especially for the export volume effect, which is by definition a virtual loss. Such exports have never been transacted, yet presumably they could have been achieved, had the circumstances of the foreign economy not changed. As their magnitude is virtual, they have no such traditionally developed calculation methods as the losses caused by the deteriorating terms of trade. Their size can be determined according to the assumptions and interpretations of economic analysis.

Empirics: pathway

For characterizing the adjustment process which followed the foreign market shock four kinds of responses have been distinguished: drawing in additional net resources; adjustment resulting from export expansion; the outcome of activities aimed at import substitution; import savings derived from decelerating growth. The path effectively covered is a combination of these elements. *Table 3* demonstrates the relative weight and various configurations of the adjustment components in the Hungarian economy between 1974 and 1983.*

It can be seen that in the adjustment process of Hungary two types of responses were dominant, i.e. the drawing in of additional net resources and the slowdown of

Table 3

Relative weight of elements of the adjustment process between 1974–1983

Adjustment components	Socialist market	Non-socialist market	Total
	in percent		
A) Average of 1974–1978 — as compared with the situation in 1972			
Drawing in additional net resources	56.6	82.6	68.6
Export expansion effect	33.2	—1.5	17.2
Import substitution effect	—	6.1	2.8
Effect of slowdown of growth	10.2	12.8	11.4
Total	100.0	100.0	100.0
B) Average of 1979–1983 — as compared with the situation in 1972			
Drawing in additional net resources	45.6	10.3	33.5
Export expansion effect	20.5	24.8	22.0
Import substitution effect	3.0	4.4	41.0
Effect of slowdown of growth	30.9	60.5	41.0
Total	100.0	100.0	100.0
C) Average of 1979–1983 — as compared with the situation in 1977			
Drawing in additional net resources	23.5	—140.0	—22.5
Export expansion effect	12.1	62.3	26.2
Import substitution effect	5.0	11.3	6.8
Effect of slowdown of growth	59.4	166.4	89.5
Total	100.0	100.0	100.0

* In the lines "Drawing in net additional resources" and "Effect of export expansion" the negative values mean the placing out of resources (resource consolidation) and relative losses of market positions.

growth. A substantial shift of emphasis was experienced in the two five-year periods, but it remained characteristic of both that the mentioned dominant reactions covered 75—80 percent of the adjustment burden that had to be absorbed in comparison to the situation in 1972. On national level the effects of export expansion and import substitution were reduced to 20–25 percent in coping with the adaptation tasks. In the first five-year period the sequence of reaction on macro-economic level was as follows: drawing in net resources; export expansion; slowdown of growth; import substitution. The sequence of responses and the size of the particular elements were different for each of the main trading partners of the country, though the insignificant part played by import substitution and the very high proportion of drawing in resources was conspicuous in both market groups.

In studying the effects of the external markets two sub-periods have been distinguished; this breakdown is even more justified when presenting the path of adaptation. In the first period, the acknowledged view of economic policy was that there was no need to modify the earlier development path. Following the 1978 resolution on economic policy, i.e. during the second sub-period in terms of the research, the policy expressly aimed at a path-modification and deliberately adopted the active way of adjustment to the changes in the world economy.

For evaluating the situation two preliminary remarks need to be made: one of them is a proposition, or, to put it more accurately, the articulation of an evidence easy to forget; the other is aimed at defining some notions. It is obvious that an economy always adjusts to any external changes, no matter whether this process has become conscious or not. Hence, the adjustment to the effects of the external market changes comes about even without decisions by economic policy-makers—in which case the responses will reveal the propensity of the economy to adjust that follows immanently from its structure. The objective of defining some notions is, in turn, to separate clearly the categories of the adjustment burden and the capability to adjust. In our case the burden of adjustment equals the extent of the external shock and, as such, may be considered an external factor. The capability to adjust results not only from the existing reflexes and structure of the economy, but also from the behavioural rules of a longer period, and the structure itself came into being as a consequence of an earlier system of decision-making and resource-allocation.

The dilemmas of decision-making and the evaluation problems of the analysed period reflect the blurring of differences between the two nations and the confusions stemming from the lack of such distinction. For, in the ten years observed neither the propensity to adjustment and the path accomplished, nor the burden and the capability of adjustment always took uniform directions.

Since in the first period the policy did not consider it necessary to modify the character of the previous development path, the process of adjustment unfolded in accordance with the existing propensity to adaptation.

Between 1974–1978 the growth practically proceeded as before and the response to the changes in the external conditions in the socialist relations had been realized with a relatively strong component of export expansion (33 percent); in the non-socialist relations the drawing in of net resources became dominant (83 percent) and a relative market loss (minus two percent) was also registered. The economy was moving in accordance with its structural propensity: export expansion and a matching growth made headway in its "natural" direction, namely, towards the socialist countries.

The question of whether or not this process was desirable will not be examined at the moment. What is more, the question whether this or something else had been anticipated by economic policy is also not to our point. The issue here is to determine the propensity of the economy to react under given conditions.

In accordance with the two types of export markets, the adaptation ability of the Hungarian economy is as two-faced as any other of its economic parameters. When economic evaluation on the macro-level—especially at the beginning of the period—suggested that it would be easier in the socialist market for the economy to overcome the shock caused by the crisis, this opinion confused two things. The fact that the adaptation ability of the economy to the demand of the socialist market is indeed better, was not separated from another one, namely, that—owing to its commodity pattern, its limited supply position and its bilateral trade practice—this market imposes a greater burden of adaptation on the Hungarian economy. The adaptation capability of and the actual adjustment burden on the economy in the capitalist market had shown a reverse relation: a minor external shock was met by a much worse ability to respond.

By the end of the first period it was clear that economic policy did not intend to pursue nor considered desirable the path of drawing in additional resources that had been unfolding in the non-socialist relations of the country. Eventually in 1978, at the end of the year, a decision was made on path modification, adopting an equilibrium-minded economic policy.

Turning back to *Table 1*, i.e. to the history of how the adjustment burden evolved, one gets some indication about the chronological relationship between the change in economic policy and the true need for active adjustment. It can be seen that the political intention of an active adjustment was formulated in Hungary only at the time when the intesity of the need for external adjustment had already reached almost half of the magnitude which burdened the country by the end of the period.

It must be mentioned, however, that the extent of the adjustment burden as regards export volume effects was not so obvious, i.e. physically tangible, in the socialist relations during the first period as it was later on. It could "merely" be seen by anticipation what kinds of grips and constraints would interfere with the country's economic expansion owing to the limited supply and changing conditions of the socialist market.

In the first period the foreign trade of the CMEA region was growing more rapidly than that in the world market and this inevitably exercised a pulling effect on Hungarian exports. On the other hand, the more rapidly increasing trade of the region was partly attributable to the fact that, in Hungary and the other countries, too, responses to the changing conditions of the world economy started with some delay. [5]

The relatively stable growth of the Soviet market and, furthermore, the circumstance that Hungary's strongly worsening terms of trade in this relationship (even for maintaining a balanced turnover in value terms) required from the outset incremental exports, seemed to justify the export expansion. This was, in addition, in conformity with the propensity of the economy to adjust. Without convertibility, however, export expansion to the socialist market can be regarded as desirable only to the extent it is counterbalanced with increasing imports, and while it helps the buying of necessary goods. The effect of the export expansion, which was positive on aggregate level, hardly functioned, or did not act at all, on the market where it would have been the most important under the circumstances of the given period. In non-socialist relations Hungarian foreign trade had, on the whole, suffered relative losses during 1974–1978.

This is the point where the questions of the adjustment burden and adaptation ability come up again. It is important to see at this juncture, how different it is to perform adjustment to a given burden in a direction corresponding to the existing structural and growth propensity of the economy, or to do so in an opposite direction. It is not at all indifferent, which of the components—in what way, and with what force—is pulling or pushing and for what reasons it is doing so.

The 1978 resolution of the Central Committeee of the HSWP declared the re-establishment of the external equilibrium as the main economic priority. Translating its content into the terms of this paper, it aimed at stopping the path of drawing in net resources; at the same time, a general import substitution and import savings policy has also unfolded. In the second sub-period the contradiction between the adjustment burden and capability of adaptation came to the surface and grew tangible.

During 1979–1983 the path of drawing in additional resources was curbed and finally stopped. Despite the radical restrictions on imports, the results of import substitution were negligible on macro-level, though the overall imports decreased rather significantly. The price paid for the equilibrium-restoring policy, in other words, the main response of the economy was: the deceleration of growth. As a matter of fact, the achieved imports savings originated in the lowering growth rate of the economy. In sum, the policy intention and its realization did not completely coincide. This was indeed not surprising, since certain components cannot be fitted into a harmonious, feasible configuration: that is, leastways not in the short run and with sudden coercion.

The great import pressure of the consolidation era could hardly increase the import substitution effect on the economy. *Tables 3* and *4* also demonstrate that as regards savings due to import substitution, the growth prior to the great import restrictions came near to being more favourable than in the following years, especially if one takes into account its division by market groups. Despite the increasing austerity a more significant change took place only between 1981–1983 and only in the socialist market.

Table 4

Annual development of the components of the adjustment process between 1974–1983

(percent)

Year	Drawing in net resources	Export expansion	Import substitution	Slowdown of growth	Total
		A) Compared with the situation in 1972			
1974	93.8	—1.6	5.2	2.6	100
1975	70.4	19.4	7.8	2.4	100
1976	62.5	13.4	8.0	16.2	100
1977	54.6	26.9	6.5	12.0	100
1978	74.8	15.4	—6.5	16.3	100
1979	47.1	24.6	0.9	37.4	100
1980	42.7	14.6	1.3	41.4	100
1981	37.2	15.9	4.4	42.5	100
1982	27.6	24.2	6.3	41.9	100
1983	24.6	26.9	2.7	45.8	100
		B) Compared with the situation in 1977			
1979	—26.8	44.3	—2.8	85.4	100
1980	—33.6	3.4	—0.9	131.1	100
1981	—20.1	12.1	9.6	99.1	100
1982	—20.9	31.0	13.0	76.9	100
1983	—20.3	31.7	4.6	84.0	100

This fact gives rise to further remarks. Since the propensity of the economy to trade imbalances is different in intensity and contrary in direction on the two markets, one might suggest that in the wake of the global economic changes that came to pass after 1973, it might have been desirable in principle for the external economic equilibrium to realign trade towards the socialist market. The formation of the import substitution effect and its market distribution indicate, however, tendencies contrary to this assumption.

The savings from import substitution recorded in the last three years of the analysed period in the socialist trade are mainly due to a strongly limited supply situation, causing first of all a slowdown in the dynamism of raw material and energy imports. This gap in the supply pushes the economy towards real and rational economizing tendencies. Within the present study there is no place, however, to evaluate its long-term effects on the growth process, economic equilibrium and on the import elasticity at macro-level. It must also be admitted that, owing to several conflicting tendencies and influences, no unequivocal conclusion can be presumed. The sources of rational import substitution are, in accordance with the logic of economics, rather limited in a small and diversified economy which is poor in raw materials.

Besides, lacking a competitive market situation, profitability cannot be judged correctly. Therefore, very soon shortfalls of production, technical backwardness, deformation of structures and, last but not least, additional import requirements may emerge.

The fact that the savings through import substitution have been negligible does not contradict the experience that the critical years of imbalance in the foreign economy almost every time revived the intention to reduce imports. The economic units lived through this hard reality. In fact, large import savings came into being, but mainly because the economy responded to the afflictions prevailing on the import side by the slowdown of growth.

The factors causing the slowdown of growth are, of course, combined and one cannot talk about a uni-directional cause-and-effect connection regarding even the relationship between growth and imports. This mutual relationship undoubtedly exists, either in the form that any slowdown of growth among normal conditions initiates effects resulting in import sawings; or, it may act from the other side, too, which means that cuts and restrictions on imports, especially sudden turns, may bring forth the slowdown of growth.

Both sides of this inter-relationship have been acting in Hungary, it is impossible to separate the intensity of the two effects. The break in the development indicators before and after 1978, as well as other economic facts not dealt with here, indicate that the strength of the shock coming from the stringent import situation strongly contributed to the slowdown of growth in the last period.

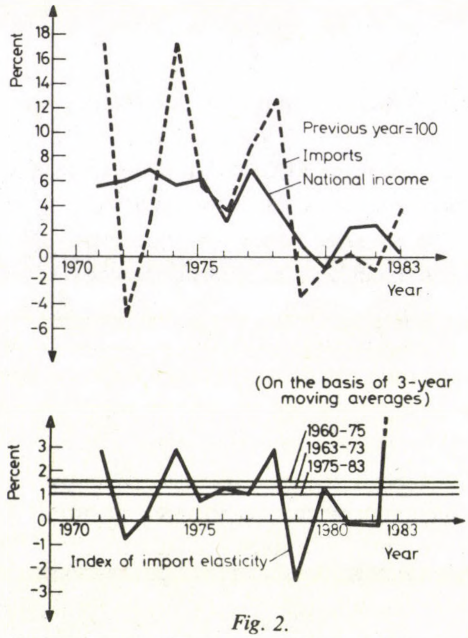

Fig. 2.

Development of economic growth and imports between 1971–1983

The chronological sequence of the changes in the growth of the two categories is shown in *Fig. 2*. It also demonstrates that in spite of fluctuations the import elasticity moved obstinately along its long-distance trend line. The equilibrium-restoring policy introduced after 1978 which, by the nature of things, had to contain export expansion, too, could assert this element in the direction of the non-socialist markets only with great difficulty. This is where the adjustment burden and the actual capability of the economy to adaptation sharply contrasted with the policy intentions. Though the role of the export expansion was continuously growing in this direction,* it did not, in any of the years, reach in absolute terms the extent that was achieved in the socialist market. The main drive of export dynamism throughout the whole time moved towards the socialist market. Though the relative weight of this component increased in respect of the non-socialist markets in the years 1982–1983, it is slightly misleading because the "norms" of these years were set by a world market in a state of recession.

In the second sub-period, i.e. between 1979–1983, the export expansion effect tried to fulfil its intended role despite all weaknesses and difficulties, and it served as a means to reduce the drawing in of additional external resources. From this point of view, the policy efforts were mainly directed towards the non-socialist markets and indeed, if one makes here comparison with the situation of 1977, then already the placing out of additional resources, i.e. resource consolidation, was accompanied by export expansion *(Table 3)*. In the socialist markets, during the second sub-period, in conformity with the characteristics of the region, the outflow of additional resources was arrested and the export expansion effect became more moderate than earlier.

Table 4 presents a double view on the period 1979–1983. It shows on a double time register, compared to the situations in 1972 and 1977, how the adaptation process went at national economic level. Looking at the column compared to 1972 one can see how the adjustment to the whole series of changes finally took place. This is important also because an adjustment policy response in the proper sense of the word started at macro-economic level only in 1978–1979 and the burdens not settled to that time formed part of the future tasks to be performed.

The comparison based on the 1977 situation is significant because it indicates the intensity of the turn in economic policy and the way of realizing its major engagements.

Taking these into account, the second period is embedded in the total process so that the radical turn in economic policy fulfilled on the whole its primary engagement, i.e. it made the resource consolidation component a permanent and significant element of the actual pathway. Still, due to the delayed start of an active adjustment policy, Hungary was, compared with the original situation—even at the end of the period—in the position of drawing in additional resources.

* In commenting on this component, attention should be called to the fact that the applied method measures the export expansion, as well as any other elements, in terms of volumes, i.e. at constant prices. By excluding the price factor it is neglected that, in the case of economic processes urged by great force, a quantitative expansion frequently involves some sacrifices in prices and/or efficiency.

One can say, in general, that the new configuration of the adjustment responses could only very slowly re-align the components of the pathway. This is apparent if we look at the whole period as compared with the state in 1972. The parameters giving the most serious warnings perhaps are: the domineering component-pair of drawing in net additional resources and the deceleration of growth, proceeding slowly and gradually against one another; the slow and laboured increase of the share of export expansion; and, finally, the meagre role of import substitution. Pointing beyond the quality of the actual pathway, all these suggest how difficult it is, in general, to change, modify or invert tendencies.

The pathway: alternatives and dilemmas

The two dominant elements of Hungary's adjustment path have, as a matter of fact, been obvious from the outset for a Hungarian economist. I conformity with the views of professional circles, they became part of everyday knowledge, almost at the level of triviality. The progress of the pathway, its switches, the linkage of the components with one another or the "predestined" nature of its development are not so clear and do not enjoy common consent. The present brief, concluding remarks try to recollect the logical interconnections of the facts and categories in order to give an overview, but, at the same time, we wish to use them for clarifying a simplified conclusion which has recently been spreading. This opinion essentially puts a sign of equality between the equilibrium of the balance of trade as a good, and the drawing in of external resources as a bad phenomenon. It seems to suggest that the country had to pay the price for drawing in external resources in the first period with the sacrifice of decelerating growth during the second period.

If a country does not consider the equilibrium of the trade balance a priority, what is more, if it reckons explicitly from the outset with drawing in net external resources, this, even in the era of radical rearrangements after 1973, does not automatically mean moving in the line of least resistance. Namely, the path of drawing in external resources has an active and a passive alternative. The active variant uses the external resources for structural renewal, the passive way opts for postponing structural adjustment.

After the radical changes in the world economy, the first hypothesis in Hungary assumed that, relying on the socialist community, the country would be able to avoid the unfavourable changes of the world market and to let them affect the economy at a slower rate, in a mitigated form. This opinion was accompanied by the view which held that it was advisable to draw in resources to a limited extent, since this would produce structural improvement and, combined with export incentives, would lead to an appropriate economic results. But, because the behaviour of the economic units was not motivated by rationality, in actual fact a path of drawing in resources came into existence along with postponing structural adjustment.

It is a sign and also consequence of this situation that growth came to a halt when, in the wake of increasing indebtedness, the development of other economic parameters had to be subordinated to the requirements of equilibrium in the foreign economy. The vulnerability of the foreign economic relations and foreign trade structure of the country became evident. The insufficient ability of the economy to export to the appropriate markets delimited Hungary's import opportunities and only allowed a very low level of imports.

In the second period the main objective was to re-establish foreign economic equilibrium. But a policy response with equilibrium on its flag also has an active and a passive version. The active variant stimulates production to make additional exports, applying at the same time a reasonable import substitution. In principle, this option does not or at least does not radically reduce growth. The passive adjustment tries to keep the deficits of the balance of payments on a reasonable level so that it achieves import savings by the deceleration of growth.

The economic policy formulated for the second period in Hungary was essentially drawn up from the elements of the passive prototype. From the components of the active version it did not include any but the factors relating to the import side. Although the realized pathway mostly embodies the particularities of the passive reaction, the linkage between the policy targets and the path accomplished allows for the conclusion that the judgement of the economic situation, and the implementation, were moving on the ground of realities and reflected the existing opportunities more than the policy and conduct in the first period.

Since the actual pathways followed the passive variant in both periods, the future development will be accompanied by difficult and permanent dilemmas. Presumably the passive adjustment variant, realized in the first period, played a decisive part in preparing for the second period a version of passive components already at the stage of policy decision itself. The practical failure and limits of the import substitution element, in turn, indicate that a small country with an open economy and poor in raw materials, in the long run cannot solve its problems by focusing on the import side, and thus the active elements have to be built into the development path in another way.

The great dilemma of the future is that it might de difficult to avoid mobilizing the active elements of the pathway; the later this begins, the greater the economic price to be paid for it will be. On the other hand, passive variants of the past make it verisimilar that bringing in active elements would, in the first run, swing the economy towards imbalances because, owing to the lack of appropriate structural adjustment, the propensity of the economy to imbalance has not changed.

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ПРОЦЕССЫ ПРИСПОСОБЛЕНИЯ В ВЕНГРИИ В 1973—83 ГГ.: ПРИНЦИПЫ, ЦЕЛИ, ФАКТЫ

Ж. БЕККЕР

В статье анализируется с помощью метода Балашша степень того шока, которому подверглась венгерская экономика со стороны внешнего рынка, и процесс приспособления экономики. В распределении на количественно определенные составляющие анализируется, в какой степени в реакции на мироэкономические изменения и изменения спроса в период 1973—83 гг. были характерны использование дополнительных ресурсов, экспортная экспансия, замена импорта и замедление роста. Проводится сравнение принципиально возможных мер и целей экономической политики с фактическим развитием. Вследствие различных динамических и структурных особенностей основных рынков венгерской экономики анализируются особенности траектории развития внешнеэкономических связей с социалистическими странами, одновременно делается различие между временем приспособления и приспособляемостю. Констатируется, что помимо запоздания реакции экономической политики развитие в основном характеризовалось пассивными элементами приспособления. Поворот экономической политики 1978 г. лишь постепенно вносил изменения в компоненты приспособления к кумулятивному бремени.

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OPEN ECONOMY AND DOMESTIC CONSUMPTION*

R. HOCH*

One of the fundamental problems of the whole economic-development strategy is whether Hungary should increase or mitigate the quantitative openness of her economy in the coming years. According to the study the share of foreign trade has to approach the optimum. Today it exceeds the optimum necessary for the enrichment of the country under the prevailing conditions, it has to be relatively reduced in the short run. This may also help in rendering the external relations more intensive. At the same time, efforts should be made to increase the foreign-trade-absorptive capacity of the economy with a suitable well-conceived economic policy and with the stream-lining of the economic mechanism without delay and without reluctance. An indispensable condition of all that is to increase the role of the domestic market, of domestic productive and personal consumption.

There are theses Hungarian economists agree on so much that they almost consider them to be axiomatic truths. Related to our subject, such "axioms" are the following:

— The economy of Hungary is open, thus an autarkic way of economic development is simply out of the question. It follows from this that trade policy is highly important, and in many respects decisive element of economic policy; it is decisive for concepts, for the system of instruments, for institutions as well as for the mechanism.

— Our joining the international division of labour must be made more efficient and the income-producing potential of domestic resources must be increased and its quality and technical standards must be improved by developing foreign trade relationships.

— Maintaining the external and internal equilibrium of the economy is of prime importance for society and economy alike. Therefore, the growth of domestic absorption can only develop in ways that will not disturb equilibrium.

— The economic policy must desist from general restrictions and a selective economic policy must be pursued on the basis of which, sooner or later, it has to be switched over to growth orientation.

These important theses are necessary, but even combined they are not sufficient for forming an economic policy which includes medium and long-term trade policy concepts.

This paper is based on the author's inaugural lecture at the Hungarian Academy of Sciences delivered April 30, 1986.

* Throughout the article: productive *and* personal consumption.

Openness

External economic relationships and the fields and forms of a nation joining the international division of labour can be manifold. They include, among other things, financial, capital and credit relationships, joint ventures, technological contacts, possibly an international movement of labour, marketing, foreign trade diplomacy, a system of economic agreements, contacts with international economic organizations and participation in their work. These features naturally include a system of *commodity-related relationships,* i.e. exports and imports. The system of trade relationships involved in joining the international division of labour is collectively formed by the afore-mentioned factors and the open or closed state of a given national economy is determined by the width and depth of the said relationships. Yet it is trade that forms the basis (and historic origin) of external economic relationships. This is also how openness is practically measured: the volume of foreign trade is compared to the national income and/or to the GDP. In the following *I am going to analyse* tendencies in the proportion of foreign trade turnover as against the GDP and thus establish its *openness using this formula.**

It needs to be mentioned that openness measured this way does not provide an answer to the question how the openness of a country is developed in general.**

The question is: *how the relative volume of foreign trade turnover on the one part and its efficiency on the other are correlated; and what factors do have an impact on this correlation?*

My theses

1. Right now, the Hungarian economy is much too open quantitatively, thus the efficiency of the external economy is suboptimal. Therefore, extent of openness must be reduced in the short run. As for the other side of the relationship: the importance of domestic consumption and the relevance of output for the domestic market must be enhanced; in other words, the proportion of foreign trade as against domestic consumption must be reduced.

2. The intensity of foreign trade relationships and the quality of Hungary's integration into the international division of labour must be improved, i.e. trade policy (or economic policy) openness must be enhanced already in the short run.

*The comprehensive article of Ferenc *Kozma* has given rise to an edifying debate for he distinguishes between *structural* openness and *trade-policy-openness* [11]. Imre *Bakonyi,* with whom I agree, suggests that we use the term economic policy openness instead of trade policy openness. These indicators express even "quantitative" openness only imperfectly; other indicators, too, may be appropriate to measure this proportion. [2]

** Sára *Pásztor* is right when she writes that "...the degree of economic openness ... cannot be qualified in itself" ([16] p. 10). "The magnitude of economic openness at any time can merely indicate the extent of dependency on the international division of labour of a given national economy but it cannot express the quality of participation..." ([16] p. 11)

3. By changing endogenous factors—using an appropriate economic policy and by firmly improving the economic mechanism—it has to be provided for that a maximum efficiency of foreign trade relationships be reached through a much bigger foreign trade turnover than at present—in other words, through a greater openness; this means that the foreign trade adsorptive capacity of the economy should be increased and *in the long* run an overall openness, including that of foreign trade, should be strived at.

Economic policy and planning documents do not offer a clear answer to the questions raised by these theses. Instead we are often told that Hungary should increase its involvement in the international division of labour. This and other generalizations are vague, sloganlike and as such, are not suitable for being used as building elements for the country's foreign trade concept.

On the other hand, widening foreign trade relationships without providing for the proper conditions and based on forcing a further increase of the volume of trade would imply going on with an *extensive* (and nowadays definitely inefficient) economic development in a special, but highly important field. To proceed on an extensive path would affect the economy as a whole and would thus also drive foreign trade in an extensive direction. Intensive development calls for the widening and deepening of other forms of external trade relationships. Of course, it is possible that this development may result in the growth of foreign trade turnover. However, what is more important, increasing the intensity of foreign trade relationships can make that trade itself *more cost-efficient*.

Capacity to absorb

All economies have a given load-bearing and productive capacity at a given date. This potential may also be called digestive or absorptive capacity.* If this potential is not exploited and the economy does not get the amount of food it can digest, then it will not develop to the best possible extent. Yet something similar happens when this potential gets overstrained. Too much food upsets the stomach of economies as well. The limited absorptive capacity of economies can be observed in connection with several economic phenomena and processes and these are closely correlated. For instance, investment absorption largely depends on the volume and structure of the country's foreign trade and *vice versa*.

The first things we learned about *investments* were that they might have an optimum size**, and even an optimum change. The optimum cannot, in this case, be understood as a precisely defined point: it is more like a zone. There were times when

* This latter term was, to my knowledge, coined by the distinguished Yugoslav economist Branko *Horvat*.

** Branko Horvat applies the term 'absorptive capacity' to investments only.

we thought that the greater investment, the better the economic development ("the sky is the limit"). According to this concept, the whole national income should be invested, but alas, the (possibly declining) consumption of the population is a limiting factor. However, we know now that investments do have an optimum size depending on the national economy's absorptive capacity. It is also easy to see that the entirety of loosely interpreted productive capital assets has an optimal size and optimal growth so that the economy can operate with a proper (or improving) degree of efficiency ([4], [5]). From this point of view, the efficiency of investments is the marginal value of the efficiency function of productive capital assets.

On the other hand, it is not yet evident* that the *economy has the capacity to absorb the volume of external economic relationships*, and *that of foreign trade in particular*. More exactly, it need not be proved that should the economy fail to exploit its capacity and deviate from optimum toward autarky, then growth will be less than possible. *Yet it is not at all evident* that a turnover pushed beyond the adsorptive capacity not only fails to render development more favourable but the other way around: it impairs the efficiency of national economy and *might even cause* a prolonged deterioration of equilibrium (with all possible symptoms) and could further reduce the efficiency. Moreover, the consequences of two-directional deviations from the optimum are not even equivalent. In connectionwith investments, *Mihályffy* and *Szakolczai* [1] point out that the diagram of efficiency is not symmetric. Approaching the optimum point (zone) from below, the value of the function gradually grows, and once it reaches the maximum, it suddenly starts to drop! It is not the shape of the diagram of efficiency of foreign trade similar to that? Quite a few experiences indicate that it is.

Exogenous and endogenous factors determining absorptive capacity

The absorption capacity outlined in the foregoing is determined by the combination of several factors, some of them being exogenous and others endogenous.

In connection with the exogenous factors, the state of the world economy—and policy—is obviously most relevant: boom or slump on the Western markets, the state of money and credit markets, of the CMEA's mechanism, the demand and willingness of Western countries to import, price trends and price proportions—to name just a few.

Of endogenous factors the following are the most important: the level and structure of the forces of production (including their state of development and structure—especially of the infrastructure), the degree of technological development, the level and structure of turning out products and the relevant energy and material intensity. They are all, to no small extent, determined by the mechanism and

* Kamilla *Lányi*, for one, doubts this [15].

institutional system of the economy, by the economic policy, including foreign trade policy with its own array of goals and means. Yet is the economic policy restrictive or development-orientated? If it is restrictive, then is it generally or selectively so? Finally, what is the state of external trade relationships? Is the debt stock large or not? How sophisticated are the different forms of external trade relationships? What is the market structure of external trade relationships and what is their institutional system like?

It clearly follows from the above that since the factors themselves are changing, so can, and does, absorptive capacity.

With the absorption modified because of the change of exogenous factors can we move toward the optimum *by adaptation* only. One can, for instance, adapt by certain shifts in the structure of exports and imports, or by increasing or reducing the absolute, but even more the relative size of the volume of foreign trade turnover. Endogenous factors, however, can be changed and through them the economy's absorptive capacity can be modified and enlarged. It appears that a given absorptive capacity can (and must) be adapted to in a shorter time that it can be enlarged. This means that to enlarge absorptive capacity is a strategic task (that cannot be started soon enough), while adaptation to a given absorptive capacity is a more short-term, tactical task [17]. It was said in the course of the relevant debate [14] that to reduce the openness would be a palliative treatment. This point can be accepted. Yet in the medical sciences, this term does not sound pejorative, since such treatment is an instrumental part of most therapies. If we managed to relieve the fever or pain of the patient, this would still not cure the underlying sickness, yet it is a precondition of curing it. The basic therapy is actually the increase of absorptive capacity. In the course of the debate on the subject these two points of view often seem to be mixed.

Growing openness in the 1960s, continuing into the early 1970s, had greatly helped add to the national wealth and prosperity of the Hungarian population. In that period

— the world's political atmosphere was favourable (an exogenous factor);

— owing to the isolation policy of the 1950s the volume of foreign trade was less than the absorptive capacity (an endogenous factor);

— the 1968 reform of the economic mechanism enhanced the absorptive capacity (an endogenous factor).

In the 1970s, however, the absorptive capacity shrank because

— the reform came to a sudden standstill and in some respects it even reversed—then returned to "manual control" (endogenous factor);

— several features of the economic policy produced adverse effects, such as the low tide of long-term planning, the lack of selective policy, investment policy etc. (endogenous factors);

— the global economic situation deteriorated (exogenous factor).

The right tactical reaction would have been to reduce openness. Instead, the period was marked in the second half of the 1970s by an investment boom, followed by indebtedness resulting from increased import openness; and by the forcing of exports (and the curbing of imports) in the 1980s: all in all, by a growing export openness.

Now we have a dual task. On the one hand, by further developing the economic mechanism and applying a proper economic policy, the absorptive capacity should be increased.* On the other hand, the economic policy and the system of regulators must drive the volume of foreign trade toward the optimum zone. Since the absorptive capacity can usually be increased step by step only, it takes, as best, years to produce a sizeable change; further, since the volume of Hungary's external trade is already far beyond the one the economy can efficiently absorb, and approach to the optimum range postulates a relative moderation of the foreign trade turnover.

Revaluation of the domestic consumption

Now let us see the other side: *what is the position and role of domestic consumption* within the economic policy concept?

Forced foreign trade going beyond the economy's absorption capacity necessarily implies pushing domestic consumption, i.e. the domestic market, to the background, depreciating and devaluating it. On the other hand, reducing the relative measure of openness might enable us to attach more importance to the domestic market: to revalue—in this sense—the economic importance and role** of domestic consumption.

This requirement is particularly imperative these days when preparation of a step-by-step shift from the stagnation—and even the fall—of domestic consumption toward its raising seems inevitable. Such a shift has become pressing for more than one reason; first of all because of the accumulation of social tensions and tasks. It is also demanded by the development of the production sphere, numerous fields of which have been put into an increasingly *difficult situation by the restriction spiral: a drastic* cut-back of investments, fiscal and monetary policies put into the service of general restrictions, widespread liquidity problems, and disrupted cooperation relationships. More generally speaking: indiscriminate, prolonged restrictions not geared to prepare growth cause an erosion affecting virtually every field of society and economy. To mention another important point the April 1984 resolution of the CC of the HSWP cannot be implemented with a stagnating domestic absorption, reduced investments and decreasing real wages. Under such conditions the reform may degenerate to partial changes of the system of regulators, which changes could easily have been introduced before, or even without, that highly important political statement of principles.

* Sándor *Balázsy* is right when stressing, in this respect, the importance of further developing the mechanism [3].

** This postulate was one of the starting points of the living standards policy concept worked out by the Institute of Economics of the Hungarian Academy of Sciences.

The concept urging a temporary reduction of the *proportion* of foreign trade as well as the revaluation of the role of domestic consumption may sound for some like an autarkic endeavour. Yet autarky under our conditions is an economic absurdity and the afore-mentioned concept has obviously nothing to do with it. Views forming the counterpole of autarky are, however, just as absurd when saying that the ideal state of things is total openness, i.e. when all domestic products get exported and all domestic demand is satisfied from imports. To be sure, no one will suggest something like that. However, I cannot help but think of this kind of reasoning when hearing and reading everywhere that the satisfaction of domestic demand with internal output is being given names like "import replacement" and even autarky; when being confronted with the effort to make the "world market's price system" our own (either as a result of actual market processes or simulated [12]); and when production for domestic consumption gets, somewhat ironically, called production "for each other".

Now let us start with the latter interpretation! Yes, the domestic consumption of domestic production is, as a matter of fact, production "for each other"—but not in a sense that hills are being moved from one place to another (admittedly, it might take such form).

Nevertheless, the point is that production must be considered as a kind of combination of output for both our own consumption and exports, and domestic absorption as a kind of combination of consuming domestic output and imports. Representatives of theory and practice must then try to keep their proportion near to the optimum zone—and with this we arrive back at the problem of absorption capacity.

If we see the economy from the outset as a combination of domestic consumption and external exchange (and not as an *actual* situation at that but as a *natural* state of things) then the basic question is at once put in a new light. Thus we avoid extremities like 'autarky' or 'total openness'.

In the concept of a "two-faced" economy the problem of cost-efficiency, or the connection between expenditures and results, presents itself in a peculiar way*. Its judgement has a dual measure. In the case of domestic consumption of domestic output the direct measure is the relationship between expenditures and results. The other measure is, considering expenditures pertaining to domestic production and transformed through foreign trade (export profitability and international purchasing power), the quantity of import products we can acquire for the domestic consumption.** In other words, a decisive factor of actual total efficiency (i.e. the amount of domestically spendable income produced by total domestic expenditures) is the distribution of all domestic output and consumption, between output meant for domestic consumption and foreign trade transformation. Consequently, the total (overall) efficiency can, to a great extent, be modified (improved or reduced) by any

* I dealt with the problem in more detail in my book [8].

** Ágnes *Kiss-Pavelcsák* interprets the efficiency of foreign trade in a similar way.

modification of this proportion. If the cost-efficiency of foreign trade transformation improves, this can, even at an unchanged rate of transformation, improve the total cost-efficiency; but the income of a nation grows even more if the rate of transformation grows as well. If the cost-efficiency of transformation declines, the situation gets reversed: even maintaining that proportion worsens the total cost-efficiency, let alone its increase. However, in this latter case reducing the proportion of transformation and increasing national self-consumption may compensate or even overcompensate for that deterioration. An analogous case with this is the drop of income of smallholders when the gap between relative prices of agricultural and industrial products (the "price scissors") widens. Smallholders define their incomes earned from products meant for their own consumption by the volume of stock used and not by depreciating it according to the "price scissors". The income status of a smallholder gets better if he sells less of his output at the market, i.e. if he transforms a lesser part of his products, and allots relatively more for his own, family and farm, consumption. All in all I have arrived again at the same conclusion: as things are now, the condition and means of improving the efficiency of the economy as a whole, and increasing the volume of domestically spendable income, is to increase the rate of "self-consumption" as against transformation. Of course, firm conditions for improving the cost-efficiency of transformation should also be provided for. Additionally, it must be ensured that the inputs of output both for "self-consumption" and exports be reduced, and with the same input more products and services of better quality be turned out.

There are many interrelationships between the two kinds of efficiency. For instance, the external economy, and more exactly foreign trade, can raise domestic efficiency.* It certainly cannot be contended that the more open an economy is, the greater the inductive impact.** Excessive openness could just reduce the inductive impact. It is again up to endogeneous factors to affect the efficiency-generating impact of foreign trade.***

Underestimating or revaluing the domestic market is related to both the mechanism and the system of regulators as well as to the economic development strategy and tactics.

What do I mean by the revaluation of the domestic market and output for the satisfaction of domestic consumption.

1. A strategy, and a relevant economic mechanism, must be elaborated and put into force that can enable Hungarian industry, and the manufacturing industries in particular, to achieve a medium-high and reliable level, while enabling the best ones to

* Ferenc Kozma calls attention to these relationships. [11]

** This is the central thought of Ferenc Kozma's concept.

*** "...technical transfer cannot substitute for the internal economic vehicles of efficiency improvement because the possibilities of technological and economic development are determined first of all by internal conditions created by the economic policy and the system of economic control and management. Therefore, it would be just as much a mistake to overestimate the role external trade relationships play, and may play, in economic development." [13]

shoot ahead and even urging them to do so. It would be illusory to expect industry, and especially the manufacturing industries, to fully reach world standards!

The domestic market does not usually demand top-notch quality but simply good products of reliable quantity. (See [6]) Yet these it wants badly and the supply of such products is a precondition to *certain* products and *certain* companies being able to make headway and being competitive on foreign markets as well. For instance, experts say that there is no realistic chance of Hungarian industry reaching the top in electrònics, including microelectronics, and thus little possibility of having a competitive edge on the world market in this field. There may be exceptions and there ought to be some. However, it is not a realistic possibility either to supply the Hungarian economy (and consumers) chiefly with electronic products from the West. On the other hand, a main condition of the overall development of the Hungarian economy and of the whole society, as well as of the export potential of other branches, is to introduce electronics on the basis of domestic production (and imports from the CMEA).

2. The mechanism must make companies *sales-oriented.* This means that the saleability of their products be elevated to a matter of life and death, and they be allowed to pocket the money of their customers only if they market products in a structure and quality required by them. In this respect, the existence of companies should depend just as much on getting the money of domestic customers as it depends on convertible currency revenues. (Of course, exports may be encouraged by extra incentives.)

We often hear that the Hungarian economy should be made export-orientated. As with any thought turned into a slogan, this one, too, is rather vague: everyone interprets it in his own way. Yet this slogan today practically means that the domestic market should take second place to (non-rouble) exports. My own attitude is not determined with the debt burden in mind but by theoretical judgement of external and domestic markets. Up to the optimal extent defined by the absorption capacity, the economy must actually join the international division of labour, and absorption capacity must be systematically increased. This is what the economic policy must strive for and companies must also be interested in this endeavour. If this is meant by export orientation, I fully agree with the slogan. Nevertheless, only a stable and expanding domestic market can be a firm basis for export expansion. Efforts which try to make output for exports and enclave within the economy are basically wrong.* *En masse* and in the long run it is impossible that the very companies producing inferior and unstable quality for the home market, might be able, and willing, to turn out good and stable quality for export purposes. The practice supplies such a multitude of examples (as a matter of fact, it is hard to find counter-examples) that the statement does not need verification. For any company, the money of each and every customer (be it domestic or foreign) must be equally valuable, and to get it must be a question of life and death

* "Export orientation in itself is not an automatic force for further progress!" [12]

for the company. That is to say that companies should be made *generally sales-oriented.* Only on this basis can effective export promotion take effect and an actual export orientation be developed.

3. No one denies that the stagnation, and even decline of domestic consumption cannot go on for an indefinite time. Sooner or later it has to be switched over to increasing domestic consumption. The only, but not meaningless, debate is around the question: sooner *or* later. In close connection with this is the kind of role the internal economy plays or may play in inducing growth. Also it is evident that, along with the growth, the noose should not be tightened around our neck—on the contrary, it should be relaxed. We have to provide for realistic conditions for the increase of domestic consumption. What is more, it is safe to say that should we fail to radically change the endogenous factors (and very soon at that) then we shall be unable to maintain existing levels and instead of rising we shall start to sink.*

Can the measure of openness be influenced?

It may be said that the measure of openness cannot be influenced because *the proportion of foreign trade turnover to the GDP is influenced by the combined effect of several factors*** *and is not the subject of economic policy and/or national economic planning.*

The first half of the antithesis is certainly true. It's not easy even to predict the combined effect of several factors. For instance, it is difficult to say if pushing vigorously ahead with the reform will result in a relative increase or decline of foreign trade. It seems obvious that an efficient increase of the autonomy, interest and inducement of companies may simultaneously give rise to both tendencies: the development of technologies involving the import of advanced machines on the one hand—and the saving of materials, energy and investment (i.e. import savings) on the other. It could also mean increasing exports if they are profitable, and stopping the unprofitable exports which are currently forced upon companies. But does the other half of the antithesis follow from its first half? I do not think so.*** It is true that a proportion seen *statically* would not show very much. But *changing* the proportions (accumulation-consumption, extractive industry-manufacturing industry, material production-infrastructure, etc.) are already subject to national economic planning in a primary way. Economic policy priorities imply, or rather should imply, what ought to be developed more quickly and what more slowly (or even what would be reduced and cut down). These goals of the national economic plan, devised to change certain

* In its report submitted to the Presidium of the Academy, the *ad hoc* committee formed for this task expressed this opinion on the sevent five-year national economic plan.

** Imre Bakonyi: "The actual measure of openness is being decided in the microsphere" [2]. The title of Tamás *Szira's* article, from which I have already cited, queries that any influence can be exercised. [17]

*** In my opinion, Gabriella *Izik-Hedri* has the right point of view in this context. [9]

proportions, must be implemented by using economic policy instruments. The flexibility of planning postulates that should conditions be changed, the changes of proportion as originally planned must not be insisted upon.

To project it on to our subject: let us suppose the plan accepts that the volume of foreign trade is disproportionate to the absorption capacity of the national economy; it is not clear how this proportion, when affected by various factors, will develop but it is more likely to grow. In this case economic policy and the national economic planning agency will be faced with the following tasks: the reduction of the share of foreign trade must be envisaged and the instruments of economic policy (the system of regulators in particular) must work toward this. At the same time, however, the increase of the absorption capacity must be envisaged and this goal must also be achieved by operating instruments like a selective policy or the updating of the mechanism. Should it turn out that the latter were more successful than expected, and both exports and imports grew more profitably than assumed, then the target set to reduce the proportion would automatically lose effect. (Much to my regret, this is not likely to happen in the next few years.)

To sum up, the measure of openness is largely influenced by

— the macrostructure policy, and by the development of infrastructure in particular;
— the investment policy;
— the selection influencing the mesostructure;
— the policy affecting the microstructure (factors with an immediate effect: exchange rates, export promotion, tariffs, quotas; and those indirectly affecting the openness: fiscal and monetary policy, price policy, income regulation);
— direction and intensity of the reform process.

I intentionally did not list here general import restrictions and the pushing of exports by direct instruments, because they are ineffective and not in keeping with our system of economic control and management.

Openness and the buyers' market

In my opinion, the gravest problem is the following: in 1968 we introduced a mechanism (which we now want to streamline), that gave a major role to the independent operation of the market. Markets, however, can exert the expected positive impacts or more precisely, positive impacts can overshadow the subsequent negative ones when it is the sellers who compete with each other and buyers are just standing there "with their arms crossed"—unfortunately, the case at the moment is just the reverse.

But it is questionable if competition among sellers can really be created mainly by letting domestic sellers compete with each other. Many reply to this question, not totally unfounded, that competition can be evoked by imports only: that is if today's hot-house-like protection of domestic seller ceases. There will be a competition only, they say, if buyers (producers and consumers) can in fact choose from among domestic and imported products.

There is much truth in this train of thought. And no doubt it is an attractive concept. But is this the whole truth? I do not think so. In addition, when judging the above concept, one must discern between a distant goal and the realistic model of the period right ahead. It is chiefly with the latter respect in mind that I set forth certain notions.

Firstly: To create import competition as outlined in the foregoing, a large-scale increase of imports would be needed such that it could only be countered with even less profitable exports or none at all.

Alternatively, we may toy with another idea. Let us tear down the hothouse and only those companies that are capable of coping against foreign goods both at home and abroad should be allowed to survive. Yet, in such a case a great number of companies would collapse. It is true that the surviving ones would continue to produce quality goods—and efficiently at that. However, such a process would imply a shrinking of the national income, including the consumption funds and real incomes, and would also entail a sizeable rate of unemployment. Of course, we could spend a lesser income on cheap quality goods. Yet while granting this, it is true that although quality and efficiency are key elements of an intensive development, the size of real income is just as important. After all, growth path correction and streamlining of the reform are needed to increase the volume and quality of real consumption.

Secondly: if it is true that imports cannot be significantly increased over the next period (and I think it is) and furthermore, if we take it for granted that an instrumental condition of operating a market is import competition, then this is a stalemate. These two premises seem to lead to the conclusion that the significant updating of the mechanism should be postponed for good.

But this syllogism is false. The basic condition of creating a buyers' market is that the very existence of manufacturers and services should depend on their ability to win the money of buyers, primarily that of domestic consumers (producers and the population). Imports can provide all but additional pressure and competition to widen the range of choice and *vice versa:* as long as a company can get along even if the customers will not, or cannot, buy its products or services; as long as companies may exist with much of their capacities unexploited, massive imports would not create actual market conditions either.

As for consumers, thus for families, it would certainly be a welcome development to choose freely among domestic (including CMEA) and Western products. It would be fine if, for instance, a machine factory could choose between Swedish and Hungarian casts, the electronic industry between domestic, Japanese or US-made chips and altogether, if users might choose between the products of the domestic electronics industry and imports. It would be equally good if the population and establishments directly serving it could make their choice between a Bosch refrigerator, a Japanese television set, Siemens hospital equipment, etc. and their domestic (or CMEA) eguivalents. Yet such options are, to put it mildly, rather limited.

The realistic alternative in the seventh five-year plan period is more Videoton and Orion TV sets, more Lehel refrigerators, more Medicor hospital equipment—or nothing. It is also worth considering that most of the Hungarian agriculture's machinery comes from abroad. Yet the rather troubled Hungarian machine-building industry is not too eager to capture this stable market by turning out the right products of proper quality; the food-processing industry imports certain types of plates while the crisis-ridden metallurgical industry is not capable (or not too willing) to produce the fine sheets required by the home market and so on. I know that all these may be explained in many ways—but it does not make it any more acceptable. The current state of things can be changed only if companies are really forced to sell, and thus getting money from domestic buyers, will be a basic condition for companies to survive. A smooth capital flow is also needed so that the financial and material conditions of production are available in the very production stages that are capable and willing to profitably satisfy the demand of the (foreign and home) markets.

Thirdly: imported technologies result in a substantial rise of the economy's technical standards (or exert an "inductive effect") only if companies, under the pressure of domestic market conditions, are forced to a high-level adaptation and redevelopment of imported technologies.

Thus a resolute streamlining of the mechanism must begin with the radical changing of *domestic* market relationships. Such a market may, lacking any sizeable import competition, work better though still imperfectly. Yet this is the only way to enhance the role of import competition *later* and thus to operate the market more successfully.

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A basic issue of foreign trade, and eventually of global economic development strategy is whether we should increase or reduce the openness of our economy—to be more exact, whether we should increase or reduce the relative importance of foreign trade in the years to come. In this article I have tried to support my reply to this question with arguments. The proportion of foreign trade should approach the optimum. Since the current measure of openness has gone beyond the one that would, under the present conditions, be optimal for the nation to grow richer, it has to be relatively reduced in the short run. This may help intensify external relationships as well—that is, it may widen and deepen the scope of effect of factors related to foreign trade turnover. At the same time, however, efforts should be made so that, with a proper and far-reaching economic policy and by further developing the mechanism without reluctance and delay, the capacity of the national economy to absorb the foreign trade turnover be increased. An essential condition of this is an increase in domestic consumption and the role of the home market.

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ОТКРЫТОСТЬ ЭКОНОМИКИ И ВНУТРЕННЕЕ ПОТРЕБЛЕНИЕ

Р. ХОХ

В своей статье автор исходит из того, что при разработке внешнеэкономической стратегии, а в конечном счете и стратегии всего экономического развития, один из основополагающих вопросов заключается в том, усиливать или сокращать открытость экономики, а точнее — относительную долю внешнеторгового оборота, в последующие годы. Автор пытается обосновать свой ответ на этот вопрос. Доля внешнеэкономического оборота должна приблизаться к оптимальной. Так как в настоящее время открытость, о которой идет речь, превышает ту степень, которая при данных условиях была бы оптимальной с точки зрения повышения благосостояния народа, в ближайщей

перспективе ее следует сократить. Это может содействовать и повышению интенсивности внешних связей, тому, чтобы воздействие отдельных связанных с внешнеторговым оборотом факторов расширилось и углубилось. Одновременно следует, однако, стремиться к тому, чтобы с помощью проведения соответствующей нынешним требованиям и концептуально обоснованной экономической политики, а также последовательного и неуклонного совершенствования хозяйственного механизма повысить абсорбирующую способность венгерской экономики в отношения внешнеторгового оборота. Необходимым условием этого является повышение роли рнутреннего потребления, внутреннего рынка.

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IS OPENING STILL TOPICAL?

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There is no way out of the difficulties of the Hungarian economy by further restricting the trade with market economies. The reduction advocated by Hoch would only lead to a further underrating of domestic consumption, that is, to a continued decline in living standards and accumulation, an increasing lag in technological development and this would push the foreign economic opening, becoming ever more difficult because of the restrictive policy of recent years, into the far future. The opening can only take place with difficult political decisions, with a reform of economic policy and of the economic mechanism and the expected difficulties make the search for ways out the mess by delaying the opening, if not acceptable, yet understandable.

Tempora mutantur et nos mutamur in illis. When analysing our economic troubles, we often recall the years after the first oil shock in 1973, the times the Hungarian economic policy failed to adequately respond to radical changes in the global economic environment. That failure, although it was a direct consequence of a mistaken perception of worldwide economic tendencies, was neither an accident nor the result of inattention. It was rather the outgrowth of a deep-rooted conditioning, attitude and principled position—a position that alleged that Hungary's economic development, just like that of other socialist countries, took place independently from that of the world economy. It also assumed that changes of the global economic environment did not affect—because they must not affect—the main tendencies of the country's economic progress; ideological, political and economic reasons called for an "autonomous" path of development unrelated to the world economy, and for a strict limitation of participation in the international division of labour.

Of course it is now a thing of the past in Hungary. Experiences of the last decade profusely confirmed that such an isolationist economic policy—refusing to adapt to external economic developments and involving considerable institutional, self-imposed isolation from the outside world—cannot save the economy from the pressure to participate in the worldwide division of labour: it "merely" robs it of the chance to savour the fruit of that participation [16]. Thus nowadays good manners (if nothing else) demand from everyone the acknowledgement that, in general and in the long run, there is a necessity to increase involvement in the international division of labour and to widen openness.

It is another thing to decide what to do *here and now:* to open or on the contrary, to withdraw? In this respect, the boundaries of good manners have not been rigidly drawn, so even radically different opinions can be voiced, and this is particularly easy to explain in the present economic situation. We have arrived at a critical point: the restrictive economic policy of the past years, the main endeavour (and instrument) of which was to curtail dollar imports by administrative methods and to force dollar exports, had exhausted its reserves: since 1985 there have been more and more indications that to continue it as it is would not only reduce the chances of finding soon a way out but also endanger the sizeable trade surplus—invariably considered a top priority by this economic policy. Accumulating tensions may thus inevitably call for a revision of the economic policy [10].

Why has domestic consumption become "underrated"?

To give a reply to the question which asks what kinds of changes are needed, it is necessary to consider another one, notably what someone thinks of the current (and former) economic policy and of the situation created by the policy pursued up until now. In his inaugural lecture [4] at the Hungarian Academy of Sciences, Róbert *Hoch* said (endorsing Ferenc *Kozma*'s thesis [7] in which was largely rejected in a debate waged in the periodical *Külgazdaság* and set forth partially theses similar to the one presented by László *Práger* [17]), that the Hungarian economy is overly open in quantitative respects; that it imports more than it can absorb (that is, more than it can efficiently use up) and that behind the production for exports, domestic consumption* is being pushed to the background and thus gets "underrated". Accordingly, he advocates that openness, i.e. the weight of exports and imports (in his conception, of exports to and imports from *non-socialist countries*) must be reduced in the short run. He expects that the efficiency of foreign trade would improve from this measure, and domestic absorption, or more precisely domestic production supplying it, should then be upgraded.

Róbert Hoch suggests all these—and this, too, is a declared part of his concept—not as a permanent strategy but as a short-term and actual economic-(development)-political task, as a response to the *current* dilemmas faced by Hungary's economic development and economic policy and as a task that, if implemented, might one day pave the way for a different policy which could lead towards growing openness.

András *Nagy* [14] was the first to respond to Róbert Hoch's article, discarding Hoch's diagnosis as well as his suggested treatment: in Nagy's opinion, it cannot be judged if the Hungarian economy's quantitative openness is excessive or insufficient; on the other hand, it can be established that the economy is institutionally, qualitatively too closed; this is its major problem and this is what has to be changed.

As it has become customary in the dispute between the two of them, I, too, will here begin by stating my principal thesis. It is my firm belief that *pushing further back non-socialist trade is not the solution to the Hungarian economy's current difficulties.* Pushing back, using Róbert Hoch's concept, would only lead to a further undervaluing of domestic consumption, i.e. to lower living standards and investment along with a

* Both the productive *and* personal consumption, i.e. the whole of the domestic absorption (Ed.'s note).

growing structural and technical backlog. This would delay openness indefinitely, and openness is getting more and more difficult anyhow because of the recent restrictive policy. Such openness can no doubt be achieved only after arduous political decisions and combined with economic policy and mechanism reforms. The calculable difficulties make suggestions to put off an opening—though understandable—not acceptable.

The problem with Róbert Hoch's view is not that he thinks that the economy's quantitative openness and the share of foreign trade should not permanently and continuously grow and that there can be periods when it should rather be decreased. It would be foolish to disagree with this statement. What must be countered is that he says that the time to reduce openness has arrived *just now*.

Some years ago, when Ferenc Kozma called the Hungarian economy too open, it was obvious that the rapid growth of imports leading to the swelling debts of the 1970s could not go on. His 1980 article may be seen as an attempt to lay the theoretical bases for the inevitable drastic (and by then ongoing) cut-back of imports; an awkward attempt at that, because it tried to blame "excessive openness" for everything, that was in fact the combined result of an outdated economic policy, a systematically and too closed economy and an economic mechanism which hardly encouraged the increase of efficiency.

The curbing of imports as urged by Kozma has since been realized, mostly by artificially blocking the import process. By 1985 the volume of dollar imports was 2 percent less than in 1978, the last year before the restrictions. This is a pretty large change of tendency as against the period preceding it, i.e. between 1970–78, when the volume of dollar imports grew by an annual average of 4.5 percent. Domestic absorption fell even more than imports did (by 11 percent, compared to a 55 percent growth between 1970 and 1978). On the other hand, the volume of dollar exports had, since 1978, grown 44 percent compared to a mere 8 percent increase of the national income generated.*

Even these few data indicate that Hoch has reason to complain about the "underrating" of domestic absorption in one sense. This is because the No. 1 economic policy priority—improving the external balance—of the period of restrictions (introduced late in 1978) was in fact accomplished at the expense of domestic absorption. Since then, consumption has hardly been allowed to grow and net investment has fallen sharply (1985 down to 49 percent of 1980, and to 33 percent of the peak of 1978). At times when the principal aim is to keep up the country's solvency and therefore to make a sizeable trade surplus, domestic absorption gets necessarily "underrated" as against production earmarked for export purposes.

To tell the truth, the restrictions had been made unavoidable by the indebtedness from the years before. In this sense the "underrating" does have a connection to all the factors which have upset the external equilibrium. Still, this does not mean that one

* All figures are based on data of the Hungarian Central Statistical Office [11, 12, 13].

should not rightfully raise the questions: *to what extent and how* has domestic absorption had to suffer from the restrictive economic policy? I hold the view that had the economy been less closed, had the restrictions been of an economic, and not so much of an administrative nature (that is, if mechanisms of adaptation had been really working that help reshape the structure of production for export *and* the home market in accordance with changing external and domestic supply-and-demand relationships, i.e. efficiency orientation) then the cut-back of imports and the increase of exports might have been less of a burden to domestic absorption than it actually was.

In my opinion, it appears from the afore-said that it would not make too much sense to launch a debate on the question of whether the present volume of dollar imports exceeds the Hungarian economy's import-absorbing capacity or not. In any case, raising this problem might have been topical at the time when the economy could, to judge from its balance of payments, no longer take the rapid growth of imports. What is really hard for the economy to swallow today—and what is a heavy burden for the domestic absorption as well—is just the opposite: the administrative curbing of imports which has been in force for nearly a decade. It clearly proves that no restrictions, no matter how severe, can be really effective for imports keep on topping planned figures—yet this again raises the question of whether the severity cannot be further increased.

Export orientation or forced exports?

According to Róbert Hoch, "export orientation" is "a rather vague slogan" that "today practically means that the domestic market should take second place to (non-rouble) exports. My attitude is not determined with the debt burden in my mind, but by the theoretical judgement of external and domestic markets."

I do not doubt the possibility of economic interpretability of the term and examine it as a development strategy or a direction of economic development [8]. I interpret an export-oriented, or outwards-looking economic policy, as any economic policy that, in order to enable efficient participation in the international division of labour (or to achieve a dynamic balance of exports and imports) eliminates (or tries to eliminate) drawbacks inhibiting production for exports as against production for the home market. In the case of the CMEA countries, the economic policy of which treats trade with each other and with outsiders differently, an outward-bound policy must necessarily eliminate drawbacks that hamper exports to non-socialist countries as against other sales (domestic absorption and exports to the CMEA).

I do not think it is justified to apply the term export orientation to today's Hungarian economy: forcing a trade surplus or dollar exports at almost any price are a far thing from that. Moreover, dollar exports must be pushed and this lays a heavy burden upon the domestic absorption precisely because the disadvantageous position of exports for the world market still persists.

At this point a few readers will have raised eyebrows. They have often been told about export development programmes, export promotion, about how important dollar exports are for a company's reputation and they also might have seen companies with large-scale (but not necessarily profitable) dollar exports have the enviable upper-hand in their bargaining with authorities. Can dollar exports *in spite of* all these constitute a disadvantageous position? Also, if they do, why?

The practice of export stimulation may, and must, be an organic part of an export-oriented policy. The statement is, however, no more true the other way around: the fact that a country pursues an extensive export promotion practice, is itself no decisive proof of the export-orientated nature of its economic policy. Forcing less profitable exports with an inadequate structure, or regrouping goods originally meant for the domestic market for export, etc. may very well suit an inward-bound policy which gives priority to the supply of the home market—especially if restoring the upset trade balance has become an urgent task. Not only that this policy has nothing to do with export-orientation but given that it leads to a stiffening of an already obsolete structure, it also hampers the increase of the economy's export potential.*

András Nagy [14] has vividly pictured the serious difficulties firms producing for export must cope with in Hungary, being systematically and effectively isolated from the world market. Producers wanting to sell at home (or in CMEA countries) face far and away less problems than those 'resigning' themselves to export to the West. This is also proved by the fact that, in spite of scores of benefits and preferences, companies display a highly cautious attitude toward participation in export development credit programmes—of which perhaps the best known was the Ft 45 billion investment credit project between 1976–1980. As it is companies are not compensated even by the seemingly generous subsidies for the efforts forced on them. The nature, direction and intensity of such efforts are a far cry from the ones they are used to and on which their management actually depends: and this is domestc and CMEA-directed sales.**

I have nothing but well-known, familiar things in mind: that Hungarian companies have to cope with fairly limited domestic competition (if any at all); their results largely depend on the benevolence and support of authorities (which are not too difficult to win for large companies operating in fields of national economic importance); that they can be much less careful as far as quality, range of choice, modernity of the products or the standards of product-related services are concerned than they should be on the international marketplace. Also one should not forget the impact of trade with the CMEA countries. Exporters must also adjust themselves here, though not to some market, but first of all to the logic of a system of trade settlements based on bilateral, inter-state agreements. Prices, too, are determined by the latter and much less by the quality, modernity or any other property of the goods. Consequently,

* It goes without saying that the instrumentality of such an export promotion also differs from the way of promotion applied by an export-oriented policy.

** For details see the analysis of *Greskovits* [5].

exporters are under less pressure to continuously improve their performance or to streamline their product pattern. On the contrary: they are interested in the first instance (and acquire the relevant skills and abilities for the purpose) in turning out and selling large quantities over a long period of time and possibility in an unchanged composition.

As a result, producers will shy away from developing and exporting for Western markets as long as the requirements of the terms of sale for different markets do not force, and at the same time make them interested in, stepping out to the world market. Such requirements depend on changes in CMEA cooperation and the domestic market, on growing demands, on the increase of domestic competition (import competition), on differentiation increasingly prompted by efficiency considerations and on tearing down barriers separating the economy from the world market: that is, on everything listed by András Nagy as the elements and conditions of qualitative openness.

In establishing the extent of respective priority the economic policy gives to exports and domestic absorption, a decisive factor is the tendency of investment or development policy. Though there have been short-term export development programmes running in Hungary since the second half of the 1970s, and they no doubt have helped increase dollar exports, Hungarian economists studying the pattern of investments have never challenged the orientation of the investment policy: it is agreed that the overwhelming part of development resources serves the domestic absorption and the trade done with CMEA countries, respectively. Also it is common knowledge that the costly programmes devised to develop fuel and energy supply and material-related branches are top priorities of the investment policy. This traditional tendency had gathered momentum in the period of restrictions. Compared with 1978, by 1985 it was only the investments in the extractive industries that rose (by 18 percent), while the volume of investments in the manufacturing and food industries fell by some 40 percent.

Such a direction of the investment policy, along with those characteristics of the domestic market that to no small extent hampered an outward turn, have had a combined result which shows that recent changes in the product pattern of Hungarian exports to the West did not indicate a growth of the share of much sought for, up-to-date, saleable goods (primarily manufactured goods and foodstuffs) but rather an increase of the share of fuels and materials [3]. Since these are precisely the items causing recurrent tensions in the domestic supply (aggravated by the stagnation and slump in the energy trade within the CMEA: a topic which will be dealt with later on), it is perfectly understandable if exportation seems to be an activity "underrating" and endangering domestic (productive and personal) absorption, even hurting the smooth operation of the economy.

A different approach: the recent export expansion in Hungary did not anticipate the facts that the structure of production and distribution might need to be continuously reshaped and products manufactured earlier for domestic purposes might have to be replaced with others, such ones that were in demand abroad and not at home, so that a boost in their exports would be in line with changes in the demand of foreign buyers. Instead, it was a case of Hungarian companies trying to export more of their existing, or already exported products. Statistical analysis supports this latter statement. In fact, there is hardly any correlation to be traced between changes in the pattern of imports by Hungary's major Western trading partners and exports by Hungary for them: "...it's just as likely that we might dynamically increase our exports for the market of the articles in demand as it is possible for us to be forced out from the market, or that we increase our exports with articles for which the demand has largely declined, or *vice versa*" ([1], p. 21). Articles newly included in the export list between 1978 and 1983 "were, with a few exceptions, all such ones that had been produced previously for domestic consumption only, and they got exported as the result of a desperate search for additional stocks of export articles."

Thus it is not at all that the economic policy upgraded exports and allocated a growing percentage of resources for export-generating development, so that the economy should operate in a way that those willing to export are in a better position than those working for the domestic market. The case was just the opposite: the lack of an export-oriented development policy and the lack of economic openness. Hence there is nothing to upgrade the domestic absorption against; its actual upgrading can only take place as the result of growing openness.

Let us draw a few conclusions: improving the balance of hard currency trade, including the increase of exports, has been a top priority of Hungarian economic policy. But since there are no, or only weak, mechanisms in the economy (due to its closedness and other properties) to facilitate the increase of dollar exports within the natural process of growth, the economic management employed various export-forcing measures that were able to regroup existing commodity stocks (or those producible by existing capacities) for exports to the West. This is why the increase of exports involves a low, and falling, efficiency and diminishing chances of success.

Possibilities and limitations of imports

All said, export expansion based on export orientation (i.e. on the upgrading of production for exports and on reshaping the structure according to efficiency criteria) still has to be achieved in Hungary. Achieving it quickly is naturally illusory as long as the conditions of the economy's operation are not radically changed. What is more, even if the economic policy and mechanism are radically reformed, a significant increase in the export potential can only be hoped for after some time has passed. Also, if exports cannot be quickly boosted (and credit resources are, to say the least, not unlimited), then it seems logical that the economic policy ought to choose its priorities and instruments in such a way that these should, at least temporarily, enable an import-saving path of growth and hold down the import requirements of economic growth.

It is my opinion, too, that the export potential cannot be spectacularly increased, and this limitation of the potential must not be disregarded when thinking of economic policy alternatives. Yet other interrelations cannot be ignored either: that a lid has been kept on dollar imports for nearly a decade now; that the ability to profitably replace imports is just as difficult to learn as it is to build up an export potential; that one should not forget the dollar import demand of development and production; and last but not least the limitations to purchasing from CMEA countries (or more generally, changes in the economic relations within the CMEA). Because of all these it would be highly unrealistic, and in its consequences even perilous to declare that an economic policy cutting back imports might be the *panacea* for our troubles.*

I said before that I held Róbert Hoch's proposal ill-timed chiefly because of the prolonged restriction of imports. What should be taken into account when considering the possibilities of a further restriction and its likely consequences, is not only the measure of the existing import restrictions but also the methods and *criteria* applied in the course of those restrictions.

In Hungary, just like in other socialist countries, the bulk of dollar imports is not competitive. We do not import products from the world market that are cheaper or more cost-efficient than the ones available at home or in CMEA countries, but those that are (in the required quality, range of choice or time) unavailable at home or for roubles. To prevent the serious operating troubles of the economy which are caused by restricted imports, missing items should be taken from domestic production (or from CMEA imports). This is obvious and also this is usually prescribed by the authorities. However, to replace stop-gap imports is from the very outset a much more lengthy, cumbersome, expensive task (with a doubtful outcome) than it is to replace imports competing with domestic production. In the latter case, making imports more expensive (of course depending on domestic regulations) may in itself give the necessary impetus to widening the volume of domestic poduction. At the time when restriction was put on the agenda, there certainly could be found stocks of commodities that replaced products once purchased from the West. Also, there were machines and equipment that were capable of producing such items and what is more, in a relatively short time and relatively cheaply (i.e. by spending less convertible currencies). Thus investments could be implemented which turned out import-substituting products. Unfortunately, it soon became obvious how little this relatively easily exploitable "reserve" was. This is no surprise for anyone who knows that as for the tendency, nature and underlying methods of import-substituting efforts, the economic policy of the restrictive period has in no way been different from the one of former times. If it does differ, it is because those efforts are being declared more

* To be precise: Róbert Hoch does not urge the cutback of imports, but the reduction of openness in a quantitative sense, meaning that dollar imports should gorw slower than the domestic absorption (and exports slower than the production of the national income). Yet since he considers this as a short-term task, and in the short run domestic absorption will hardly increase (actually, it has been falling—except for 1981—since 1978), it is reasonable to interpret his suggestions as meaning a reduction in imports.

emphatically. This is, however, being more than countered with the sad fact that there is less money, and above all less convertible currency, available for import-substituting development purposes.

Consequently, the bigger efforts the economic policy is making in order to delete items from the import list* that can, or may, be domestically produced in view of the technical, economic and personal conditions, the more clearly a dual process gets outlined. On the one hand, in the name of import rationalization allowances for quality up-to-datedness and thus for efficiency must be made (such, however, cannot stem the increase of shortages); on the other hand, remaining imports are getting even "harder" and with them, a further and efficient reduction of imports (based on economic criteria) becomes illusory.

That imports are getting "harder" has been indicated by the fact that owing to the restrictive policy, the share of development-geared imports, previously not very big, either, has largely shrunk within Hungary's imports from non-socialist countries. Machines from our dollar imports accounted for a mere 12 percent of the total in 1985 (back in 1978 this was still 16 percent). The proportion of imports meant for final consumption, is also relatively low. Three-fourths of all imports consist of materials, semi-finished products (intermediaries) and parts to be used in the production process.

Imports to be used in production may be of varying importance for the individual branches. Some branches and activities *operate* by using relatively more, some by using less, dollar imports just as some branches require more machines imported from the West for developments than others do. The fact of varying import intensity may suggest the assumption that dollar imports (or at least the bulk of them) have a more or less *well-defined place, field of use,* and function in the Hungarian economy. In other words, that the volume of dollar imports depends on development policy tendencies and by changing the latter the level of dollar import demand (or the import intensity of economic growth) may also be reduced.

This notion has been criticized by many.** I believe that when working out any development concept, one must take into account the varying dollar import intensity of alternative versions as well—of course, along with all the other factors that may also affect efficiency. Yet I do not think that this triviality could significantly help change the development strategy, at least not in the sense that Róbert Hoch wants it (i.e. by "upgrading" domestic consumption). As it is, the dependency of the Hungarian economy on dollar imports has been related not only to efforts geared to increase

* Or, what amounts to the same, to omit necessary new products from it.

**"There are opinions which suggest that in order to stimulate production, branches should be picked out that are less import-intensive and for the products of which domestic demand has, for a considerable period of time, been unsatisfied. This is, however, hardly viable because even if the cumulated import demand of such products could be properly estimated, the commodity supply necessary to tie up the surplus purchasing power released by the accelerated production will be not there. Also, if we do create it, the import demand entailed will hardly differ from the average one. The increase of production for domestic use, considering specific import requirements, can at present take place only at the expense of the trade balance."[6]

dollar exports and to turn out products of "world standards", but also to the production for domestic uses and exports to CMEA countries, respectively. Even if dollar imports are indispensable for the modernization of each and every branch of the Hungarian economy, this is not restricted to imports required for development and for supplying high-technology production with materials and components. It serves the production of the widely varied technical-technological levels going on in the different sectors of the Hungarian economy, including the "good medium but reliable" level that may be interpreted at will, and the achievement of which Róbert Hoch puts in the centre of the suggested development strategy. As a matter of fact, dollar imports may be, and indeed are, entailed by any possible activity existing in the Hungarian economy. Their necessity depends just as much on the specific operational features of the Hungarian economy (and those of the economies of the CMEA partner countries) as on the physical characteristics and properties of products available from Western countries.

Consequently, the dollar import intensity of the economy depends on the orientation of the economic policy in a way different from that assumed by Róbert Hoch. It is only through an export-oriented development and an opening towards the world economy that it can be hoped that the inevitability of dollar imports will loom less gloomily above the Hungarian economy than it does now: on the one hand, as a direct result of the opening—provided the increase of the economy's export potential eases the burden of countering imports; and on the other, in an indirect way, by increasing institutional openness, thus facilitating the cost-efficient domestic substitution for dollar imports and helping to omit really superfluous import items on the basis of cost-efficiency considerations.

Openness and CMEA relationships

Róbert Hoch did not handle the issue of our economic relationships with the CMEA countries. Of course, authors are free to draw the borders of their chosen theme at their own discretion. However, in my opinion it seems that today in Hungary it is hard to say much that is important about openness (i.e. the relation between domestic and external economy, about how foreign trade trends affect consumption and investment) by leaving the bigger half of our foreign trade unnoticed. Whoever formulates the thesis that quantitative openness toward the West be narrowed (and certainly anyone who asserts the opposite), should not side-step the question of whether this thesis is valid irrespective of the tendencies prevailing in our trade with the CMEA countries, and if it does depend on those tendencies, in what way.

Coming to my point of view, I believe that to push for curbing trade with the West can lead to very untimely and wrong conclusions in view of the trend of Hungary's trade with CMEA countries. It is a well-known fact that from the second half of the 1970s a dual tendency has persisted in our economic relationships with the

CMEA countries. This is because, simultaneously with the, by us uncontrollable, narrowing of purchasing possibilities the terms of purchase have tendentiously and largely deteriorated. At present, to counterbalance our rouble imports—the volume of which has (in spite of Hungarian efforts to increase it) virtually been stagnating since 1978—incomparably bigger efforts must be made (i.e. much—44 percent—more goods have to be exported than back, and with a much less favourable commodity structure at that.*)

These trends, much like the ones seen in our trade with the West, have taken shape under completely different conditions and as a result of quite different efforts. Unlike the restrictions imposed on dollar imports, in CMEA relationships the economic policy strove at buying as much as possible of at least the necessary "hard" goods.

The original postulate of this *import-maximizing policy* is that, besides political reasons, the economic considerations (lower prices, more favorable terms of payment and settlement, a well-established infrastructure, etc.) suggest that it is better to buy the afore-mentioned goods from within the CMEA than from the West. The relative advantages of purchases from the CMEA as against the terms of buying from the West are to be interpreted as absolute advantages. If, for instance, oil may be bought from within the CMEA with better terms than from the world market, then it is advisable to import as much oil as possible from the CMEA (i.e. settled in roubles). For this it is worth (and reasonable) making sacrifices in order to increase the quantity available, or to maintain stability for a few years, even if this affects our convertible currency balance and/or the Hungarian economy's potential to produce convertible currencies.

In other words: all goods available within the CMEA must be bought there and only there. Dollar imports are necessary, but only to the extent that they involve goods not to be had at home or in CMEA countries, and they can be only as advantageous as they are necessary. This reasoning implies that substituting dollar imports with purchases from socialist countries must be kept high on the agenda, the more so at times when the state of the balance of payments calls for curbing dollar imports—even if experience of the past decade has shown just the opposite trend.

The above conception is connected with what has been said about the lack of export-orientation in the development/investment policy. Namely, economic development depends basically on imports from socialist countries, or more precisely on their "hard" part. Therefore the main tendency of economic development, branch structure and product pattern are all determined by the obligation to counterbalance socialist imports with exports. This has manifold results, like the one that the increase of dollar exports, be it as big a short-term economic policy priority at the time of growingly critical balance tensions as it is, cannot be a really important structure-reshaping factor. Hence the familiar fact most frequently used to justify the import-maximizing

* Between 1970 and 1978 the volume of rouble imports soared 73 percent and that of exports 102 percent.

policy (i.e. that it is "easy", or at least "easier" to export to socialist countries than to the West and therefore goods meant for socialist exports and capacities geared to produce such goods cannot, or only with difficulties, be switched to exports for other destinations) ismerely the outgrowth of this policy.

Just because of this, an import-maximizing policy can be viable only if the CMEA partner countries do need Hungarian manufactured goods and foodstuffs (and are willing to accept them with agreeable terms) for the supply of which we have specialized. If this is not the case, the Hungarian economy may face serious structural problems.

A radical change in the terms of trade, too, may cause difficulties. From 1975 up until now such difficulties have been caused by the deterioration of the Hungarian terms of trade, entailing that the volume of Hungarian exports have for a prolonged period grown much quicker than the imports, which have in fact stagnated. When urging the upgrading of domestic absorption, one should not forget this circumstance, since rouble exports outgrowing imports weigh heavily on the hard-currency trade balance as well as on domestic absorption. Yet *vice versa:* the dilemma is still there even if the terms of trade are improving, because under the given conditions of trade within the CMEA, surplus capacities emerge which, owing to the afore-mentioned reasons (that can hardly be switched over for exports to the West) are difficult to be disposed of.

Finally, I think that the relationship between the volume and cost-efficiency of imports, mentioned by Róbert Hoch in connection with the hard-currency trade, should justly be raised precisely in connection with import-maximization. Namely, the latter is a serious obstacle in the way of an efficiency-oriented economic development and management, respectively. According to the logic of import-maximization, economic development is constrained by purchasing possibilities and it is this limitation that has to be widened, and the economy must adapt itself to the possible level of import purchases (and the domestic production). That is say, not primarily to high prices and changing cost relationships but to the fact that the physical quantity of inputs cannot be raised above a certain level. According to this approach it is only natural that any quantity of imports and production of materials and sources of energy are qualified *ex post* necessary: the economy consumes every bit of it. This, of course, is no proof at all that some other economic policy would not result in a more reasonable utilization of material and energy, and that the quantity imported is irrespective of the conditions created by the economic policy, by all means necessary. It is just the other way round: international comparison indicates that the reduction of specific energy consumption is going on very sluggishly in Hungary.*

The latest international economic developments have made this problem more acute than ever before [15]. On the one hand, the raw material supply possibilities of our CMEA partners have grown increasingly limited, because of their production difficulties and the general pressure toward getting hard currencies. On the other hand,

* For more details, see [9].

prices within the CMEA, as compared to those of the world market, have become much less favourable than they were in the previous years and this may also reduce the burden and expenses of changing the import-maximizing policy in the short run. Thus it seems that the Hungarian economy can expect impulses from the trade with the CMEA that will partly make us see gradually growing weight of the West within our foreign trade as advantageous, and partly we might even be forced to increase its percentage. Therefore, improving the efficiency of our foreign trade depends not so much on the reduction of hard-currency imports and exports but rather on how, for what purposes and with what results we will be able to use the resources freed in the wake of the revision of the import maximizing policy.* Opening toward the world economy is still very much on the agenda. Moreover: it is becoming a burning issue with the implementation conditions of other trade policy alternatives getting less and less favourable.

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* With respect to the quality problems of raw material imports for metallurgy the daily *Népszabadság* wrote: "...The spiralling costs of metallurgy... are surely forced up also by the low ferrum contents of Soviet iron ore... should we use, beside the Soviet ore, that of better quality available on the world market at better prices, this would entail considerable advantages... Experiences prompt a gradual increase of ore imports from the West... This would allow a sizeable reduction of material and energy costs, and possibly the manufacture of better steel. As a result of such an action, the national economy could be relieved of further investment burdens necessitated by increasing imports of Soviet iron ore..." [2].

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АКТУАЛЬНА ЛИ ОТКРЫТОСТЬ?

А. КЁВЕШ

Включаясь в дискуссию об открытости экономики, автор доказывает, что венгерское народное хозяйство не может найти выхода из испытываемых им в настоящее время трудностей, если будет продолжаться ограничение внешней торговли с капиталистическими странами. Такое ограничение приведет лишь к дальнейшей девальвации внутреннего потребления, т.е. к дальнейшему снижению жизненного уровня и к созданию накоплений, усилению структурной и технической отсталости, что отодвинет достижение внешнеэкономической открытости, что вследствие реструкционной политики последних лет и без этого становится все более трудным, в неопределенное будущее.

Подтверждая свой тезис, автор показывает, что внутреннее потребление страдает не от экспортной ориентации, а — напротив — от ее отсутствия, что динамизация венгерской экономики невозможна параллельно ограничению капиталистического импорта, и наконец, что в свете нынешних направлений венгерской внешней торговли с социалистическими странами объявление даже в качестве ближайшей задачи политику сокращения количественной открытости венгерской экономики (по отношению и капиталистическому рынку) было бы особенно неактуально и чревато тяжелыми последствиями.

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OPEN WE MUST!

A. NAGY

Arguing with Róbert *Hoch*, the author explains that the main trouble of the Hungarian economy is not that it is too open, but that it is too closed. Openness has both a quantitative and a qualitative aspect, and one of the gravest concerns of the Hungarian economy is its big quantitative openness and its simultaneous qualitative closedness. We cannot know under the given conditions whether the quantitative dependence of the Hungarian economy is greater or smaller than would be desirable. This would only become clear with a greater autonomy of firms, their greater interest in profit, with a uniform rate of exchange, with liberalized imports and a free flow of capital. The indispensable structural transformation of production and foreign trade can only be implemented through domestic and external opening.

Parallel to the growing impossibility of continuing the economic policy restricting growth or even reducing accumulation, technological development, and personal consumption, the question of development *strategy* is coming into prominence: where do we want to arrive? So is the question of *tactics:* how and by what steps can we get there? In these questions, the strategy and tactics of Hungary's foreign economic relations are of a special importance. I think the time has come to discuss these questions with a view to clarification and to more research energy to be spent on the unsolved questions.

Obviously, the openness of the Hungarian economy is a question of central importance from the aspects of both where and how; this is exactly why so much attention has been paid to it in economic thinking. The debate on the question of whether the Hungarian economy is too open seems to have been resumed once again,* even if the naïve reader thought that the debate carried on in *Külgazdaság* five years ago** had made it sufficiently clear that the concept of "excessive openness", introduced by Ferenc *Kozma*, could not be theoretically interpreted. The proposals with which he tried to make economic planners to reduce openness might have been seen as harmful, for they gave rise to the belief that, instead of improving efficiency qualitatively, the economic difficulties of the country could be solved by a quantitative regulation of foreign trade. Some misbeliefs seem to be, however, stubbornly resistant to arguments and now reappear in a new shape.

In Róbert Hoch's opinion, an almost axiomatic agreement exists among economists that, among other things, "the economy of Hungary is open, thus an autarkic way of economic development is simply out of the question". This is followed by his first thesis: "Right now, the Hungarian economy is much too open

* See [1] and [2].

** See [3]. It contains the bibliography of the debating articles [p. 52].

"quantitatively", thus the efficiency of our foreign economic relations is suboptimal. Therefore, the extent of openness must be reduced in the short run." [1, p. 190] In a similar manner László *Práger* talks of "unreasonably high", "wasteful openness" and makes the statement: "The high foreign trade ratio is *also a consequence of the fact* that our measuring system *selects* imports as well as exports *worse than what should be possible,* so that both are larger than the optimum." [2, p. 661.]

In his further theses Hoch takes a stand for augmenting the intensity of foreign economic relations, improving their quality, and increasing the openness of economic policy. Further, he says: "by firmly improving the economic mechanism . . . it has to be provided for that a maximum efficiency of foreign trade relationships be reached through a much bigger foreign trade turnover than at present, in other words, through a greater openness;". This is to say in the short run quantitative openness should be reduced, and in the long run it should be increased.

It is no wonder that the opponents of the reform or those who view it sceptically take a stand against openness, as the system of directive planning has always been closely attached to an autarkic economic policy. Yet Hoch's entire article argues for an "intensive further development" of the economic reform. That is why I consider it important to discuss the interrelations between progress on the way of the reform, and openness.

Let me state my own theses against the above:

1. The main defect of the Hungarian economy is not that it is excessively open but, on the contrary, that it is excessively closed.* An autarkic economic development policy is not at all excluded, but is still playing an important role in practice. Therefore, it is to be feared that its harmful effect may even grow, if the advice concerning reduction of openness is taken.

2. Whether the quantitative dependence of Hungary on the world economy under the present circumstances is higher or lower than what it should be cannot be known. It could be found out only if enterprise independence and profit incentive were essentially increased, a uniform exchange rate consistently applied, imports liberalized, and the impediments of the flow of capital and labour removed.

3. As the country ran into heavy debts in the late 1970s, the export-increasing and import-restricting measures introduced in the early 1980s, with a view to avoiding insolvency, damaged the efficiency of Hungarian foreign trade. That is why a number of such products are manufactured (and partly also exported) which should not be (instead, they should be imported), while artificial obstacles block the way to enlarging the production of several articles that could be efficiently produced and exported. The indispensable structural transformation of production and foreign trade will become possible only by opening the Hungarian economy, both internally and externally.

* This had been stated by Sára *Pásztor:* "The Hungarian economy is largely dependent on the international division of labour (it is very open), while it is a national economy *secluded* from the world economy. In the structural sense, it is nearly closed." [4, p. 49.]

The concept of openness

The concept of economic openness is in most cases, unfortunately, reduced to quantitative openness, i.e. to the extent of participation in the international division of labour measured by the ratio of foreign trade turnover to GDP—even if it is mentioned sometimes that "trade policy" or "economic policy" openness also exists. These are, however, not treated in detail, as a rule. Yet the economic openness of a country has both a *quantitative* and a *qualitative* aspect, of which the latter is the more important. Quantitative openness can be described by the ratio of output crossing the border of the country, and by the ratio of consumption originating from abroad. The features of qualitative openness are much more important from the aspect of the country's economic and cultural development: the freedom of flow accross the borders of raw materials, agricultural and industrial products, capital, labour, money, technologies, services, scientific and other information, tourists, etc. The question is: to what extent do borders present barriers to the free flow of human activities and products motivated by economic and cultural interest? The quality of openness shows the degree of freedom of movement enjoyed in the international division of labour; its quantity shows the degree of the dependence (or interdependence) of domestic production and consumption on the world economy.

The two aspects of openness are, of course, interrelated: if a country is very open qualitatively, its quantitative openness theoretically depends on the dimensions of the domestic market, its level of development, and its distance from the major markets. Conversely, a small country may be quite open quantitatively,* and too closed qualitatively. In such case, the contrast between openness and closeness entails especially grave consequences, since comparative advantages remain unused because of closeness—which affects a great part of domestic production on the side of both exports and imports. We can hardly be wrong *in considering the contrast between the high degree of quantitative openness and the similarly high degree of qualitative closeness as one of the gravest problems of the Hungarian economy.*

The extent of quantitative openness or dependence is a function of a number of different factors, and its measuring methods are often misleading. The "share" of foreign trade in the national income (or in the GDP) gives the non-professional the impression that there is some upper limit to the trade turnover, e.g. the national income, and it cannot exceed the latter, since it would mean that all that has been produced is exported. Yet there is nothing of the sort: trade can be greater than the national income

* Several research works have already investigated the extent of the socialist countries' quantitative openness. These, however, have not demonstrated any significant difference from the openness of other similar non-socialist countries, and in particular they have not suggested that they would be "excessively open". See: [5, 6, 7, 8].

and in a few small countries it actually is greater.* It should be remembered, that foreign trade is a gross, and national income a net, category. Therefore, they are not directly commensurable unless they are reduced to a common denominator.

In my opinion, qualitative openness is the *real openness,* and it would be useful if the debate could be guided towards this question of quality. When I say that the Hungarian economy is too closed, I am using the term in this sense, and I mean that as long as we do not reduce the high degree of seclusion from the world market, we cannot achieve any considerable improvement in the field of efficiency, in technological progress, in competitiveness, in flexible adaptation, nor in providing for a lasting equilibrium—that is to say, there is no hope for raising the living standard significantly. It is quite evident that the mass and intricacy of the rules concerning the crossing of borders represent a high barrier blocking the free and reasonable flow of commodities, production factors, money, information, know-how and ideas. Everybody knows well enough, how little "free" the consumer (or the industrial, and the agricultural user of materials, or the investor) is to choose between domestic and imported products. The long seclusion from Western imports and unsatisfied needs "upgrade" imports as well as convertible currencies to an unjustifiable extent (as does the black market). This is, however, only an ideal "upgrading", as the practice of the Hungarian economic policy gives preference to domestic production and consumption (as against imports) wherever it can, following the principle: "if he does not like it he may lump it". Is it necessary to explain how many restraints and obstacles there are preventing capital and labour flowing across national borders? Is it not clear enough how complicated and risky is the manoeuvring to which those are forced who want to take their forints abroad, or bring their dollars into the country? Naïve people may think at least exports are not hindered—what is more, they are by every means promoted by the Hungarian economic policy. If, however, the producer is not free to import either material, or capital, or technology, but instead, he must provide for these under the extremely difficult circumstances of the domestic shortage economy and of "over-regulated" enterprise activities, how can we say that there is no domestic obstacle to exports?

The question of qualitative openness can be asked, of course, not only with regard to the world economy, but of the domestic economy as well.** Hungary is not open qualitatively, either towards the outside world, or in its domestic economy: even within the country, there are a thousand obstacles in the way of the free flow and

* In Curaçao, for example, where Venezuela's mineral oil is processed in huge oil-refineries, and hardly anything else is produced, foreign trade exceeds national income. Similar examples are the Dutch and Israeli diamond cutting, where the value of the imported diamond, or that of the exported cut diamond may exceed by far the value added.

** As is justly pointed out by Iván *Szegvári* [19, p. 49]: "...the comparative advantage... is the basic category or leading principle not only of the *international* division of labour but, *in general*, of the division of labour."

reasonable distribution of commodities, capital, labour, money, and technology. What is more, it is not central regulation alone that is to be blamed, but also the high degree of monopolization—quite unique in history—which have only recently been started, very cautiously, to reduce. Everywhere in the world, monopolies and collusions create strong obstacles in the way of "entry" and "exit", preventing the flow of commodities, capital, and information, competition, and of efficiency improvement. The question is justly asked: if a country is qualitatively strongly closed and disintegrated in its domestic economy, how could it be open towards the world economy, or integrated into it? The question can be reversed, too: is it possible to do away with domestic closeness without opening towards the world economy? Hardly so, in my opinion.

Is there an optimum volume of foreign trade?

In examining the extent of quantitative openness of the Hungarian economy, it has first to be cleared, whether there exist an optimum volume and commodity pattern of foreign trade, whether it can be found, or approximated and, if so, how. In talking about excessive openness, Kozma, Hoch and Práger assume that foreign trade does have an optimum volume (or such "band") and they assert that Hungarian exports and imports are larger than that. Unfortunately, however, they make no attempt at demonstrating the validity of either statement. Kozma believes he can recognize "excessive openness" [9, p. 43] by such "ill omens" as the deteriorating terms of trade, low efficiency of exports and the devaluation of national labour and currency. It has been demonstrated in the course of the debate that these factors are not suitable for measuring the extent of deviation from the optimal volume of foreign trade. In fact, they are to be considered as the causes or consequences of the foreign trade deficit [10, 4].

Róbert Hoch introduces a new concept: the "absorptive capacity" of the economy with respect to foreign trade; if trade is less, the economy does not develop as well as it could, and if it is more "too much food upsets the stomach of economies as well" [1, p. 191] or, "...a turnover pushed beyond the absorptive capacity not only fails to render development more favourable, but the other way round: it impairs the efficiency of national economy." [1, p. 192] Hoch compares the concept of foreign trade *absorptive* capacity to investment absorption (i.e. the optimum size of investments), whereas, in my opinion, those two are not comparable at all. It is obvious that investments must share the national income that can be used domestically with consumption: if the share of the one grows, that of the other must diminish. If the share of investment is too low, the economy cannot grow sufficiently; if it is too high, the economy cannot use it efficiently, and household consumption decreases. It follows that the two must be held in proportion and, if adequate criterion is applied, an optimum proportion can be found.

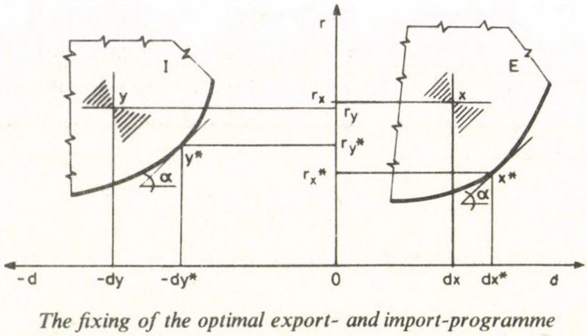
Foreign trade is, however, different from investment: it does not share in the national income in such a way that if its volume increases, either consumption, or investment should decrease. As we have seen, there is no obstacle in principle why it could not be bigger than the national income—and whether a change in it will increase or decrease the national income depends on its commodity structure.

Instead of the not too closely determined concepts of "optimum openness" and "absorption capacity", it would be more useful to discuss the question of whether there exists an optimum volume of foreign trade, and if it does, how it could be defined *in principle,* and shown how it could be approached *in practice* (that is, what needs to be regulated: the volume of foreign trade, or something else).

Such discussion is no novelty in Hungarian economic literature and it is to be regretted that many seem to ignore it. [11, 12, 13, 14, 15, 16] I am well aware that the participants in the debate cannot be expected to remember articles written more than twenty years ago, yet if I quote some of the statements made at the time, I do so only because I think that quite a number of the questions now raised were clarified in that earlier debate, which prepared the principles of the reform of our economic control and management system.

In every given time interval, we have a wide range of choice as to what to produce and how much, and what to export and import, and how much*. That is to say, what we produce and how much of it will be exported, or what and how much of our consumption originates from imports, constitute a set of feasible activity-alternatives. These can be plotted in respect of exports and imports—disregarding a number of other important features of reality—on the plane of domestic inputs and foreign exchange receipts and expenses as can be seen on the figure below.**

On the horizontal axis (to the right) are shown the total foreign exchange receipts from exports, and (to the left) the total foreign exchange expenses on imports; and on the vertical axis the total domestic input. In the set E of export activities a large number



The fixing of the optimal export- and import-programme

* Let us just consider the fact that if the production, exports, or imports of any product are increased or decreased to a small extent, they represent different production and foreign trade activity alternatives.

** The problem can only be presented here in a strongly simplified and shortened form. For more detail, see [11, 12, 13, 14, 15, 16].

of alternatives are to be found, and each of its points (for example, x) corresponds to a set of products which can be exported in the given time interval and to which a total domestic input (r_x) and foreign exchange receipts (d_x) belong. On the left, the part of domestic production which can be substituted by imports (the set I) is represented; to each point of this belongs a group of products, part of which is domestic production, and another part imported. The total input of the production belonging to the point y is denoted by r_y, and the foreign exchange expenses on the imports of the corresponding part, by d_y.

In seeking the optimum volume and pattern of foreign trrade, we seek a pair of points of these two sets of the feasible activities, oneset of export products and another one of imports and substitutions, at which the balance of trade is given ($D = d_x - d_y$), and the total domestic input ($R = r_x + r_y$) is at minimum.*

It is easy to see, and it is our first important statement, that *the optimal combinations of export and import activities cannot be the inner points of the sets*. There are, namely, quite a number of better and more efficient export programmes than x, in the sense that the total foreign exchange receipts are higher and inputs are lower. Such are the export alternatives falling into the second quadrant of the small system of coordinates drawn around x, i.e. those corresponding to the shaded part, falling "to below right" from it. At the same time, it can be seen that x is a more efficient programme than those falling "to above left", as the latter bring less foreign exchange receipts with a higher total of inputs. It follows from this simple criterion that, if there exists an optimum export programme, it is to be looked for at the "lower right" edge of the set, i.e. on the thick line of the figure. This is because, compared to them there are no more efficient export alternatives, i.e. there are no feasible export programmes, "to below right" of them, and all the other alternatives (the inner points of the set) are less efficient.

Applying the same principle within the set I of imports and of domestic substitutes, a similar result is reached: an inner point of the set cannot represent an optimal combination of activities; such can only be found at the thick "lower right" edge of the set. The imports and domestic production combinations "to below right" from the point y cost less in terms of foreign exchange, and their domestic input is also less.

It is now clear that the optimum export-import programme—if such exists at all—is to be found at the thick edge of the two sets. Our purpose is, therefore, to find a pair of programmes which fulfil the condition concerning the trade balance, and of which the amount of domestic inputs is at minimum. In our example, the pair of the programme x*, y* is to be considered the optimum one, as its trade balance is equal to the prescribed D, and the total inputs (R) belonging to it are at minimum. This follows from the fact that the slope of the tangent of the curves at the optimum points x*, and y*

* Of course, some other objective function, such as the maximization of consumption could also be applied. However, for simplicity's sake we shall neglect them here. Our optimization problem presented here is static, even if it is interpreted for a future date. In a dynamic case, a long-term equilibrium of the trade balance could also be prescribed.

is equal to α. All other pairs of programmes fulfilling the foreign trade balance prescription are worse than that, as their total inputs are larger. This can be seen from the fact that by starting out from the points x^*, y^*, only an accordion-like movement is feasible: the foreign exchange expenses on imports can grow only as much as the foreign exchange receipts from exports are increased and, if the latter decrease, the former must diminish as well. However, if we start from x^* "upwards to the right" along the thick line of the efficient export programmes, their inputs will be growing faster than the decrease of the inputs of domestic production substituted by imports, as we move "downwards to the left" of y^*. In other words: the deterioration of the efficiency of exports (the growth of input per unit of the foreign exchange receipts) will be greater than the efficiency improvement achieved by import substitution (reduction of input per unit of the foreign exchange expenses). The reduction of the volume of foreign trade starting from the programmes x^*, y^* leads to a similar result: the additional input into domestic production substituting for imports will be higher than the inputs saved through reducing exports.

It is, therefore, characteristic of the optimum pair of export-import programmes that they fulfill the prescribed foreign exchange balance, and that the slope of their tangent—which is in fact the marginal rate of exchange—is the same. Starting out from this point following an "accordion-like" movement and progressing along the thick line, the slopes of the tangents are bound to deviate: either the marginal cost of exports will be higher or that of import substitution—which results, either way, in increased total inputs.

If the prescription or expectation concerning the trade balance changes, we must move in the same direction on both thick lines. If the surplus is to be increased, the pair of the optimum programmes are to be found "to the right", through increasing exports and decreasing imports, or, if the deficit is allowed to grow, it is to be found "to the left", through decreasing exports and increasing imports. Also in this case, it is characteristic of the optimum pair of programmes that the slope of the tangents, i.e. the marginal exchange rate, is the same.

Let us draw a few conclusions:

1. Foreign trade has, in general, an optimal volume to which a certain export, import, and production pattern belongs. In our simplified model this optimal volume is characterized by a minimum of total domestic input with a given trade balance.

2. A uniform marginal exchange rate belongs to the optimal export-impoı programmes.

3. Under the influence of external and internal changes, the optimal commodity pattern and volume of foreign trade are constantly changing. The adaptation to this requires an adequately flexible system of incentives and motivation.**

* W. *Trzeciakowski* [13], I. *Ábel* and W. *Riecke* [16], Z. *Krasznai* and G. *Oblath* [17] come to the same conclusion by analysing the marginal costs of exports and the marginal yields of imports. The advantage of the method presented here consists only in that it clearly demonstrates the change taking place within the sets, which will have significance in the following.

** See in more detail [18].

4. If the trade balance is to be changed, both sides of trade must change, while the exchange rate must remain uniform.

Where are we now?

It need not be mentioned (and we could not even enumerate), how many factors, important in practice, are neglected in the theoretical model, described above and how much simplification is made,—while they could not be treated like this if an actual application were intended. However, hardly anybody would believe today that such an optimization can be made, and even less that its result could be put into practice.* Yet all this does not reduce its truth content, nor the validity of the conclusions that can be drawn from it.

Reading the articles about "excessive openness", one can compare the authors to lost mountaineers who, before deciding which way to go, must first realize where they are. The advice of the peasant in an Irish joke is no help: he answered, when someone asked him for directions to Dublin: "Sir, if I were to go to Dublin, I would not set out from here."

Let us see, therefore, just where we are now? What is our present foreign trade turnover like in comparison with the optimal volume and export-import commodity pattern? Hoch says: "... the volume of Hungary's external trade is already far beyond the one the economy can efficiently absorb, and approach to the optimum range postulates a relative moderation of the foreign trade turnover."** This statement suggests that increasing the turnover has (so far) reduced efficiency, while the reduction of foreign trade would work towards its improvement (in the future). Well, this would be evidently the case if, 1. we could assume that the Hungarian foreign trade in its present state consists of the export and import activities called 'efficient' in the preceding section (marked by thick lines in the figure); and if 2. we could know that we have gone beyond the optimum point. If these two conditions were satisfied, the elimination of non-efficient exports and the substitution of excessive imports by cheaper domestic production would doubtlessly improve efficiency; in our example, the total inputs would be reduced.

Unfortunately, however, the situation is worse than assumed by the propagators of the "excessive openness". Of the first one of the two conditions mentioned above, we know for certain that it is not satisfied; as for the second, nothing can be said about it as long as the first one has not been fulfilled. One thing is sure: that the pattern of Hungarian exports has traditionally, for many decades, developed in such a way that

* In the late 1950s and early 1960s several of us fostered illusions of this kind, and the adherents of "optimal planning" may still do. That the economists engaged in optimization models joined in the preparation of the reform of the economic control and management system was the consequence, among other things, of their realizing the fact that an approximation of the optimal solution is practically possible only through the market, i.e. by decentralized decision-making.

** See: [1, p. 194]. As we saw, Práger says the same thing: [2, p. 661].

the most favourable and most efficient possibilities have not been fully used, consequently, it is not true that only the exports of unefficient goods can be increased. The Hungarian investment policy, the system of incentives for enterprises, export subsidies, and the intricacies of differentiated taxation and tax exemptions could only lead to a situation such that the pattern of production and exports has grown to be extremely heterogenous from the aspect of efficiency, and the potentials for improvement are significantly unexploited.

Iván Szegvári is perfectly right in saying that "the present pattern of the Hungarian economy has not been shaped by comparative advantages. This tradition goes back, in fact, to times several decades before the socialist industrialization began... this tradition is so strong that not even the efficiency orientation, ever more emphatically demanded from the early 1960s, could break it. One of the self-evident consequences of this long process, which penetrated deeply into the Hungarian economy, is that the efficiency of the various producing activities measured by world market standards is dispersed over an extremely wide scale... *our comparative advantages and disadvantages* (i.e. the unused advantages) *are too large. I hold this condition to be more important* even ... than the low efficiency level almost exclusively emphasized in our debates." [19, p. 56]

The above-said holds, of course, not only for exports, but for import substitution as well. It is well known that, for a long time, and even more so recently, the substitution of imports has been considered a praiseworthy act, enjoying all sorts of advantages, almost independent of the costs of domestic production. The idea that imports may be more economic than domestic production was almost a heresy, and it still is in the eyes of many.

It follows that, reverting to our figure above, we may be sure that we are in the interior of the sets of the feasible export and import activities (let us say, in our figure, at the points x and y), far from the efficient combinations of activities. Starting from such a situation, exports can be increased in a way such that total inputs are growing, as well as in which they are decreasing (in the figure, both "upward right" and "downward right" movements are possible). Conversely: the reduction of exports cannot only decrease, but also increase inputs. Similarly: the increase or decrease of imports may be concomitant with rising or diminishing total inputs of domestic production. We may go in all directions, unfortunately.

As regards the actual practice, Hoch is probably right in that the pushing of exports and import substitution has deteriorated efficiency—which is to say, translated into the terms of our figure, that we have moved "upward right" from the points x and y. This does not alter the fact, however, that we must be very far from the optimal export-import alternatives x* and y*.

As long as we are at the inner points of the sets of alternatives, we can have no idea whether the total of our exports and imports, i.e. our quantitative openness, is higher or lower than the optimal one: $d_x \gtrless d_{x^*}$? What we know is only that, moving in the direction of efficiency, our inputs will be decreasing ("we are going downwards").

However, whether this will increase or decrease our total foreign exchange receipts and expenses, we cannot know.

Krasznai and Oblath [17, p. 56] are right in pointing out that "exports and imports are worth enlarging only up to the point where the marginal cost of exports does not yet exceed the marginal returns of imports", which also infers that "a given product can be exported only if all possibilities to export products of higher efficiency have been perfectly exhausted. Similarly, a given product is imported only if the possibilities of substituting imports for domestic production of less advantageous conditions have been fully exhausted. If the reallocation of resources, and transformation of the *internal* pattern of production, exports and imports can bring no further improvement in the efficiency of foreign trade, then—and only then—would the statement to the effect that Hungary is "excessively" engaged in foreign trade ("we are too open") have a practical meaning".

Obviously, we all agree in that unprofitable exports and import substitution must be decreased, whereas profitable ones must be increased. However, on the questions of whether the two different movements are compensatory and, whether, as a result, total turnover will be increasing or decreasing, our opinions continue to differ. Those who hold the Hungarian economy to be excessively open assume that the shifting to more efficient production (in exports as well as in import substitution) cannot make up for the gradual phasing out of inefficient activities. Our opinion is that there is no way of knowing this and therefore it is no use recommending the reduction of trade. Instead, we ought to concentrate forces on a stronger implementation of the efficiency criterion which, with a prescribed balance of trade, will eventually build a trade volume, smaller or bigger than the present one. In other words: the fact that many of the Hungarian export goods and much of the production substituting imports are inefficient, need not lead to the conclusion that the volume of trade is too large. A small foreign trade volume can be very inefficient, if the selection criteria of exports and imports are wrong.

I think that our differences of opinion are not rooted simply in the differences between a more pessimistic or more optimistic mentality, but rather in the extent to which we consider what we have called above "the external and internal qualitative openness of the economy" to be given, or to be changeable. To replace inefficient trade and production activities by more efficient ones requires qualitative openness to be increased considerably: capital, labour, professional knowledge, technology, money and commodities ought to be flowing more freely even within the country (the barriers raised by trusts, trade monopolies, counties, branches of industry, rigid enterprise forms, "earmarked" financial funds and innumerable regulations should be strongly reduced), as well as across national borders. Subsidization—"at all price"—of exports and import substitution and the thousands of restrictions on imports should be considerably decreased or removed. This is how our debate on quantitative openness leads to the questions of qualitative openness. We agree in that, with an unchanged structure and under the same conditions of incentives, the pushing of exports and the restriction of imports can cause damages. However, we do not agree on the ways that could lead us out of our acute troubles: I think that reduction of the trade volume would provide no solution; qualitative openness cannot be replaced by anything else.

It does not need special proof that in the Hungarian economy the potentials of efficiency improvement are noticeably unexploited. This is no wonder, for the whole of the Hungarian economic development (and especially the development of industry), has been going on practically on the basis of an inward oriented protectionist conception, the ideological roots of which go back to the German economic nationalism of the late last century.* Seclusion from world economy, import substitution at all price, and government intervention into foreign economic relations have long traditions in Hungary which were, between the two world wars, closely connected with the revanchist nationalism of the period and the awareness of "being encircled" by the Little Entente. All this had contributed, even before World War II, to the militarization of the Hungarian economy and later on to its near total dependence on Nazi Germany.

After 1945 and especially after 1949, this self-secluding, inward oriented development policy became even stronger and more intensive, finding new arguments, leaving its basically protectionist character unchanged. "The second phase of import-substituting industrial development was started in the years of war and of the reconstruction, and fully evolved by the industrialization policy initiated within the framework of the socialist transformation at the turn of the 1940s and 50s. The characteristic feature of that period was the development of the domestic production of primary materials with a view to achieving the highest possible degree of autarky. This entailed the introduction into production of the widest possible range of investment goods, and preparations were made for the manufacture of industrial consumer durables—also produced by heavy industry."—says Iván T. *Berend,* and continues: "The structural changes of industry made after 1956, important as they may be in comparison with the early 1950s, have not affected the fundamental conditions. The major investment projects using the greatest amount of resources have preserved their import-substituting character and the driving back of imports has remained a primary objective of economic policy, as we could see on numerous occasions in the metallurgical and chemical industries, and even in mechanical engineering." [22, pp. 396–397].

At the time of the socialist transformation, and particularly after the establishment of the CMEA, the inward oriented, import substituting industrialization policy was, of course, closely related to the changes of economic and political environment in Hungary. It was not only Hungary, but also the other socialist countries which were striving for autarky on the CMEA level, wishing thus to achieve independence of the division of labour and its efficiency requirement developing in other parts of the world.

* For more detail, see: [20, 21],

The fact that an inward oriented economic policy does not reduce but, on the contrary, enhances the dependence on imports and quantitative openness has been observed by many, and with reference to several countries. The essential difference between inward and outward oriented, protectionist and liberalized trade policy does not lie in quantitative openness, but in differences in efficiency and in that, in the former, export capacities necessarily remain below the demand for imports, and the propensity to indebtedness is constantly growing.* This entails, as a consequence, the pushing of exports "at all price"—just like the substitution of domestic production for imports "at all price" (i.e. a deformation of the production structure neglecting comparative advantages), which then pulls down, as if in a whirlpool, the potentials of the economy and increases the pressure for raising loans towards a critical point.

At the core of the contradiction in which some see the Hungarian economy as excessively open, whereas others as excessively closed, there is in fact the question of whether we wish to continue, or discontinue the longstanding inward oriented protectionist economic strategy, or, in other words: whether we hold integration in the world economy to be possible and desirable. Obviously, the development process which has shaped the economic structure for so long cannot be changed at once, from one day to the next. What is more, excessive haste and thoughtless "radicalism" may be more harmful than advantageous. Yet this does not alter the fact that it is high time to admit the necessity of a change, i.e. of "opening", and of setting down without delay to the gradual implementation of such a policy.

A protectionist past, and the suppression of efficiency considerations in foreign trade entail the "advantage" that there are great unused comparative advantages and efficiency-improving potentials latent in the production and export-import pattern. Under such circumstances, it is not only technological development, the improvement of productivity, technological discipline, quality, and economy of materials and energy, etc. on which the raising of living standards depends, because the benefits to be gained from transformation of the commodity structure of production and foreign trade are of a similar order of magnitude. In fact, it would be difficult to say whether it is in the field of technological level, efficiency and up-to-dateness of production, and in the economy of materials and energy that Hungary has a greater lag behind the more developed countries, or whether it is in the extent to which it leaves comparative advantages unused. It would be just as difficult to find out about the cause of the relatively low Hungarian living standards and of the slowing down of development: whether they are caused by low efficiency of production, the deficiencies of work discipline and incentives, or by our failing to attempt efficient integration into the world economy—which could not succeed if it was not even attempted.

* An excellent analysis of this was made by Ferenc *Jánossy* [23], pointing out that "the shifting of the economic structure towards autarky, and an increasing dependence on foreign trade *are,* therefore, *not mutually exclusive or neutralizing processes.*" What the author calls here "dependence on foreign trade", is the same as "quantitative openness" in my terms.

Although our answer to the question "where are we now?" is not exactly cheering, it is not totally disheartening, either; it would be more pleasant, of course, to set off towards an optimum from some more advantageous position than the actual one. Nevertheless, it is true that the disadvantages of our position are to some extent counterbalanced by the magnitude of the reserves that can be utilized.

As long as our potentials to increase efficiency inherent in the structural transformation of production and foreign trade are great, there is no way of knowing—as we have seen—whether the trade volume is smaller or larger than the optimal one. We must agree with Kamilla *Lányi* [10, p. 42] in that, if we cannot determine the degree of the optimal quantitative openness of the economy, "it cannot be one of the important duties of the government and the economic decision makers to regulate the openness of economy—what is more, they cannot have such duty at all." The Hungarian economic policy makers may indeed be justly criticized for numerous deficiencies. However, they do not reserve reproach for having rendered it "excessively open". It is a much more justifiable criticism which says that, despite the innumerable decisions, declarations, and doubtless sincere efforts, it has yet not found the instruments with which the efficiency of production can be considerably improved and make better use of the advantages inherent in the international division of labour. This is the primary cause of Hungary's stagnation in the last few years, and this is the unsolved problem to which an answer must be found.

In which direction to proceed

One might believe that, if we do not know where "we are" and we do not know what the optimal size of foreign trade is and what its commodity structure is like (i.e. we do not see clearly either our own position, or the target to be followed) then we cannot know, in which direction to go. Fortunately, the situation is not so bad as that.

There are two things we do know: 1. a uniform rate of exchange must be applied in exports as well as in import substitution in comparing costs and foreign exchange receipts or savings; 2. if profitable production is increased and loss-making production is reduced or eliminated, progress is made in the correct direction (in our figure, "downwards" in both sets), i.e. towards reduction of inputs per unit of foreign exchange.

This advice is so widely known that it is considered a commonplace. Yet we cannot consider it exclusively so, since innumerable declarations of principle, resolutions, and programmes of all levels notwithstanding, we are not only very slowly progressing in this direction, while countless movements are made in the opposite direction: a great variety of special advantages supporting exports and import substitution, thousands of artful instruments of differentiated taxing away and equalization of profits, the many obstacles preventing labour and capital from flowing into more profitable activities; investment (for example, into energetics) and production-supporting decisions leaving profitability entirely out of consideration, and most of all, the extremely low profit incentive and cost sensitivity of the enterprises—all these work in the wrong direction. The question arises: if the direction we ought to follow is so obvious, why do we not follow it?

If the top-level decisions and modifications of the financial regulators were enough to improve efficiency and develop a more efficient commodity structure of production and foreign trade, Hungary would have become by now the most competitive country in the world, seeing that so many such decisions have already been made, and such a lot of experiments with financial regulators tried by the authorities (taxing the enterprise's patience). That we make little or no progress towards improvement of efficiency is, in my opinion, to be traced back to two main causes:

a) neither the rewarding, nor the penalizing (forcing) of enterprises are sufficiently effective for the improvement of efficiency and the increasing of profits. Also, enterprises are not sufficiently independent to be able to dispose of their resources freely and reasonably in order to achieve these objectives.

b) In economic regulation, and in its countless modifications, the predominant decisions have been those which gave preference to certain sectors, enterprises, counties, or activities—making exceptions with them, contrary to the interests of the national economy, society as a whole, and consumers. In other words: organized minorities in the economy can, unfortunately, impose their will upon the unorganized majority in our case, too*

Both phenomena are closely related to Hungary's very strong protectionist seclusion from the world economy, and its high level of monopolization. J. Tucker has already recognized that in the 18th century "all men would be monopolists, if they could." It is no wonder (instead, it is quite natural) that in a small country which has qualitatively secluded itself from the world for a long time and ideologically condemned economic competition, such a degree and intensity of monopolization have developed. The sectoral and regional collusions have obtained countless different advantages, special favours and chances of windfall profits, so that the central organs can justly say that their profit is "unjustified", i.e. not due to their own efforts, and must therefore be taxed away from them. Consequently, high profit (whether it comes from monopoly rent, or is the fruit of efficient work) is from the outset "suspicious": it is to be taxed away without differentiation—so the central organs think; but then it is not worth even gaining—so the enterprises think. Thus the most important momentum of efficiency improvement, reward, has been weakened and even cut out.

Domestic opening obviously requires the thorough transformation of the system of financial regulators: differentiated taxation and tax-reliefs applied at present hit, as a rule, well functioning and profitable activities and their entrepreneurs, while helping

* The question, why small organizations representing minorities are more successful in asserting their interests than big ones, have been revealed by M. *Olson* [24, 25]. His theory is justly considered as one of the most important new schools in social sciences.

the weak. A stricter monetary policy would make it harder to get credit, but it could make its utilization much more free. Unless the internal economy is not more liberalized, external opening is impracticable.

Protectionism and monopolization exclude penalty and compulsion even more than reward: there is no danger of lagging behind, losing markets, loss of prestige, and finally, of bankruptcy—which would be the other major promoter of keeping pace, adjustment, and efficiency improvement. It is the natural rule and attitude of collusions and interest organizations that it is difficult to be admitted—but once in, the organization provides protection. The most effective means of protection is the elimination of competition. One of the most important conditions of this is, particularly in a small country, to make it impossible to freely choose between imported products representing "real" competition, and domestic ones. Let us be not misguided: the protectionist seclusion was not simply forced upon the economy centrally or by some ideology, not even only by the chronic shortage of convertible foreign exchange, or the scarcity of competitive products, but it has been the natural consequence of monopolized production. To obtain protection against imports is the natural reaction of producers, and the elimination of competition is always in the producer's interest. It is this protectionist "hothouse immunity" (i.e. the elimination of competition) that breeds poor quality, non-competitive products and thus shortage of convertible foreign exchange—which then makes it impossible to enlarge imports. Thus the circle is closed: "protection" of domestic industry is ensured once for all.

One might say that, though the producer is not interested in competition, and especially not in a free competition of imports, in his quality as user, he would like to be free to purchase materials, parts and components from the supplier offering the best quality at the most reasonable price. This effort appears, of course, everywhere: every monopolist, while protecting his own market from competition, holds the abolishment of monopolies, and the functioning of free competition to be desirable in all other fields. In this conflict of interests it is usually the minority-producer interest that will be asserted against the majority-consumer interest and, unfortunately, this is so in Hungary, too.

The view is often expressed that the reduction of openness would serve the consumers' interests. As he sees no possibility of considerably enlarging imports, Hoch says: "The realistic alternative... is more Videoton and Orion TV sets, more Lehel refrigerators, more Medicor hospital equipment*—or nothing." [1, p. 201] It is, of course, not a new demand, and it may be quite popular that more of the Hungarian salami, quality shoes and cloths, and durables—all made for export—should remain within the country. There are only two defects of this view; first, it is exactly these competitive products, which are much in demand, that are, in most cases, of our profitable export goods. Therefore, if their exports were to be reduced, it would largely deteriorate export efficiency in general, and reduce the utilization of our comparative

* Names of Hungarian firms.

advantages. Second, those who express these views do not, as a rule, explain what they deem to be superfluous on the import side. So far, of course, everybody is in agreement that reduced material and energy consumption would enable a considerable reduction of imports. The wasting is, however, obviously not the result of "excessive openness", but of the failures in investments, distorted enterprise interests, shortage, and of financial regulators. It is to be feared that further seclusion from world trade, and the reduction of competitive exports would decrease the already extermely narrow import quotas of consumer articles and, presumably, also the imports of materials and parts indispensable for the Videoton, Lehel and Medicor products. The consumer would only lose if foreign trade were reduced: he would have even less choice between imported and domestic products than at present, the increasing shortage of foreign exchange would cause troubles in the domestic supply, and the consumer would become even more dependent on domestic producers enjoying monopoly.

The consumers' and users' interest is clearly the qualitative opening, more free competition, further liberalization of imports. Not only because in this way the range of choice would enormously grow and thereby its economic rationality would also be improved (no disadvantageous forced substitutions are necessary, no unreasonably expensive materials and parts or of poor quality need be used), but also because this is what can, in the first place, press domestic producers for a substantial improvement of quality, competitiveness, assortment and services. This is what could put an end to the leisureliness of producers whose attitude has been shaped by their monopolistic position, and to the indifferent flouting of consumer needs.

The main argument against liberalization of imports is that it would entail a sudden growth of imports that could not be balanced on the one hand, and the mass ruin of Hungarian enterprises on the other: in this case, says Hoch on . . . ". . . a large-scale increase of imports would be needed, such that it could only be countered with even less profitable exports, or none at all." He continues: "Let us tear down the hothouse and only those companies that are capable of coping against foreign goods both at home and abroad should be allowed to survive. Yet, in such a case a great number of companies would collapse." [1, p. 200] If, however, this way is not practicable, what is the solution? Should we, at the price of grave sacrifices, keep alive the enterprises unable to hold out in foreign competition? This would mean the conservation of our lagging behind, low living standards and stagnation; or should we encourage, help, and if necessary, compel, enterprises to hold their ground in world market competition? If all this comes to no avail, we should make it possible to redirect their resources to where we have comparative advantages. I see no other way to put an end to Hungary's lag of development, except this: opening.

The theory of foreign trade recognizes a single acceptable argument for a *temporary* protection of the domestic industry: the one that supports infant industries until they are strong enough to hold out in world market competition. Unfortunately, however, it is rather easy to abuse this argument, and difficult to terminate support:

thus it happens that certain industries quickly grow from tender babies into senile old men in need of support, without ever reaching the age of competitive manhood.

The time has come to assess the experiences of those outward oriented countries which have recently been successful in fast adjustment to world market changes, improvement of competitiveness, and the structural transformation of production. It would also be useful to look into the experiences of the post-war recovery of the advanced European countries: in a situation much more difficult than ours is now, they decided for trade liberalization and the introduction of convertibility. Approaching it from the other way round, it is also worth examining what has happened to those countries which have insisted on the inward-oriented, protectionist economic policy.

A sudden and total liberalization of imports could, of course, entail an incalculable growth of imports, thus it is suggested by no one. It can be introduced only gradually, but it would be highly important to set it up clearly as a strategic objective, and to start with it where it is possible. It is a welcome fact that genuine results have already been produced in the research of this subject.* For example, János *Gács*'s latest study [31] thoroughly examines the advantages and disadvantages of the gradual import liberalization, and the tasks to be solved parallel to its introduction. If the financial authorities succeed in reducing aggregate demand, and enterprises become in fact interested in profits and sensitive to costs, the rate of exchange can be used for reducing the demand for imports. This is to say that the internal and external qualitative opening can be put into practice only in a parallel and gradual manner. Import liberalization could cause serious troubles if not accompanied by a considerable enlargement of the freedom of the domestic market, and with a severe restrictive financial policy. The growth of imports to an unbearable extent would, therefore, follow only if the financial organs are unable to control money and credit creation, if enterprises are not afraid of going in red and if the domestic currency is overvalued. If it is assumed that these conditions cannot be changed, one cannot, of course, suggest the liberalization of imports.

Is it true that opening would ruin a great number of Hungarian enterprises? It would be true in two cases: 1. if opening took place suddenly and with the local currency overvalued to such an extent that it made a great part of the domestic products more expensive than the imported ones; 2. if in organization, technology, and in workers' and managers' potentials there were no unexploited reserves necessary for adapting to the new situation. The greatest advantage of import liberalization is that it would release the reserves hidden behind low efficiency, which could render what we produce in this country competitive, up-to-date, profitable, and thus also exportable.** Obviously, this would not go without serious difficulties, shocks, and a thorough structural change: to stop the manufacture of irretrievably aged or unprofitable

* [26, 27, 28, 29, 30].

** Werner Riecke [28] is right in pointing out: "For an import competition, the foreign product need not *be actually present* on the domestic market. It is enough, if producers are *aware* of this possibility."

products and the extension of profitable activities all meet with numerous difficulties, demanding hard thinking and struggling. Yet this is exactly what we are after: making use of the advantages offered by foreign trade. It is far from us to underestimate the concomitant shocks and the risk—this all speaks for a careful preparation, and a cautious and gradual introduction, and demands that the reallocation of capital and labour should be solved as smoothly as possible. Such a wide-ranging structural change of production will impose a heavy burden on a number of enterprises and collectives, which are innocent in becoming victims of an economic policy which has previously been over-protecting them. It is, therefore, the duty of the economic policy makers not to let them down. Nevertheless, it has to be realized that the abolishment of unprofitable production does not only serve the interest of the majority, but in fact, of everybody, even of those who are momentarily forced to make sacrifices.

We are arguing about something of which none of us can be sure: what would be the consequences of opening to the world economy? How far could the Hungarian enterprises adjust themselves to the new situation? How many could make their production competitive and profitable against imports? What extent of structural change would this demand? Could the central authorities control aggregate demand, could they resist unjustified applications for subsidies, and could they, by means of a correct exchange rate policy, encourage exports and restrict imports in a liberalized situation? Relying on earlier experience, all these questions can be answered from a standpoint of doubt or of trust. Similarly, we could not give a unanimous answer to the question of how our international environment would react to such an essential change. We cannot be sure of what support we could get, or what resistance we would come up against.

Nevertheless, relying on our own as well as on other countries' experiences, we can say with an amount of certitude that, exactly on account of Hungary's high degree of quantitative openness, we have no other means to render our production efficient, competitive and flexibly adjustable, thereby putting an end to stagnation, and thus starting to develop and raise living standards, but the gradual elimination of the qualitative seclusion. Therefore, the alternative facing us is to give this up, or:

"Open we must, I'm whistling.
Open we must,
believe and trust—
we must." [32]*

* Translated by Gy. Hajdu.

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НАДО ОТКРЫВАТЬСЯ!

А. НАДЬ

Дискутируя с положениями статьи Р. Хоха «Открытость экономики и внутреннее потребление», автор высказывается за решительное повышение открытости венгерской экономики, прежде всего в качественном отношении. Под качественной открытостью А. Надь понимает свободный обмен сырьем, капиталом, технологиями, услугами, научными знаниями, информацией и т. д. Без этого невозможно повышение эффективности экономики на деле, ускорение технического прогресса, достижение конкурентоспособности на мировом рынке, гибкое приспособление к его требованиям, а вследствие всего этого — обеспечение устойчивого внешнеторгового равновесия и значительное повышение жизненного уровня.

Что же касается оптимального обьема внешнеторгового оборота, то автор, ссылаясь на свои прежние статьи по этому вопросу, выступает за разработку такой внешнеторговой программы, которая обеспечит достижение намеченных показателей внешнеторгового равновесия и при которой сумма затрат внутри страны является минимальной. В эту оптимальную экспортно-импортную программу входит и единый валютный курс. Поскольку под влиянием внешних и внутренних условий оптимальная внешнеторговая программа непрерывно изменяется об объему и составу, то приспособление к этим условиям требует соответственно гибкой системы заинтересованности и стимулирования.

Нынешняя производственная и внешнеторговая структура далека от оптимальной. В настоящее время это ведет к большим потерям, однако с точки зрения будущего представляет собой значительный резерв. Для реализации этого необходимо введение единого курса цен (предельного) как для экспорта, так и для импорта вместо индивидуальных льгот, направленных на поддержку экспорта и импорта. В результате этой перестройки следует обеспечить повышение заинтересованности предприятий в увеличении эффективности и прибыли, в сокращении издержек; постепенно следует добиваться того, чтобы венгерские предприятия были поставлены в условия конкуренции мирового рынка (конкуренции импорта).

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ECONOMIC CONTROL AND THE STRUCTURAL INTERDEPENDENCE OF ORGANIZATIONS IN HUNGARY AT THE END OF THE SECOND DECADE OF REFORM

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In 1981 a major research project, launched in the Institute of Economics of the Hungarian Academy of Sciences, was directed at the organizational system of the economy. In this paper the two leaders of the project report on the results, relying on several hundreds of analyses and case studies as well as on a debate conducted in the Institute.

The grave functional disturbances of the Hungarian economy, which recur from time to time, were already indicating in the sixties that the socialist transformation—nationalizations and the collectivization of agriculture—as well as the planned economy based on the former had led to such obsolete and bureaucratic management that a brake was put on Hungarian economic development and hindered its catching up with the more advanced countries. The reform of Hungarian economic control and management, proclaimed in 1966, wanted to help in solving this problem. The two decades which have passed since then have supplied important evidence about the opportunities the socialist ownership of the means of production provides for *substituting a planned regulated market* for the exclusive role in economic control of governmental administration, and about the difficulties arising in this process.

1. Structural interdependence of organizations in the economy after the introduction of the New Economic Mechanism (NEM)

The economic policy programme of a regulated market, approved in 1966, set the aim not only of abandoning the practice of directive planning and the central allocation of materials, but also of making cooperative ownership equal to state property, and of opening the way for private initiatives. It wished to transcend the system of central state administration and the centralized control and direct checking by party organizations, the subordination of monetary processes to the national economic plan, as well as the strong limitation of the economic freedom of citizens.

Comparing the results of a great number of case studies and of analyses relying on other sources with the results of other investigations, it may be established that:

I. In the course of its development between 1968–1984—albeit not free from fluctuations—the Hungarian economy was capable of raising the efficiency of management by resolving the internal inconsistencies of the directive (mandatory) planning system, and of securing for its citizens, as producers, a growing freedom in choosing jobs and exploiting creative opportunities and taking them closer to consumers' sovereignty.

2. It also became clear that the hierarchically organized state and cooperative enterprises, necessary for market conditions, *cannot get their autonomy by simple declaration.*

The actual evolution of enterprise autonomy is hindered by

— the virtual and confused dependence of firms on the territorial, functional and branch administration, and on the institutions of the Party—all of which *appear in the formal and informal systems of relations;*

— *the large number of financial prescriptions* which provides an opportunity for the control agencies to prevent firms from freely using their money stocks, and to restrict the use of enterprise incomes to paying wages (earnings) and to financing investments; here belongs also the price regulation which prescribes the price formation rules of the so-called free-priced products;

— finally, the lack of capital and labour markets; conditions under which one firm can not have access to resources even for the fast paying-off investments, while another one can use its own resources and get even credit for loss-making investment projects.

It may be thus stated that the changes implemented between 1966–1968 started a process towards a planned regulated market in the course of which no adequate conditions were set for improving efficiency—owing to inconsistencies in the implementation of the programme, conservative political forces and some problems which had not been thoroughly considered and thus remained unsolved. Within the framework of centrally-determined financial regulators the firms could decide themselves on questions of production, procurement, sales and even investment—but if their financial results deviated from the planned targets, and if their profits did not increase consistently, the extent of their autonomy became restricted by state interventions. As a matter of fact, owing to unforeseen developments in domestic or external markets, or to deviations in their own performances from the planned ones, the results of firms frequently fall beyond the narrow path deemed acceptable by the authorities—this path demanding the securing of profit under the given regulations. In such cases, when incomes of the firm are more favourable as expected the central agencies collect their gains, while when income conditions are unfavourable, the firms concerned are at the mercy of the central agencies—whether they reduce taxes or even grant subsidies. And the authorities, because of the large number of firms in distress, come to the rescue by modifying their own earlier issued rules.

3. The structural interdependence of organizations *was determined,* even under the conditions of the NEM, *by the the simple functional, easily surveyable, division of labour developed after the nationalization* and the collectivization of agriculture—thus an easy opportunity was provided for controlling enterprise activities. The reorganizations were aimed at reducing the number of economic unities, at abolishing

competing activities, and concentrating production—in the interest of reducing unit costs.

The enterprise organization thus functioning is characterized not only by a significant reduction of the number of firms, and the lack of competing firms, but also by the fact that firms suited for satisfying similar demands, having similar production lines, develop such a division of labour that competition is reduced to minimum. Further, adjustment to demand can only take place by modifying the production pattern of existing firms—which are generally large and not sufficiently sensitive to costs and revenues—because of the lack of bankruptcies and *automatisms for founding new firms*. All that results in a slow change in the product-mix.

It causes perhaps even more harm that firms cannot get rid of their loss-making products, because the authorities expect them to satisfy demand for these products—at practically unchanged prices.

4. Firms can *regard their profit as a measure of success only to a limited extent*. This is so on the one hand because prices could be used to influence demand and supply in a restricted scope and, also, they are forced to produce and sell loss-making products. On the other hand, a great part of their profit was taxed away if the remaining profit proved to be too small to secure the necessary wage rises necessary for the firm's survival or to repay the credits, they could regularly bridge over difficulties with central support (tax reduction or subsidy).

5. The slowing down of the reform process after 1972 was primarily a consequence of the fact that, under the impact of the disturbances in management accompanying the changes and because of the insufficient care in elaborating elements of the 1968 reform, the autonomy of economic entities was further restricted. The economic policy braking the reform—while avoiding the restoration of directive planning—emphasized the delivery commitment of firms towards the state and restricted their autonomy with financial and political measures. Measures were also taken against the spontaneously developing small entrepreneurial activities (complementary activities of farming cooperatives, household plots and private small-scale farming); inefficient big firms were financially rehabilitated by amalgamations and other methods and, instead of a uniform regulation by the state based on economic efficiency criteria, individual "bargaining" took place concerning the regulators. The central economic leadership, occupied with the restriction of enterprise autonomy and strengthening its own position substantially, had lost, by the mid-seventies, its ability to perceive problems. As a consequence, it was late to recognize the external shocks the country suffered between 1973–1979 and thus hardly reacted to them. Instead of working out an adequate defensive strategy, economic policy prompted enterprises to such development projects (without properly analysing the return of capital) which later pushed these firms into insolvency.

6. Experiences of the period between 1968–1978 demonstrated that to bring about a successful mix of plan and market was a more complex task, and demanded more comprehensive and deeper changes in control and management than had been

thought two decades earlier. *The heritage of the directive planning mechanism continued to survive* in the supervisory role of the state and party organizations, in the overcentralized structure of firms, and in the monopolistic commercial relations. Major decisions concerning the economy continued to be taken in the control apparatuses—outside the economy. The approval of ambitious development programmes exceeding the country's potential remained characteristic. But there is a great price to be paid for such seemingly useful programmes which, despite this price, can always be well justified: in fact, they prevent firms from giving an answer to genuine market demands. No substantial change could be achieved in the dependency relations. There is a particular contradiction observable in the fact that the modernization of the control system could only take place by decision of the highest power. Thus, only the leading body of the party could have settled the unresolved problems, restrict the rights of the economic control organizations and expand the scope of money in such a manner that the firms observing their own interests should be forced to effectively adjust to domestic and external demand.

The government and party apparatus controlling the economy got used to organizing and checking economic processes directly and in detail. Thus they are inclined to treat arising disorders in the old ways (wage differentials, the "labour-sucking" effect of complementary cooperative workshops or of consumer co-operatives). This puts a brake on the changes that could force a more flexible and efficient operation of the economy. Owing to these factors the economic policy reacted to the unsolved problems of the reform and to the external market shocks of 1973 by trying to circumvent the troubles. Between 1973–1978 the economic leadership put off the solution of the emerging problems and it hardly changed the earlier consumption and investment tendencies of the country which objectively involved Hungary spending at the expense of foreign indebtedness.

2. Renewed recognition of the necessity of reform

The accumulated stock of debts and the expected changes in the conditions of the international credit market as well as the diminishing deliveries of raw materials from CMEA countries suddenly changed Hungary's economic development at the end of 1978. The declarations showed that the period of hidden recentralization (that is, the economically lost period) had come to an end. The period had been characterized by the formal endorsement of concrete reform measures, involving the abolition of directive planning and of the central allocation of materials but accompanied by strengthening central control and by firm-by-firm regulations.

The changes after 1978 undoubtedly represent efforts at improving the balance of payments. Besides successfully improving the balance of trade until 1984, three directions of change have emerged which deeply affect the organizational system of the economic mechanism and which, although in harmony with the market-oriented declarations uttered since 1979, have been implemented with some contradictions:

1. Transformation of the big enterprise organizations. Expansion of entrepreneurial activities and small ventures.

2. Harmonization of branch control, especially that of industry, with the requirements of the regulated market.

3. Suppression of the individual elements of economic control, and development of a uniform—in common parlance "normative"—regulation of price, wage and investment control aimed at bringing about competition among firms. Appearance of market methods of regrouping incomes among firms (issuing of bonds, foundation of joint enterprises, etc.).

2.1 Problems of the enterprise structure

One of the question of major portent, but unsolved even today, is the enterprise structure, more precisely the dominance of big firms and the lack of small and medium ones. Several debates were conducted about the desirable enterprise structure. The periods of success for those who advocated the dominance of big firms fall between 1962–63 and 1975–77 when the number of economic entities clearly diminished. Opposing tendencies could be observed between 1968–1970 and after 1979.

Those participating in the discussions knew well that the concentration of production entails savings in unit costs and that efficient management demands definite sizes of establishments and firms. They also knew that adjustment to changing, ever diversifying economic needs would be helped in general, and in the branches not characterized by capital concentration in particular, by competition among firms, and within this by the appearance of firms with new supply.

From the background of the debate, which also included ideological arguments, the following actual problems should be underlined:

The strong enterprise concentration developed since 1950 has in most cases not brought about such big firms—to be counted as big also by international standards—the activities of which would have produced significant savings in unit costs. In those branches where international practice is characterized by strong concentration the Hungarian firms are, in general, not big. Still, in Hungary, there are, relatively speaking, many such enterprises which are regarded as big, but are squeezed out from international competition. They are not sufficiently specialized and thus only concentrate the disadvantages deriving from being big: the slow change of the product-mix, clumsiness and the concomitant high per unit production costs. The unchanged survival of unsuccessful firms is in the interest of many people who spare no pains to argue about the economies of scale with general statements—without analysing the concrete cases. For this they also exploit the natural political reluctance which is developing because of the social problems brought to the surface by the losses of the major firms. The lack of small and medium firms is most characteristic in the Hungarian economy in those branches where technical progress demands division of labour on the market and cooperation among diversified smaller productive units as well as a fast modification of production patterns (light industry, services, agriculture, fine chemical industry, certain branches of engineering, etc.). The creation of firms that are big in their own area by international comparison—though insignificant relative to the biggest mass-producing concerns—can be deduced from the internal logic of directive (mandatory) planning and from the efforts of direct control aiming at an easy handling of firms. This logic was further supported, even after the proclamation of the economic advantages were unambiguous. This was because as, has been mentioned—production lines, and the specialization of enterprises allowed to call firms to account not only and not primarily for profit, but also for the quantitatively measurable domestic and foreign deliveries—that is, for commodity supply. Secondly, the post-reform Hungarian economy accepted and strengthened the big firms even where their economic advantages were unambiguous. This was because as has been mentioned—Hungarian firms can operate without government support only if their actual results do not show too large dispersion from the one taken into account when the regulators were "calibrated". In reality, the bigger and the more diversified a firm, the more likely it is that the deviations from the expected conditions will level out and thus the planned and actual results will not show any significant differences, either. The trend, evident all over the world, which shows that the raising of the volume of output through diversification reduces uncertainties in the results of enterprise management holds true *a fortiori* under Hungarian conditions. It follows that if, with the regulation of demand and investment valid since 1968 to the present, there had been smaller, specialized firms operating, the individual subsidies and tax reductions could have been avoided even less. All that makes it understandable, although not offering an explanation, why the supreme authorities and firms did not abandon their earlier efforts at concentration, and why the organizational efforts, reappearing after 1979 and stimulating competition, have not led to a conclusive success.

Nevertheless, from 1979 to the present significant changes took place. The decline in the number of state and cooperative firms has stopped and even a slight increase has been registered. The biggest changes occurred in the food processing industry and in some services. Although progress in the breaking up of large organizations has not reached the planned extent, the results are worth attention. Even more significant is the formation of subsidiaries and so-called (enterprise and cooperative) small ventures. Parallel to them, new forms of enterprise have also appeared (economic workteams, civil law associations, specialized cooperative groups, etc.), and economic workteams have also begun to spread within the enterprises. However, as regards the latter (actually the most widespread form) it may be stated these teams have not become new forms of enterprise in reality; we cannot regard them to be anythig other than work brigades operating under the dependency relations of the enterprise while enjoying autonomy in the selection of members and income distribution.

This development, itself not free from contradictions, resulted in a significant number of economic organizations with more or less autonomy not only in the agriculture—for instance, household plots and the complementary farming of employees with main jobs in other branches as well—but also in industry, construction, trade and services.

However, the strict division of labour between big firms and their subsidiaries, the avoidance and lack of competition remained essentially the same as had been earlier the case. Several case studies indicate that state and cooperative, big and small, organizations—first of all in industry, construction and catering—reacted to declining demand and sharpening competition by reducing supply, instead of increasing their efforts. Similar phenomena could be observed in the activities of the already existing smaller ventures, as well as among the small servicing firms of the state and cooperative sectors. We shall later revert to the question—in the context of the general regulation of earnings—of how the defensive behaviour of new and old small enterprise organizations became possible, and why they were not forced to compete for the solvent demand.

The behaviour of state and cooperative firms, and within in that of the new small enterprises and cooperatives, is determined by the activity expected by the centre: this may be called with some simplification "the supply task". If the profitability of this activity was not satisfactory, the meeting of the task was supported by individual subsidies and tax reductions. But the situation did not essentially change even after the reduction of subsidies and moderation of tax facilities in firms with deteriorating results. The latter ones reacted—while their staff was diminishing—with price rises and used the depreciation allowance for covering current costs. Some of the workers withheld the full potential of their labour within the firm during the legal worktime, but were capable of getting extra income (through overtime, tips, enterprise workteams, small ventures outside the firm and illegal work).

From the private activities the most successful ones have been the family household-plot farming of cooperative members and the complementary farming of employees of state firms. The value of output from these small farms steadily exceeds one third of the gross output of agriculture—in animal husbandry this is 40 percent and as regards the net output of agriculture more than a half. Small-scale production secures for people living in the countryside a considerable additional income—true, at the price of much extra work. However, as regards the future, without adequate mechanization and modernization small-scale agricultural production can hardly grow and keep pace with the necessary requirements for efficiency—thus food supply and exports may be threatened. In addition, lacking domestic and import supply, there is no opportunity for adequate mechanization in small-scale production and thus capital must be substituted by so much labour that its economic rationality is questionable. The country is not prepared technically for mechanizing small-scale production.

The security of agricultural producers continues to require substantial state procurement actions. At the same time, it is a task of procurements to better stimulate farmers to produce products that can be efficiently sold on the world market.

The problems of private activities are different in the other sectors of the economy, and the picture is highly differentiated. In the traditional artisan trades low mechanization and the administrative restriction of the number of employees is coupled with difficult living conditions and the extinction of many trades.

In some fields, however, the situation is different. While in the state and cooperative sectors firms are generally forced to restrict earnings, and are sometimes even incapable of paying the wages absolutely necessary for solving their tasks, private activities sometimes result in very high personal incomes. A considerable part of those performing private activities in the new small organizations are *not* full-time employees. They consider entrepreneurial activity not as a means of livelihood—for their whole lifetime—but as a transitory state lasting for some longer or shorter time, which they only maintain as long as they can earn significantly more than their labour income, even if complemented perhaps by tips or through other (illegal) activities. This is remarkable not because some people may earn through small-scale entrepreneurial activity essentially more than the employees of big organizations, but because—as against capitalist market conditions—small entrepreneurs across a wide scale of industrial, construction, commercial, catering and transporting activities consider such high income as normal, and if they cannot get it, they abandon the small entrepreneurial activity.

All that shows that the rather radical transformation of the concentrated enterprise structure in the eighties entailed contradictory consequences. On the one hand, the organizational structure that has emerged continues to be polarized, although it has brought many changes in the size of organizations: the medium-sized firms are invariably missing beside the large and small ones. On the other hand, this change in the production structure, even if it has improved the range of supply, has approximated equilibrium only by relying on competition on some partial markets (e.g. bread or taxi-cabs), but it has not resulted in a general breakthrough towards a buyers' market. Small entrepreneurs need not take, in general, any particular risk when they shift from their employee status to the entrepreneurial one. With a few exceptions, they are forced to make either only small or easily mobilizable investments, and thus can abandon the activity in question without any risk, and can return to their employee status without losses—or, and this is even more characteristic, they can look after new business.

2.2 Reorganization of branch control

In the course of the economic change after 1978, economic policy unambiguously wanted to alter the much criticized situation in which, against the spirit of the reform, the autonomy of the profit-motivated firms is restricted through the branch ministries exercising the supervisory rights of the owner.

In harmony with this criticism a delayed element of the reform ideas of the sixties again came to the fore, i.e. amalgamation of the branch ministries and the formulation of a qualitatively new control function. As happened earlier in the history of the reform, the starting point was the transformation of the control of industry. On January 1st, 1981, the Ministry of Industry was formed.

In principle, the new ministry could not determine the tasks of firms belonging to industry and, as distinct from its forerunners, it had no scope of authority in respect of the trade in the means of production nor was it to be a price authority. Thus, according to the approved resolutions, its function was restricted to elaborating the development concepts of industry and within that the central development programmes (as well as organizing their implementation) and providing help in the acceleration of technological development. In a complementary capacity, its task was to actively participate in the organization of technical and economic cooperation with CMEA countries, that is of product and production cooperation and specialization. Finally, its scope of authority included the supervision of enterprises, extending to the foundation, liquidation and separation of firms, appointment of the higher enterprise executives, and their dismissal, awarding and supervision.

Also the internal organization of the new ministry was built up in view of these goals and, by reducing the staff of the control apparatus, it was intended to forestall interference with the life of enterprises. This was reinforced by the separation, within the ministry, of the functional control activity from the supervisory function—lest the free decisions of firms should be restricted by abusing the latter.

However, practice demonstrated a sharp contradiction with the accepted principles and ideas about control. The ministry had to choose daily whether to answer the system of general requirements accepted for the government administration and relating to the new Ministry of Industry, or the continually repeated expectations of the economic control bodies (Council of Ministers, State Planning Commission, Economic Commission) demanding operative measures, and thus ceding to the pressures demanding individual regulations for firms. It was pushed towards the latter option by its own apparatus (formed from the three legal predecessor ministries) the members of which knew, from their earlier practice, that for strengthening the government apparatus positions of the Ministry the crisis-averting interferences are more advantageous than the principles approved when the Ministry was founded.

Thus, from 1982 onwards the main activity of the Ministry was to stimulate exports with the aid of wage preferences and performance premiums, granted individually to firms, as well as to regulate imports so that in the meantime the supply of the domestic market should not deteriorate too much. But the new organization of the ministry did not provide an adequate framework for managing the crisis. Therefore, when in 1984 important personal changes were made in the leadership of the Ministry (although certainly for reasons beyond the viewpoints of ministerial control), work also started to give a new definition for the tasks of the Ministry of Industry—although the principles have not been clarified to this day. Together with these changes the programme for the reorganization of branch control, pointing beyond the industry, was struck from the agenda or was essentially modified.

2.3 Changes in the financial system

It was the financial regulations which had to struggle with the largest number of internal contradictions. After 1978, both the documents determining monetary policy and those of fiscal policy, and even those establishing the frameworks of price and earnings regulations, proclaimed the idea of a competitive economy. It was then that the idea of a competitive price system—adjusting to world market prices—appeared and the idea of a uniform, normative regulation—not differentiated by firms—was underlined more than ever. Later, in order to mitigate the negative consequences of the rigid regulation of earnings and prices, an experimental regulation of earnings was introduced. This was extended to the scope of efficient firms, and a wage and price club was brought into being for the same. For the efficient firms the rigid prescriptions were relaxed under the particular forms of government administrative control. The principle of price calculations, which prescribed the depreciation allowance should be obligatorily accounted among costs, was abolished with general validity. Thus a chance was created for the utilization of unexploited capacities if this would help reduce losses. To facilitate rational reallocation of capital the market instruments of capital regroupment among firms were given a role, such as associations, the issuing of bonds, and also small financial institutions were founded.

The promulgation of market-oriented measures came into complete conflict with the established practices. Referring to economic difficulties, the central agencies continued to directly control the firms with formal and informal instruments. Thus the new market methods, introduced with great emphasis, largely continued to be empty forms. The changes of free prices were linked to the obligation to announce them previously; the firms were ranked into the regularly changing forms of a competitive price system and wage regulation by official measures, thus restricting their freedom of decision. These measures caused difficulties mainly for the large firms. Many of them could continue to operate only by getting financial facilities—usually tax remission—and by becoming indebted to other firms. The financial difficulties of the medium and small firms were usually not solved with the aid of discriminatory financial measures. The cause of the difference is not that they are more efficient than the big ones, but the fact that their management is not so easy to survey for the central agencies because of the many details—thus their position is more advantageous in the "regulation bargaining" which takes place between them. In the final analysis, the fiscal and credit institutions as well as the price control agencies continued to take discriminatory measures essentially to keep alive all firms, or to prevent their incomes exceeding the planned outlays. In the interest of the survival of the indebted—mostly large—firms, taxes were remitted, and credit repayments were rescheduled. The overwhelming majority of small and medium firms could acquire the conditions necessary for survival through the price bargaining conducted with the authorities.

The large number of changes facilitating the capital movements did not affect the major proportions of capital allocation, and did not amount to a substantial change towards the market. Their function was rather to solve current investment problems and to do this in harmony with the central ideas, as well as to support the market slogans.

The revenues of the budget and the possibilities of money creation proved to be unsatisfactory for covering the budget subsidies and other budget expenditures, as well as the burdens of the international debt service. Thus a general tapping of incomes originating in the enterprise sphere also became necessary. The use of enterprise reserve funds was prohibited, and part of them was taxed away, the credit amortization payments of firms with liquid monetary reserves were accelerated and increased burdens were put on investments by ulteriorly cancelling valid agreements.

The fiscal and credit policy measures, combined with export-import regulations and steps taken in the field of economic diplomacy proved to be sufficient. Also some world economic circumstances were advantageous for avoiding international insolvency, but, as against the earlier targets, they did not lead to improving economic efficiency, and even prevented realization of the economic policy slogan of a new growth path.

2.4 Weaknesses of the economic restrictions between 1979–1984

Between 1979 and 1984 the danger of insolvency was averted with the strong reduction of investment and real wages, and at the price of some deterioration in domestic commodity supply, but without any substantial improvement in the efficiency of state and cooperative enterprises.

However, the restrictive economic policy could not lead to a major success, that would have not only allowed avoidance of the payment crisis, but would also have provided foundations for further progress. This was because, under the pressure of having to reduce debts, the central economic leadership preferred administrative measures to the curbing of aggregate demand and to strongly moderating the detailed administrative interferences which were permeating every field of management. Under such conditions the halt of economic growth did not entail either a change in management behaviour or the beginning of a substantial transformation of the production structure. The performance of the economy did not improve, economic entities continued to remain rather indifferent to consumers' needs and to changes in demand and supply. It was only the activity of the small economic entities, falling beyond the main scope of economic regulation, that became livelier.

The state and cooperative enterprises were not pressed and thus were not capable, either, of forcing towards their employees or members to greater performance. The population tolerated the fall of real wages and of the real value of social benefits without major troubles. In fact, quite a few people could make up financially for the losses suffered by operating in the second economy.

In order to avoid all this, a general regulation of aggregate demand would have been needed instead of the administrative measures chosen in 1979. The general regulation of demand—instead of administrative regulation—means that the state, in harmony with the production potential of the country, determines solvent demand and controls it through the budget and credit emission. The survival and growth of firms operating under strict financial limits depends exclusively on whether their income earned with their products and services covers—apart from shorter transitory problems—their costs and allows growth. Enterprise also has institutional conditions. It suffice to refer to the transformation of the property rights of enterprises asserting the viewpoints of wealth (increase of capital), to the opening possibility of bankruptcy, to the substantial relaxation of the rigidities of price regulation and the control of incomes—as well as to the development of the protection of various interest groups.

The general regulation of aggregate demand also entails a greater differentiation of enterprise incomes than the present practice. The regulated money supply forces the business units to efficient production, to adjust to the demand and supply conditions, and to cost reduction. Only the economic coercion can entail efficient enterprise management, entrepreneurial spirit, and pressure towards an efficient production structure. Under such pressure state and cooperative firms will more strongly counter the workers' efforts at withholding their performances, the lack of discipline, the private work done during legal worktime, and the use of enterprise assets for private purposes. All that may also help repress illegal elements in the whole economy as well as curb illegal incomes.

In order that firms should be forced to pay attention to demand and that they be at the same time able to adjust to these, their operation must be freed from the special price, wage and investment restrictions.

The shift would no doubt entail several unfavourable side effects lasting for some shorter or longer time. The curbing of aggregate demand—without the compensation of enterprise incomes—might even force the closing down of workshops, establishments and even enterprises unable to manage financially. Such a structural change of the economy would put an end to job safety. Dismissals in the wake of the necessary transformation of the production structure, and the handling of the ensuing, even if transitory, unemployment demand serious government measures—among them support to be given to individual attempting self-employment. Owing to the growing role of actually free prices the rate of inflation is not likely to decrease even with a successful monetary policy; and it is more difficult to prepare the population for price rises, since they would not be preceded by central administrative measures.

Any change entailing unfavourable consequences needs political will. Thus, without political determination the economy is incapable of emerging from its gradually deteriorating situation.

Impact of the 1984 resolution of the CC of the HSWP, and of its measures taken in 1985

After long preparatory work, the Central Committee of the Hungarian Socialist Workers' Party passed a resolution in April 1984 concerning the question of streamlining economic control. The resolution and the measures following it brought major changes and posed questions in three areas: institutional foundation of the autonomy of firms, development of the financial regulations and the methods of market surveillance.

3.1 Steps towards enterprise autonomy

The property rights of a major part of state-owned firms were taken from the hands of government administration. It was only the firms producing public utilities and some in exceptional position in which the property rights remained unchanged—in their case the supervision of the owner continues to be exercised by the branch ministries and the local councils. A great part of the property rights of the market-oriented firms was transferred into the authority of the general assembly of employees. It is the enterprise council, the meeting of delegates, or the general assembly that elects—in agreement with the local and branch agencies—the manager and decides on essential questions of enterprise development.

The bases for the new forms of enterprise control were provided by three concepts: the one relating to *self-management* which wanted to place the whole control over enterprise management into the hands of employees;—the *corporative solution* in which the enterprise council consists of three parts: representatives of the state, of the employees, and of the management. The council is in charge of the strategic control of firms;—and finally, the one in which *the property* rights were given to several competing, profit-oriented state holdings controlling firms from the viewpoint of the return of capital.

The present solution, preferred to experimenting with the three different concepts, and equally of closed logic, approximates in its principles rather to the system of self-management. It transforms the enterprise supervision rights of the branch ministries and the local councils into rights for the inspection of legality. This restricts, in principle, their rights to checking whether the laws have been observed. There have, however, remained several loopholes through which the central bodies can formally or informally interfere with enterprise decisions. A further weakness of the new practice is that it has not provided means to handle the conflicts between enterprise collectives and the government regulations. It is a source of even greater problems that the contents of the property rights of the working collectives (formally disposing of a great part of property rights) has not been adequately clarified. This is also expressed by the fact that the settlement of enterprise interests in maintaining and increasing the value of firm's assets failed to materialize. It was intended to put this question on the agenda only in 1986. Thus, it was not clear how an enterprise collective, using the property rights, becomes interested in taking decisions exceeding the demand for a short-term increase of its income, how it will comply with decisions increasing the long-term profitability of the firm and the long-term safety of the working collective. Is the enterprise council or general assembly capable and willing to counter exaggerated claims for wage rises, and if so, on what considerations? The difficulty of the problem is indicated by the fact that, from the viewpoint of the returns, enterprise wealth not always coincides with even the long-term interests of the enterprise collective. The utilization of enterprise assets demands weighing from time to time also from the viewpoint of the given collective, e.g. what should happen with the assets that cannot be efficiently exploited, etc. In addition, not only the collective but also the society outside the enterprise. It has short- and long-term interests attached to increasing the wealth of the enterprise. It has not been adequately clarified whether a representation of these interests is not necessary and feasible for exercising such a task.

For the perception of the questions involved, the recently emerging problem can be mentioned that the new regulations permit wage increases at the expense of depreciation allowance. In such cases there is a conflict between the short-term incomes of the enterprise collective and the interest in the increase of the value of the enterprises' assets. Thus it may be advantageous from the aspect of the short-term interests of the whole enterprise collective, or even more from that of the older workers to turn the depreciation allowance gradually into personal income. At the same time, from the aspect of the long-term interests of the younger members of the collective it may be more advantageous to provide for the safety of current production, to reconstruct assets and, for citizens outside the enterprise, it may be more advantageous to close down the firm and sell its assets. In such cases the interests of the enterprise collective exercising the rights of the owner may be divided and/or may get into conflict with efficient utilization of enterprise assets. The latter may entail a reduction of the income of those producing the obsolete products, perhaps a reduction of staff and/or a change in the structure of labour.

The above also indicate that the new order of exercising the state property rights has not solved the basic problems: the concerns of the regulation of personal incomes and investment. After the changes, the enterprise management and the body checking it do not comprise forces in whose interest it is to raise their voice against the further operation of non-efficient firms misusing the means of the state budget. Nor do the bodies controlling the enterprise comprise such forces which, on the basis of their interests, would advocate the breaking up of large organizations if this were demanded from the viewpoints of efficiency.

The multitude of unsolved problems might easily lead to the new system of enterprise control becoming formal. Already the danger is felt that, following the transitory shock accompanying the formation of new leading bodies and the election of managers, a situation develops with which everybody is dissatisfied.

The enterprise management is not satisfied because amidst the essentially invariable regulations and expectations restricting its scope of movement it also has to try to come to terms with the enterprise council or general assembly. Therefore, many managers feel that, instead of facilitating their work, the introduction of the new forms of management rather makes it more difficult. At the same time, employees did not expect the expansion of their rights. Earlier they did not demand the introduction of self-management, and their demands included, at most, participation in decisions affecting income relations and working conditions. Now, under the new conditions, perhaps an increasing number of them will learn the tasks to be done and will even take a liking for it. But the fear is not unjustified that in practice—under the impact of the likely manipulations—the chance offered by the self-management will not fully evolve and employees will grow sceptical about the new forms.

3.2 Financial policy

In 1985 the system of regulators was transformed and the system of taxation, that is, of the income centralization channels established in the course of time, was rationalized. The profit tax was reduced. In the interest of enforcing the efficiency requirements the role of taxes on resources increased; thus a tax on enterprise property was introduced and the wage tax increased. But the changes promising progress are of doubtful value. For instance, with reference to the difficulties of the economy, a tax on accumulation (investment) was introduced—yet this hinders development and is thus economically unjustified. But the changes as a whole rather increased than diminished the extent of income centralization—nor did the system of enterprise subsidies and tax reductions disappear.

A great promise in the price mechanism was the gradual abolition of administrative price formation rules in manufacturing and more flexible price formation in agriculture and trade, accompanied by the abolition of the notions of unfair profit and unfair price. According to the new rules only a price higher than those of the competitors counts as unfair. In price control, the price limitation linked to the rate of profit was eliminated. Thus, in principle, the contradiction causing troubles in earlier periods was overcome. This contradiction was that, although the raising of profit was considered to be the goal of firms, when prices were officially checked it was considered as a harmful or at least a suspicious phenomenon if the price calculation of some products (or that of a whole company) comprised a higher than usual rate of profit. Also, the prescriptions about the obligatory adjustment to changes in world market prices were to be abolished gradually and in a widening scope.

The changes pointing towards a regulated market did not exert their effect in reality. Fearing an unexpected and strong rise in prices becoming free, the evolution of the substantial impacts of the price mechanism was retarded by imposing an early warning system.

The rigid regulations affecting the raising of incomes of enterprise executives and employees were mitigated by the introduction of various forms of less rigid ones and, within it, by relating the level of earnings to the profit. The latter—particularly if working without the simultaneously introduced brakes—abolishes the distinction between wage increment and wage cost—harmful from the economic efficiency point of view. But a more rational regulation of earnings leads to increasing efficiency only if firms are unambiguously interested in profit, and in increasing the value of assets. If there is no change in the latter respect,—and the firm continues to operate as an economic entity fulfilling supply and export tasks—it will subordinate its strategy and tactics to this goal in other fields of management as well. Thus, in the interest of higher profit it will not risk its relations with the employees and will not spare costs, including wage costs.

It may be thus established that the firms' behaviour was logical from their own point of view when they exploited the diversity of the wage regulation mainly for finding the form enabling the payment of high wages. The new form of the regulation of earnings that came to the fore in 1985 favours those firms which attain a high rate of profit and can bear, in the long run, the fact that the high wage-tax accompanying the new regulation puts a great burden on their costs.

Thus, it cannot be considered a mere chance that the development of enterprise revenues and of wages was not synchronous in either 1985 or 1986.

Also the new forms of capital allocation were consolidated: associations, the issuing of bonds and shares, the formation of financial institutions, etc. But the determining forms of capital allocations are, and will remain in the foreseeable future, the old ones. Therefore, the—earlier reviewed—most important contradiction, related to investment financing, will continue to assert itself. The firm investing a considerable sum relative to its own capital will be forced to resort to credit, not being capable of relying only on its own resources, and thus its success will not depend on the success of the development but on the conditions negotiated in the credit agreement—and this differing firm-by-firm. And the firm implementing small investment relative to its own capital can remain profitable even if the profitability of the development does not attain the desirable level.

The most ambiguous case of changes is the bankruptcy of loss-making firms and activities and the accompanying dismissals. The long delayed bankruptcy law has been put into force in such a way that the creditor, finding its interests endangered, can initiate the liquidation procedure forcing the debtor—through accelarated court procedure—to sell its assets and indemnify him only in agreement with the state administration. It has also to be feared that the simultaneously introduced changes will not force the liquidation of low-efficiency workshops and factories either. A direct consequence of both actions would have been, according to earlier plans, the cutting of jobs. However, in practice the original ideas gradually lost ground. This is expressed not only by the fact that, owing to the continued strong centralization of free incomes, the purchase under market forms of failing establishments and factories (i.e. the free exchange of properties without central decision) remains impossible, but also in that "the reorganization of the wealth of not adequately managed economic entities to be liquidated" is expected from the decisions and organizational activity of state organs. The weakening of efforts at closing down the non-efficient workshops is also indicated by the fact that, in spite of the strong excess demand on the labour market, the institutional preparations for the dismissals (unemployment) is progressing slowly (system of aid for retraining, etc.).

The contradictions of the financial changes implemented in 1985 is mainly rooted in the fact *that the order of the money emission has hardly been affected.* Although the programme of *bank reform* has been approved with great delay, no resistance has been developed against forced interfirm credits, and a strict regulation of the money supply is still missing. Instead of a programme for regulating aggregate demand, the banking system continues to make it difficult for efficient firms to raise credit and does not—cannot—stop granting credit to low-efficiency firms, nor does it strongly interfere in order to stop the heavy indebtedness of firms to each other.

The way the money supply has developed has not restricted the aggregate demand, but has essentially secured the survival of every firm. This practice brings about a particular situation. The unexploited capacities are coupled with shortage on the market of goods and services and with excess demand on the labour market.

The smooth supply of money to the state and cooperative firms, not strictly depending on their results, has brought about an infernal chain of complicated interrelations. On the one hand, not even the almost unsolvent state and cooperative firms are forced to withstand the price-raising efforts of their partners, to dismiss superfluous staff, and to save wages. They solve the difficult production tasks, not by organized internal work, but with overtime, enterprise economic workteams, orders given to expensive suppliers etc. Nor do they stop supplying their buyers in default of payment. On the other hand, as a natural concomitant of all the above, the just reviewed changes in market-oriented price and wage regulations have not entailed a growing role of money, but have loosened the financial conditions of management. In this case the economic leadership of the country can protect itself from runaway inflation only with methods discarded in its declarations. Finally, the unfavourable phenomena observed in the scope of state and cooperative enterprises also loosen the management conditions of small ventures.

3.3 The development of trade

The development towards a market system raised strict requirements for trade as well. The economic reform demanded a multi-channel, diversified trade system which has not been brought about to this very day. The declared free choice of partners cannot assert itself in most of the cases, as there are too few partners from whom to choose. More firms competing with each other would be needed. But the ambitions and chances of founding firms are restricted even more in trade than in production.

In the eighties, and particularly after 1985, efforts were made to change the situation. The firms, first of all of the productive ones, obtained new possibilities in the trading in raw materials, capital goods and consumer goods, moreover in foreign trade, too. Also organizations were transformed and this increased the number of commercial firms. That of firms with rights to trade abroad suddenly increased. Still, except for the appearance of private retail shops, the changes do not unambiguously point towards the desired objective. Competition among commercial firms is still in an embryonic stage, which, among other things, is a consequence of the price not being sufficient enough for covering trading risks, and of the big commitments entailed by trading rights.

The government entrusted the *market surveillance* organization with the task of bringing about diversified commercial relations, as well as organizing and controlling markets. This institution is one of the most controversial elements of today's economic control. Namely, a multi-channel market can only come about by changes in the general conditions, which the market surveillance can help but cannot bring about with its organizing activity. Therefore, it is still the "trouble averting" activity that is preponderant as against the tasks of market organization. It is still far from being a reality for free market areas to be unambiguously delimited from the trading areas belonging to the scope of market surveillance and, also not yet realized, that the latter should be interfered with—apart from separate authorization—only by exploiting the incentive role of the funds made available for this special purpose. Instead, the situations have persisted (and their number even increased in 1986) when the market forces have not solved the market shortages. In addition, the measures of government agencies mowing between unambiguous legal limits have been weak, too. It is with growing frequency that branch organizations, councils and territorial party organs try to settle social conflicts (commodity shortage, spontaneous price rises, dismissals, etc.) with the means available to them. In this way, however, only the relief of short-term tensions can be helped, while the local interferences do not point in the direction to be followed in the long run; they even weaken the desirable behaviour of economic entities that should be based on enterprise interest and autonomy.

4. Economic results and changes in 1985–1986

After the 1984 resolution of the CC of the HSWP, and then in early 1985, at the time of the 23rd Congress of the HSWP, a particularly optimistic atmosphere developed. The favourable judgement of the changes implemented relied on two factors. By the end of 1984 it had become clear that, through the market-oriented tone of government resolutions, and as a result of formal and informal administrative actions towards enterprises, the country improved its positions on the international credit market and succeeded in emerging from the credit crisis. On the other hand, precisely on the basis of the achievements, it was assumed that the complex market-oriented programme of streamlining the system of economic control and management, even if modest relative to the radical proposals, would be sufficient for accelerating the growth rate and for a well-founded development of the economy.

The economic results of 1985 and of 1986 do not support this assumption. The easing of administrative control, keeping in view the balance of payments, has not been replaced by the pressure of monetary processes towards efficiency. With the emergence of the new forms of management, the firms economize even less on wages and exploit their greater freedom in setting prices and, first of all, wages. Loss-making firms and establishments have not, in practice, been closed down. Enterprises were very cautious with dismissals. The economic policy leadership was glad that the unfavourable side effects were missing because of the weak financial pressure, while it was surprised that the economic performance of the country did not improve. National income, exports, domestic commodity supply and efficiency lagged not only behind the targets of the national economic plan, but also behind the results of 1984, while the incomes of firms and of individuals kept increasing more than did the results of management. This clearly shows that the advantages of the regulated market cannot be called to life without accepting the disadvantages entailed by turning towards the market. Enterprise behaviour may be considered, in general and even in this case, as a rational response to the measures taken by the economic leadership—even if not quite successful in the case of every firm.

The conditions of progress are likely to deteriorate further if we refrain from deep changes in the institutional position of firms.

4.1 The state of the Hungarian economy

The development of the Hungarian economy has been dissatisfactory since 1973 not because the gap with the leading industrial countries has not been closed, or because the country has been lagging even behind the growth of some medium-developed countries, but because Hungary is menaced by becoming greatly detached from developing trends of the world economy. It is also regrettable that the political and economic leadership might not be able to change a part of the unfavourable processes in the foreseeable future. Even if Hungary succeeds in making progress in the development of the infrastructure, neglected ever since 1950, the modernization of transportation, the telephone network, etc. to satisfy the requirement of an advanced economy will not be attained for a long time.

Our chances for integration with the big markets have not improved—yet this would be perhaps the most important factor for the progress of a small country. The ways of integration become possible only over long historical periods. The main obstacle to integration with the CMEA is that the established system of planned economy in the other countries of the CMEA does not favour openness towards external markets, and offers a way merely to an integration directed from a centre, which makes the cooperation between sovereign economies impossible. The chances for more intensive links with the Western economies are influenced by the unhealthy state of East–West relations. It would be an illusion to expect a quick improvement in opportunities.

Finally, we cannot expect a quick and decisive change to a system of requirements adjusting to the demands of buyers and to competitive conditions in working organizations which have grown unaccustomed to the hard requirements of management and also accept loose labour performances.

Thus, under the given conditions, instead of closing up we can only aim at the more modest but difficult target of reducing the extent of our lag, so that with time we should have a chance of actually closing up.

4.2 The lack of additional resources necessary for the change

The resources available for the development of the economy have narrowed down. In the case of major earlier changes in management two, relatively easily mobilizable, financial sources were at hand: the means released by stopping the (frequently unrealistic) big investment projects, and the foreign loans. Today it is more difficult to mobilize both of these factors and their volume is more modest as well. The first, because the level of investment is now low indeed, since it was mostly with its reduction that we succeeded in avoiding the credit crisis. (It is a further problem related to the scarce resources that a major part of the investment funds available under the 7th five-year plan is committed to such government programmes—the Yamburg gas pipeline, the hydroelectric power plant of Bős-Nagymaros, the reconstructions of ferrous metallurgy and coal mining, etc.—which do not directly help efficient management.) There is some chance for getting access to the latter source, i.e. foreign loans, if conditions for direct foreign investment are made essentially more advantageous for investors than is the case at present. But this cannot become, for the time being, a determinant of our economic strategy. Owing to the extent of the country's indebtedness—as well as the instability of the international money market—increasing the stock of debts involves even greater risk than earlier.

Because of the above, however difficult it is, we have to acknowledge that the changes in management—which anyway cause tensions—cannot be coupled with a significant rise in living standards. It cannot be excluded that it will also be necessary to calculate whether the preparation of changes in the conditions of management does not demand such safety reserves that the mobilization of such reserves might transitorily endanger the living standards.

4.3 The reform and the requirement of accelerated development in CMEA countries

From the viewpoint of economics the results of our investigations may be summed up in four statements:

1. The efforts of two decades at bringing about a planned regulated market have been successful and have proved that the social ownership of the means of production also *allows management methods other than those of directive planning*. The results achieved in the course of creating a planned regulated market may be called merely initial steps. The state and cooperative firms freed from the pressure of directive control are essentially freer than was the case earlier, yet they are not forced to make rational target-oriented efforts, since the coercion of the plan-instructions has not been replaced *by the pressure of the market, of monetary relations*. The firms continue to enjoy the superiority of the sellers and their placid behaviour is not disturbed by either the insolvencies menacing some of them, or the lack of funds, or the narrowing sales possibilities within the established pattern of production. Current experience convinces the management of poorly operating firms or that of firms in a dangerous situation, that a radical adjustment to market demands and efficiency requirements would produce such conflicts within the firms and in their system of external relations which would be more difficult to endure than the continued bargaining for favours.

2. Since a powerful reaction to the demands of buyers has not evolved, *shortages* regularly occur. To mitigate them, the state administration called into being certain enterprise commitments—frequently called 'responsibility for supply',—with which the laws were not familiar. On the other hand, the large number of repeatedly emerging questions which remain without solution because of the lack of voluntary enterprise activity, has convinced the functional, branch and territorial apparatus (accustomed to their supervisory role) as well as the political apparatus, that *firm-by-firm interferences are justified*. Thus an individual settlement of problems is the dominating method of the central management, while the strict planned control of aggregate demand, that is, the control of purchasing power through the harmonization of the credits and fiscal expenditures launched, has not been given the green light.

3. The state and cooperative firms have operated in the last twenty years not only as institutions exclusively responsible for supply. Among their economic goals it was a dominant aim to increase the earnings of their employees. *The economic entities neglected the augmentation of company property*. This was and is, among other things,

the reason that the administrative method of wage control—disturbing efficiency—had to, and still has to be, maintained.

The elementary conditions of income-reallocation outside the firms have also been missing for a long time. Since then the situation has essentially changed because of the new opportunity of forming associations, issuing bonds and interfirm crediting. *The market flow of capitals is nevertheless still insignificant.* Besides, the value of the assets is not regularly revalued in the firms.

4. Beside the not yet market conforming and in many respects overregulated activity of the state and cooperative firms, the productive, servicing and commercial activities of small ventures have appared and are playing an ever growing role. But the two kinds of management have not yet been successfully integrated. This appears in the first place in the income differentials frequently to be found between the two kinds of activity, and in the lack of investment into small-scale ventures.

Under the above indicated circumstances it is a natural effort on part of the political leadership to maintain, and later increase, the level of personal incomes, to mitigate the significant differences between legal incomes and suppress the illegal ones, to preserve full employment—in the present interpretation: job security—and to reduce the rate of inflation. They trust that the performance of the economy can be successfully improved through the firm-by-firm administrative, frequently informal, interventions with the economic entities, and by introducing tax reforms which put a brake on the inequalities of legal incomes, yet without threatening the conditions expected by the masses—as was explained above in detail.

There is, however, a great danger that if the present complacency persists, there will be a diminution of social wealth, yet the problems arising from this will be borne by the future generation.

All that justifies the case for the economic leadership going to meet the changes and, enjoying the trust of working people, taking the undoubtedly difficult steps which can reverse the deterioration in the performance of the economy, and thus avert the danger of having to face much graver decisions tomorrow.

The streamlining of economic control demands such measures which change not only the tactics of the economic entities, but also the basic characteristics of their behaviour.

Such measures are necessary in three fields.

1. In the political sphere: *the development of democratic forms.* Within that, in the current period, when it is particularly difficult to harmonize the welfare of individual groups with the interests of the progress of the economy as a whole, it is necessary that the interests of social groups, strata, enterprises and establishments should be institutionally protected, with a legal guarantee. The development of democracy is indispensable since, without understanding the problems, without bringing to the surface and discussing the contradictory interests, the political leadership cannot turn against conservatism and particularism and stop the decline of the economy.

2. The main economic policy task for government administration is—besides developing public services, the infrastructure and directly guiding social policy—*to determine the aggregate demand that can be satisfied by the current production.* The aggregate demand policy—meaning the restriction of the money supply in harmony with the performance of the economy—demands first of all that the volume of credit emission be defined. The long-term strategy relating to credit has to be kept in hand by the National Bank of Hungary because this is the institution in charge of the money supply. The guidelines of money supply are determined by the government, but the viewpoints of this strategy have to be asserted through the banking network. The issue of money also has to be in harmony with fiscal expenditures. The money issued through the channels of credit and the state budget may provide easily predictable conditions for the firms which not only compete but also possess considerable freedom in pricing, wage-setting and investments. The restricted quantity of money, together with changing rates of interest, will also provide good orientation for efficient and safe developments. Such financial control will force the firms which do not meet their commitments into insolvency.

By further developing the market channels of capital allocation, also including the spreading of joint stock companies, further progress should be made towards the creation of independent credit banks and financial institutions. The wide activities of the existing ones should be stimulated. The strict regulation of solvent demand will adequately prevent state and cooperative firms from abusing their freedom in questions of wage-setting and pricing, so that a further reduction of particular state restrictions becomes possible.

Strictly regulated demand and increased freedom will bring about the arena where firms can and will freely fight for their survival and development. The practical independence of the firms operating under more difficult conditions should be consolidated to preserve their autonomy vis-à-vis the government administration. This involves the abandonment of the strict control of aggregate demand, and the formal and informal interferences by the government administration and by social organs.

A further task of government administration is to transform the too concentrated structure of enterprises. Experience, however, suggests that this cannot be implemented with administrative measures, thus the emphasis must be put on bringing about the conditions under which new enterprises can be formed for the production of, and trade in, products and services promising good profit. When firms getting into financial difficulties are rehabilitated or liquidated such efficient solutions may be preferred which, by increasing the number of firms, improve the conditions for competition.

It is also necessary to thoroughly elaborate how the forms of enterprise, within it of private ventures, should be developed and how their security can be guaranteed. In the meantime it has to be clarified, together with those interested, what the alternatives are for ventures that have grown too big, and what the conditions of inherited wealth should be.

3. *Finally, in the interest of the institutional consolidation of the autonomy of firms and of their efficient management, moreover in the interest of eliminating the wasting of social resources, it is indispensable to protect the property of firms better than today, and institutionally stimulate the increase of this property.* In order to support the weak interest in property in the state and cooperative firms, it is necessary to work out a detailed programme of action. In this framework the following problems have to be further investigated:

— The possibility of increasing the wealth of members at the expense of the indivisible property of cooperatives.

— It has to be examined whether institutions of society, the regular commitments of which assume that they possess a property entailing rent (social security, insurance companies, etc.), should not be transformed. Instead if the state budget, they should manage their property in a way which allows them to meet their obligations towards their clients. In addition, they might obtain the right to decide more freely on the use of their liquid incomes as well. This would stimulate them to invest, in the interest of adequate returns, into enterprises participating in the economic competition.

— The commercial banks should not renew the bigger debts of competitive firms by granting new credit. Instead, they should transform the stock of debts of the indebted firms into ownership shares. They should entrust financial institutions—specialized for this purpose—with the handling of their property thus partially owned, giving them the task of increasing the capital made available to them.

— It also requires an unambiguous formulation that the employees of state enterprises should not merely represent their own interests in the organs controlling the firm, but should consider it a task of equal rank to call to account the management for the development of company wealth and for its expected income-creating ability.

It is only the ensemble of these changes that can make the socialist economic entities into truly profit-motivated enterprises adjusting to the economic conditions. In the interest of survival they must compete with each other and the private economy for consumers, thus increasing the performance of the whole Hungarian economy.

ОРГАНИЗАЦИОННАЯ СИСТЕМА УПРАВЛЕНИЯ ЭКОНОМИКОЙ В СЕРЕДИНЕ 1980-Х ГОДОВ

А. ШИПОШ—М. ТАРДОШ

В статье обобщаются результаты программы научных исследований, в ходе которых анализировалось развитие организационной системы экономики. Констатируется, что сложившиеся после 1968 г. институты не обеспечили эффективного функционирования планово регулируемого рынка. Формирование рынка и начавшееся в 1968 г. его развитие в конце 1972 г. на долгое время остановилось. Вновь начавшееся с 1979 г. развитие также не привело к решающим результатам.

Наиболее важной причиной трудностей было отсутствие рыночных институтов распределения ресурсов (капитал, рабочая сила и т. д.), а также по существу неизменная власть унаследованных от периода обязательных плановых заданий институтов. Это вызывает — в особенности тогда, когда хозяйственные условия складываются более неблагоприятно, чем ожидалось — такую степень вмешательства централизированных органов, а также такую волну неожиданных и часто принимаемых задним числом изменений регуляторов, которые практически уничтожают провозглашенную самостоятельность предприятий.

Апрельское постановление ЦК ВСРП 1984 г. устранило новые препятствия на пути независимости предприятий. Была ликвидирована формальная иерархическая зависимость большинства предприятий от государственного управления, негибкость финансового регулирования существенно ослабла. Начала возрастать роль рынков ресурсов. Однако слабостью изменений по-прежнему является то, что рыночные пути распределения денежных средств многократно пересекаются с решениями формальных и неформальных органов управления экономикой, что смягчает общественные напряженности, но ослабляет принуждение приспосабливаться к платежеспособному спросу.

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SOURCES OF THE GROWTH OF ENTERPRISES IN HUNGARY

(An empirical investigation of investment and enterprise growth)

É. VÁRHEGYI

The budgetary (fiscal) and banking allocation of the investment resources tends to detach capital enlargement from capital efficiency. All the considerations analysed here, playing a role in selecting the enterprise to be promoted in a dynamical growth by means of central resources (branch of economy, form of ownership) are asserted *against* the capital efficiency. Whatever the motives of the economic control agencies in allocating investment resources, it has to be taken into account that this practice of allocation *necessarily leads to a national economic capital structure of a deteriorating efficiency*. What is more, the statement can be ventured that, without a radical change of the allocation mechanism and lacking external resources, the self-amplifying process will produce an increasingly bad situation, on the one hand, by trying to promote such enterprises (activities) in a dynamical growth which, for want of an adequate utilization of the invested capital, will immobilize, or just devour any amount of money accumulated elsewhere, on the other hand, because external investment resources will dry up for an increasing number of enterprises (of which some carry on profitable activities) what is more, so will, necessarily, the available enterprise development resources, because of the budgetary fiscal redistribution.

It may seem rather unusual to examine growth in a stagnating economy. Is it worth dealing with the factors affecting the growth of enterprises at a time when the investments of the socialist sector have been practically unchanged for years? In fact, when the sources of growth are increasingly scarce, it is particularly important to examine what chances the different enterprises have, and what sources they must obtain, to replace or perhaps to increase their fixed capital. Even in this period of slow growth a *polarization of enterprises* is clearly seen. On examination of the three years from 1982 to 1984, nearly a thousand enterprises and cooperatives are found in the material sectors of the economy in which fixed capital was growing at a rate higher than 20 percent. However, the number of the enterprises in which the net value of fixed capital fell amounted to one and a half thousand. This fact might as well be a symptom of revival, if there lay behind it the expansion of profitable, and the reduction of unprofitable, economic activities.

In the material sectors *two-fifths* of the investment resources come from the bank and the state budget. Less than half of the enterprises can have access to bank credits, and about a third get financial means for development from the budget. Thus the allocation of budgetary and bank resources plays a determinant role in the growth of enterprises.

The mechanism of capital allocation by the state and banks has not substantially changed even in the restriction period. ([1], [2], [8]) The expansion of onerous contracts (such as government loans and the provision of funds) has only formally added to earlier demands for returns; in fact, it has served to settle earlier accumulated enterprise debts, which had become unmanageable. The criterion of returns could not become a determinant factor in the crediting practice of the bank, either, as it has continued to be outweighed by the responsibility of keeping enterprises alive, and by serving the centrally decided development projects. Therefore, it may be assumed that *the polarization of enterprise growth is not the product of selection according to capital efficiency*.

In the present article I shall attempt to prove this hypothesis by quantifying the factors that affect the growth of enterprises' fixed assets. I shall distinguish between enterprise, bank, and budget resources. The reason for distinguishing between enterprise an bank pecuniary means is that in Hungary the enterprise's chance of obtaining credits is not strictly tied to future enterprise resources that would provide for due repayment of the credits. On the other hand, credits and budget resources are separately treated because, while it is logically *expected* of the allocation of credits that it be subject to repayment conditions (even if representative of economic policy preferences), financing from the state budget may be directly connected to economic policy objectives and the efficiency consideration is to be asserted only within this sphere.

I shall follow the sequence of thought as developed below.

First I shall examine, what financial resources and which money holders play a determinant role in the *differences* of enterprise growth, second, which enterprises are helped in their growth by the state or by the bank, and which are left to rely in most part on their earlier accumulation ability. Finally, the question of rationality of the investment allocation will be examined.

The method of analysis

I shall attempt to prove the verity of the above-formulated hypothesis, and to answer the questions—roughly perhaps, but to the point—relying on the results of an empirical examination.* The examination is based on the mathematical-statistical processing of the economic indicators computed from the 1982, 1983, and 1984 balance-sheet data of 4254 enterprises and cooperatives working in the material sectors of the Hungarian national economy.

* Within the framework of the research project "Redistribution of the state-owned enterprises' income" carried out for the Ministry of Industry under the guidance of János *Kornai*, I studied the effect of the credit system on the enterprise budget constraint. I did my study in the Institute of Financial Research. László *Cserjés* solved the tasks of computation techniques. As regards the approach to the question, as well as the system of indicators and methods, this investigation was closely related to the earlier investigations of János Kornai, Ágnes *Matits* and József *Temesi* ([2], [3], [4], [5]). A more amply documentated description of the results used in the argumentation of the present article is to be found in the study [7].

I use two different indicators to describe the *growth* of enterprises. One reflects the rate of the *changes in the net value of the fixed assets* of enterprises between 1982 and 1984. The other one is the indicator of *investment activities:* it shows the relationship between investment outlays and the total value of material and financial enterprise assets. That is to say, the latter indicator measures the *effort* made to replace or increase fixed capital, whereas the former quantifies the effect of this effort as it is embodied in the changes of the enterprises' fixed capital. The two indicators do not necessarily move parallel to each other. If, for example, fixed capital is of a high proportion within the total capital, or if the fixed capitals are very worn out, even a higher-than-average investment may result in a lower-than-average growth of the fixed capital.

Three indicators are used in the examination to describe *enterprise resources:* 1. fund set apart for development purposes from the depreciation fund and from profit (in the following: enterprise development resource) relative to the enterprise capital; 2. fund set apart for development purposes from the profit (in the following: development resource from profit) relative to the value of enterprise capital; 3. share of the enterprises' own contribution in the investment outlays. The mean values of the years 1982 to 1984 were computed for each indicator.

The role of the *bank credit* is described with the aid of two different indicators. One compares the enterprise's outstanding *debt stock* in the given year (1982, or 1984) with the value of the fixed assets of that year. The other one shows the share of bank credits *granted* in the investment outlays of the years 1982 to 1984. The rates of the stock and flow of the *budgetary development sources* were registered in a similar manner.

Enterprise *profitability* is described by the rate of profit—formed in three different phases of the budgetary redistribution—to the total assets. The profits of the different phases are: the so-called original profitability, profitability according to the balance sheet, and accounted profitability. The three indicators have three values each: that of 1982, 1984, and a mean value for the period.*

The mathematical-statistical elaboration of the indicators (determination of the mean value, standard deviation, correlation matrix, empirical regressions) was carried out in the sphere of the enterprises of the material sectors. Beside revealing factors characteristic of the full sphere of enterprises, a few homogeneous groups of

* The *original profit* is the gross enterprise profit cleared of the non-price elements of the budgetary redistribution. The *profit according to balance sheet* is the gross enterprise profit including the uniform budgetary taxes and subsidies. And the *accounted profit* is the gross enterprise profit containing the individual taxes due to and subsidies from the state budget.

I borrowed the category of original profitability from the studies of János Kornai and Ágnes Matits ([2], [3]). It should be noted, however, that I consider this profit *original* only in the sense that it is the *clearest* indicator to be obtained from the balance sheet reports. Under the circumstances of price formation in Hungary, however, we have no reason to consider this category as *objective* income (i.e. such as would reflect the social value judgement). Different from the Hungarian practice, I measure *profitability* by means of an indicator of income relative to the *total* of material and financial assets, as it is more reflective of the enterprise's capital efficiency.

enterprises were examined separately, in order to throw light on the different forms of enterprise behaviour, as well as on the selection aspects of economic management. In the course of selecting the criteria for a group, I had to be content with the criteria that could be *quantified* from the balance-sheet data, because of the wide sphere of the full sample. Therefore, I could examine only a part of the selection criteria actually in use in reality. The groups of enterprises were determined according to the considerations as follows:

— form of ownership: state-owned enterprises and cooperatives;

— sectors and branches of the national economy: industry, within which separate groups are constituted by the engineering-, chemical- and light industries to be considered as the most competitive ones; further groups are formed by the building industry, food-processing industry, agriculture and domestic trade;

— magnitude of the enterprise's capital: "Giant enterprises" (above Ft 2 thousand million net value of fixed capital), large enterprises (between Ft 100 million and 2 thousand million net value of fixed capital), small and medium enterprises (below Ft 100 million net value of fixed capital);

— the growth of fixed capital: dynamical enterprises (growing by more than 20 percent in two years);

— enterprises' exports against convertible currencies: enterprises with a considerable amount of such exports (amounting to more than 20 percent of the returns from sales);

— profitability: enterprises of high profitability (more than 12 percent accounted profit), and enterprises of low efficiency (profitability below 4 percent);

— use of credit: enterprises availing themselves of development credits, and enterprises doing without them.

Factors affecting the growth of enterprises

The growth of enterprises is thus described by the changes in the net value of fixed capital on the one hand, and by investment activity on the other. Although both indicators are concerned with the replacement or enlargement of fixed capital, they do not move strictly parallel to each other: their correlation is not higher than 0.13 in the whole of the national economy. In the more homogeneous sectoral samples the correlation coefficient is usually higher than that: 0.1 to 0.7. Because of the loosely parallel movement, the relations between the two different indicators are to be separately studied.

The upper section of *Table 1* shows the relations of the growth of fixed assets, and its lower section those of the investment activity. The different columns of the Table include those enterprise samples in which some indicator (either of stock or flow) of the investment resource shown in the heading displays a correlation higher than 0.3 with

Table 1

Correlations of the investment resources with the growth of fixed capital and investment activity[a]

Indicators of dynamism	Indicators of resources		
	Accumulation of development funds	Credit	Budgetary development resource
Growth of fixed capital	Cooperative building industry (0.51) State-controlled machine industry (0.59)	State controlled domestic trade (0.98) Cooperative industry (0.42) Food industry (0.45) State-controlled light industry (0.45)	State-farms (0.89)
Investment activity	Cooperative domestic trade (0.52) Cooperative agriculture (0.45) Food industry (0.44) State-controlled engineering industry (0.42) State-controlled building industry (0.38) State-farms (0.38) National economy (0.39) State-controlled domestic trade (0.42) Cooperative building industry (0.30)	State-controlled domestic trade (0.52) National economy (0.35) Food industry (0.35) Cooperative domestic trade (0.32)	State-farms (0.40) Cooperative agriculture (0.38) State-controlled industry (0.38) State-controlled building industry (0.36) State-controlled engineering industry (0.35) National economy (0.32)

[a] The *Table* covers the enterprise samples in which, according to one pair of indicators, a correlation coefficient higher than 0.3 exists between growth and investment resources. In the brackets, the value of the coefficient is given.

some indicator of growth.* Conclusions should be drawn from the Table with caution, of course. It is found that fixed capital growth moves parallel with the investment resources in fewer samples than investment activity. I see the probable reason for this in the differences in the enterprises' capital composition (ratio between fixed and circulating capital). Yet more surprising is the fact that, in state-farms, there is an extremely high (0.89) correlation with central resources, and so is the correlation 0.98 with the credit source in state-owned domestic trade controlled by the ministry.**

* With indicators of quotient nature, even a lower coefficient than this one shows that the indicators under examination are not independent of one another. ([5] p. 91.)

** The state-owned enterprises are of two kinds: those controlled directly by ministries and those controlled by (local) councils. In this paper only the first group is discussed.—Ed. note.

Namely, this makes it seem likely that *in state farms it is the chance of getting central resources, and in the domestic trading enterprises that of getting credits that is decisive for the prospects of the growth of fixed capital.*

As for investment activity, the picture is somewhat more complicated. It can be said that in most groups (as well as in the full sample) the enterprises' investment activity is not independent of the enterprises' development resources. (The correlation coefficient is below 0.3 only in the industrial enterprises and cooperatives.) It is to be noted, however, that this correlation covers, in most cases, only the resources coming from the depreciation allowance. *A positive correlation between the investment activity and the development fund coming from profit* is only found *in the cooperative building industry and the domestic trade controlled by the ministry.* This correlation is, however, *negative* in the state-owned industry (controlled by the ministry) and in engineering. It is astonishing that it is not credit, but the central resources that show a closer correlations with investment. This holds especially in the case of the industry controlled by the ministry.

In the different samples the role of credits and that of central resources are mutually substituting rather than complementary in promoting dynamical growth. Not one sectoral sample is shown simultaneously in the columns of the two external resources.

In *Table 1,* the enterprises' (own) contribution to investments is not included. Behind this lies the surprising fact that *a negative correlation exists between investment activity and own resources* in almost all the sectorial samples. *Figure 1* shows the proportions of enterprise, bank, and state resources of enterprises' investment as a function of the enterprises' investment activity.

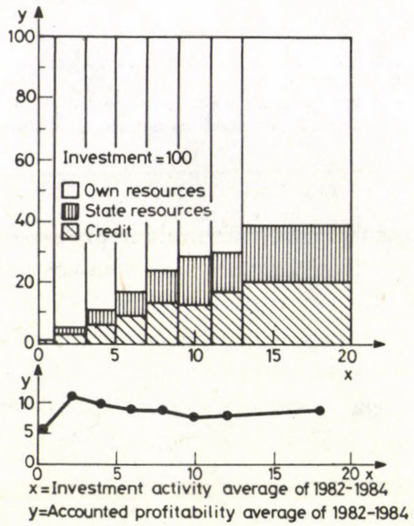

Fig. 1

Distribution of investment resources and profitability as a function of investment activity

It is a most conspicuous tendency that, the greater the enterprises' investment, the higher the *proportion* of external resources and, as of course, the lower that of the enterprises' own contribution to the investments. The most strongly negative correlations of the samples presented are shown by domestic trade (controlled by the ministry) (–0.59), enterprises controlled by ministries (–0.48), industry controlled by the ministry (–0.45), and cooperative agriculture (–0.42).

The mean values of accounted profitability in the groups formed according to the extent of investment activities are hardly different. *Investment activity is practically independent of profitability.*

Basically, the differences in the enterprises' investment activities are explained by the different chances enterprises have in obtaining external resources. *A higher accumulating activity of the enterprise results in more investments only if there are also external resources available.* In the *greater part* of the enterprise and cooperative sphere (in the industry and building industry controlled by the ministries in state-farms and the cooperative agriculture), the chance of a livelier investment activity is tied to the *central* development resources.

In *Table 2* the group of enterprises dynamically enlarging their fixed assets is compared to the group of average enterprises. Beside the indicators showing the growth of fixed capital and its direct resources, profitability indicators are also drawn into the examination. The comparison reveals that while the value of indicators related to the enterprises' own resources in the dynamical group practically does not surpass

Table 2

Characteristics of the dynamical group of enterprises

Indicators	Average value of indicators		Average values of the dynamical group in percentage of the national economic average
	in the dynamical group	in the national economy	
Growth of fixed capital	41.2	7.6	542
Investment credit stock/fixed capital	18.2	9.9	184
Budgetary development resource stock/fixed capital	15.3	12.5	122
Accumulation of development funds/resources	8.2	8.0	103
Accumulation of development funds from profit/resources	2.1	2.1	100
Original profitability	12.3	14.0	88
Accounted profitability	7.5	6.8	110
Number of enterprises	921	4254	—

the national economic average, their use of credits amounts to almost double the average value. Accordingly, the growth of the fixed capital of the dynamically growing enterprises is attributable partly to higher per unit *investment credits,* and partly to the central resources. Neither the profitability indicators, nor the accumulation of the development funds show higher values in this group of enterprises. The indicator of original profitability is even lower than the average in this group.

In the allocation of investments, as well as in the differences of enterprise growth, the decisive factor is, therefore, not the differences in the enterprises' development resources, and even less those in profitability, but it is the access of the enterprises to banking and budgetary financial means.

In the dynamism described by investment activity the decisive role is usually played by central resources and the depreciation allowance, while the dynamism embodied in the growth of fixed capital is basically related to credit sources—yet in most samples it is not correlated with the accumulation of development funds. This shows, on the one hand, that the *detachment from enterprise resources is largely characteristic not of investments maintaining the capital stock and the level of output but of those enlarging the fixed capital.* On the other hand, the two different external sources play different roles: the budgetary resource rather prevent the reduction of the enterprises' fixed capital while the bank credit is intended to enlarge it.

The different growth prospects of the groups of enterprises

In the preceding section we have examined what could best explain the growth differences *within* each group of enterprise. It is, however, not without interest to ask the question, *what differences, in respect of dynamism and its sources, the enterprise groups formed according to given viewpoints show in relation to one another.*

We shall examine three different kinds of grouping: one according to sectors (branches of economy), the other according to ownership, and the third according to size of capital. In all three cases, the comparison will be based on the average investment activity of the years 1982 to 1984, by relying on the indicators of the rates of credit, central development sources, and the enterprises' own resources in investments.

In *Table 3* the different sectors of the national economy—also divided according to form of ownership—are ranked by investment financing credits, central resources, and own resources. The columns of the Table show these rankings. The last column shows the differences between the ranking according to the ratio of own resources and that according to investment activity. The differences of a positive sign express that the groups of enterprises concerned are in a preferred position, which is to say that their obtaining external resources puts them into a better position for investment than the size of their own resources would. In a similar sense, a dispreferred position can be mentioned in the case of the groups with a negative sign.

Table 3

Ranking by investment activity and investment resource

Ranking by investment activity	Ranking by investment resources			Preference, dis-preference[a]
	credit	central (state) resources	own resources	
1. Cooperative agriculture	5	5	6	+5
2. State-controlled industry	3	1	10	+8
3. State farms	4	3	7	+4
4. Cooperative industry	8	8	2	—2
5. State-controlled food industry	2	2	9	+4
6. Cooperative building industry	9	10	1	—5
7. Cooperative domestic trade	7	6	5	—2
8. Cooperative food industry	6	9	4	—4
9. State-controlled building industry	10	4	3	—6
10. State-controlled domestic trade	1	7	8	—2
Rank correlation with the investment activity indicator	0.08	0.37	—0.40	—

[a] Difference between the ranks according to own resources and according to investment activity.

The last row of the Table shows the *rank correlation coefficients* which express the nature and closeness of relations between investment activity and the various investment resources.

The ranking according to credit sources, practically, does not show any relationship with the ranking according to investment activity, while it certainly plays a determinant role in growth differences *within* the groups. The ranking according to own resources shows, however, a *negative* correlation with the one according to investment activity. The ranking according to central development resources shows a *positive* correlation. This is to say that the groups' position in their investment activity is basically determined by the chance of obtaining central development resources.

The last column of the Table also shows which sectors and which forms of ownership are preferred, and which are dispreferred, by the external resources. The *preferred* groups of enterprises, in the order of the extent of the preference, are the following: state-owned industry, cooperative agriculture, state-farms and state-controlled food industry. Dispreferred groups in the order of extent of dispreference: state-owned and cooperative building industry, cooperative food-processing industry, state-owned and cooperative domestic trade, and cooperative industry. It is clear, too, that *the dispreferred position is caused, in a number of cases, not by belonging to a certain sector (branch of economy), but belonging to a certain form of ownership: the comparison gives evidence of a "disadvantageous position" of the non-agricultural cooperatives.*

The composition of the investment resources also reflects the non-agricultural cooperatives being left to themselves. *Table 4* shows the distribution of the investment resources according to national economic branches and forms of ownership, also stating the values of investment activity and accounted profitability.

Table 4

Composition of investment resources by ownership

Enterprise samples	Investment resources in percentage of investment (average of 1982–1984)			Investment activity	Accounted profitability
	credit	state centre resources	own sources		
Economy total	17.3	24.0	58.7	5.4	6.8
State-owned enterprises	19.3	30.1	50.6	5.3	6.8
— industry	23.7	37.6	38.7	6.0	7.1
— construction	1.0	11.3	87.7	2.6	7.9
— food processing	24.1	30.1	45.8	4.4	5.5
— agriculture	19.7	12.8	67.5	5.3	4.5
— domestic trade	34.5	7.6	57.9	2.4	7.4
Cooperative sector	14.9	9.8	75.3	5.8	7.3
— industry	5.6	2.3	92.1	4.9	15.8
— construction	2.4	0.8	96.8	4.3	13.5
— food processing	12.6	1.4	86.0	3.3	3.1
— agriculture	17.2	10.7	72.1	6.8	5.7
— domestic trade	10.6	10.0	79.4	3.4	8.4

The state-owned enterprises show, on average, twice as high ratios of external resources for their investments than cooperatives do. Within this the differences between the rates of central resources are threefold. The highest difference is found in industry: in the cooperative industry the ratio of external resources only reaches 8 percent, in the state-owned industry it amounts to 61, whereas profitability in the cooperative industry is double of that in the state-owned industry. (The Mutual Aid Funds of the industrial and agricultural cooperatives are not discussed here; they produce a further redistribution of incomes.) Cooperatives also suffer considerable disadvantages in obtaining external resources in the food industry and domestic trade.

The differences in the financing pattern of investments according to forms of ownership are remarkable. Not only budgetary money, but *even most of the bank credits promote the investments of state-owned enterprises*. Of course, the effect of this is not felt in each part of the investment activity, as in certain sectors the lack of external resources is compensated through a higher accumulation of development fund (construction, domestic trade).

The bias of the bank credits towards one form of ownership is further indicated by the fact that *while in 1982 78 percent of the state-owned industrial enterprises (controlled by the ministry) had credit debts, only 28 percent of the industrial cooperatives had.* 43 percent of the state-owned industrial enterprises had high debt stocks, i.e. above 10 percent of the value of fixed capital, while only 12 percent of the industrial cooperatives had such debt stocks. In the agriculture, differences are smaller between the indicators showing the use of credits by the two different forms of ownerships.

Within each form of ownership the sectoral (branch) affiliation is, of course, of considerable importance. *Within the state-owned group, the sectors included in the samples have a rank correlation coefficient of +0.98 between investment activity and central resources,* while this coefficient is −0.80 between investment activity and own resources. Within the sphere of the competitive sector, central resources strengthen the investment position of the chemical, light, and food industries, which goes on mainly at the expense of the building industry and domestic trade.

Now let us see, in which way the *size of* the enterprise's *capital* influences the enterprise's growth prospects. *Table 5* allows the drawing of comparisons between enterprise samples composed on the basis of the net value of fixed capital, regarding the composition of investment resources, as well as investment activity and the growth of fixed capital.

Parallel to the size of the enterprise, both the ratio of external (mainly central) *resources, and investment activity are growing.* At the same time, the growth rate of fixed capital shows a reverse interrelation. The paradox is solved, however, if the

Table 5

The resources of growth of enterprises with different sizes of capital[a]

Enterprise samples	Number of enterprises	Investment resources in percentage of investments			Investment activity	Growth of capital	Investment intensivity	Accumulation of development funds
		credit	central (state) resources	own resources				
National economy	4254	17.3	24.0	58.7	5.4	7.6	0.50	8.0
"Giant" enterprise	73	17.2	36.6	46.2	7.1	6.8	0.78	8.1
Large enterprise	1388	19.4	17.1	63.5	5.0	7.3	0.43	8.2
Small and medium enterprises	2793	9.8	9.5	80.7	3.7	12.1	0.29	7.2

[a] The group-forming criterion is the net value of fixed capital.

investment intensity of the groups with different sizes of fixed capital is investigated. The indicator of investment intensity compares the value of the enterprise's fixed and circulating capital with the value of sales (returns from sales).* The investment intensity of the "giant" enterprises is almost double that of the large enterprises, and almost treble that of the small and medium enterprises. These differences account for the differences in investment activity. It is, therefore, by no means unnatural that investment activity should grow parallel to the size of the enterprise's fixed capital. What is more, as can be seen, even larger differences would be needed for a proportional growth of fixed capital.

The question is, rather: *what makes it necessary that bank and central development resources should have such a higher share in the investments of the largest enterprises?* The answer is found in comparing the rates of the accumulation of development funds within total capital: in "giant" and large enterprises, this rate is hardly above the national economic average. Although, if not from the profit** but from the depreciation fund, a development fund of much higher ratio than the average should accumulate, exactly because of the much higher ratio of fixed capital. It is, therefore, probable that *bank and (mainly) central resources basically serve to replace the depreciation allowance that is not realized: capital is made available to enterprises in which not only capital income but even the return of capital is not guaranteed.*

The fact in itself that central resources flow in a higher proportion to enterprises with big capital would do no harm (this is characteristic also of the banking practice in advanced capitalist countries), nor is it the case that such capital can produce smaller profit than elsewhere. The fact, however, that the capital thus invested will most probably be *immobilized* and thus hinder the development of profitable activities elsewhere does cause concern. What gives reason for worry is that 48 percent of budgetary and banking development resources go to 73 "giant enterprises" of the material sphere covering 4254 enterprises in all; and, though these "giants" hold 45 percent of the next fixed capital, only 31 percent of the development funds are accumulated in them.

Promoting enterprises' growth, and rationality

The interdependencies and tendencies so far revealed cannot be qualified in themselves. The budgetary and banking allocation of investment resources is *biassed* as a matter of course: it can favour or exclude certain groups of enterprises. This can only

* Such definition of the investment intensity (or, using a synonymous concept: capital intensity) is found in Franz-Friedrich *Neubauer*'s book ([6], p. 21.)

** The above-cited book quoted in the previous footnote demonstrates exactly, relying on the data of 250 US enterprises, that capital intensity (investment intensity) shows a strongly negative correlation with capital profitability ([6], pp. 72–77.)

be judged upon examination of whether, behind the *bias,* the marks of *economic rationality* are to be found, or at least, whether it does not thwart the latter.

In a commodity producing society, *capital efficiency* expresses a stable rationality which the central structural policy and, as part of it, investment allocation cannot ignore.

Let us see what correlation exists in Hungary between budgetary and banking resources promoting the growth of enterprises on the one side, and the capital efficiency of enterprises on the other. Two aspects of the question will be examined. First, we shall examine what share the group of enterprises of low, and that of high, efficiency have of the central resources. Second, we shall seek an answer to the question about what profitability the group of dynamically growing enterprises had, and how this profitability was changing.

Categorizing the enterprises on the basis of the average profitability indicators of the years 1982 to 1984, about a quarter of them is found to be of *low profitability* (below 4 percent), and a quarter to be of *high profitability* (above 12 percent).

Table 6 shows the composition of the sources of the growth and investments of the two enterprise groups. It is to be seen that *the group of low efficiency is not below the national economic average either for investment activity, or fixed capital growth.* The explanation is the outstanding share of *central resources.* In the composition of the investment resources, it is remarkable that the ratio of credit in the investments of the group of low efficiency remain hardly below the national economic average.

This fact in itself is sufficient to demonstrate the *effects of* the investment *credits towards selection of the unfittest.* This emerges even clearer from the computation result which shows that in the period between 1982 and 1984 *the ratio of credits in the investments of the 400 enterprises, loss-making on the basis of the original income, exceeded the average national economic value by 37 percent.* The distribution of credits also breaks away from accounted profitability. *Figure 2* illustrates that in the group of

Table 6

Sources of growth of enterprises with different profitability

Enterprise samples	Number of enter-prises	Ac-counted profit-ability	Invest-ment activ-ity	Growth of fixed capital	Investment resources in percentage of investments		
					credit	central (state) resources	own re-sources
National economy	4254	6.8	5.4	7.6	17.3	24.0	58.7
Enterprises with low profitability	1132	1.2	5.6	7.4	16.6	33.7	49.7
Enterprises with high profitability	1145	16.3	5.5	9.9	24.6	4.1	69.7

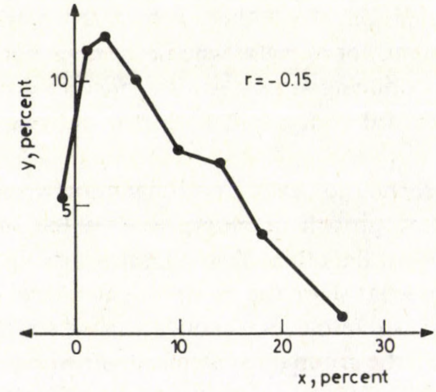

Fig. 2
Ratio of investment credits granted as a function of profitability

enterprises with higher than 4 percent accounted profitability a clearly *negative connection exists between profitability and the ratio of credits.*

The suggestion arises, however, that it is perhaps *the hope for a future profitability* that justify bank and state in granting capital for promising activities, disregarding previous enterprise results. Although it is from the outset doubtful that *masses* of enterprises of expressly low efficiency are apt or, more exactly, that it is precisely they that are apt for profitable capital investment, we shall not reject the assumption without a thorough examination.

Relying on *Table 7* a comparison can be drawn between the group of enterprises with a dynamical fixed capital growth, and that of enterprises with debts for development credits on the one side, and the average enterprises on the other—from the aspect of profitability as it was in 1982 and how it changed between 1982 and 1984. Examining the changes in profitability by redistribution levels, the effects attributable to changes in income regulation can be distinguished.

Table 7

Changes in the profitability indicators of the dynamical enterprises and enterprises using credits (percent)

Enterprise samples	Original profitability			Profitability according to balance sheet			Accounted profitability		
	1982	1984	1984/82	1982	1984	1984/82	1982	1984	1984/82
National economy	14.0	14.2	101.4	6.3	5.5	87.3	6.8	6.9	100.0
Dynamical enterprises	12.8	12.0	93.8	7.3	5.7	78.1	8.1	7.1	87.7
Enterprise using development credits	15.3	15.8	103.3	6.5	5.7	87.7	7.2	6.9	95.8

According to all three indicators *the profitability of the enterprises dynamically enlarging* their fixed assets *remained below the average*. The smallest difference (or 8 percentage points) is found in the change of the original profitability—though, according to this indicator, profitability is lower here than the national economic average even in the initial position. The highest difference is found in the change of the accounted profit rate: in the dynamical group this indicator fell by 12 percent, while the national economic average remained unchanged. A comparison of the two kinds of differences clearly shows that income regulation was not favourable to the dynamical group of enterprises, either. This allows the presumption that there is an inconsistence between the central income redistribution and capital allocation. *On the basis of original profit, the dynamical enterprises not only were less profitable than the average, but they remained so. What is more, their relative position further deteriorated in two years.*

This statement must be completed in two respects. This is because on the one hand, dynamical enterprises in Hungary are those helped in their dynamical growth by external resources. Therefore, I would render the above statement more exact by saying that the enterprises that are helped in their dynamical growth through budgetary and banking resources do not improve but rather deteriorate the efficiency of the capital stock of the national economy. On the other hand, it has to be made clear, in order to form a realistic judgement, that in Hungary the interest charged on the budgetary loan or the bank credit cannot be considered as the market price of loan capital, but rather as a cost item, of which a high ratio functions as a tax. Therefore, the profitability of even efficiently functioning enterprises is deteriorated by the use of a high ratio of external resources. Even if a more differentiated picture is given of the causes, it will not change the consequence, which is that the budgetary and banking allocation of investment resources counteracts capital efficiency.

It is worth separately examining the group of enterprises promoted in their growth through investment credits. The group of enterprises using credit includes the enterprises which had outstanding debts for banking investment credit in 1984. The Table shows that in this group the original profitability slightly surpassed the average values at the beginning and end of the period, and growth was also somewhat higher than the average. The accounted profitability of these enterprises was, however, decreasing, and by 1984 it had reached the national economic average. Therefore, it cannot be said of the enterprises helped in their growth by credits, either, that the profitability aspect was in particular asserted in them.

However, another computation result allows the formulation of a stronger presumption than that. If it is examined, namely, whether in the long run the efficiency-improving effect of the bank credit asserts itself, the picture we receive is even less favourable than the previous one. In *Figure 3* enterprises are categorized according to the size of their investment credit debt relative to the value of their fixed capital. (This measures the ratio of earlier raised investment credits.) As a function of this, I drew up the average values of accounted profitability in each group, for the average of

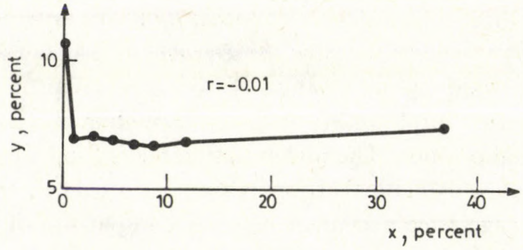

Fig. 3

Accounted profitability as a function of credit debts in 1982 relative to capital, average of 1982–1984

the years 1982 to 1984. The Figure shows, on the one hand, that the profitability of the economic entities going without investment credits rises above that of enterprises using credits; on the other hand, that the size of the debts does not affect the subsequent profitability level of the enterprises. Upon the basis of this interrelation, we may be justified in questioning the practical assertion of credit allocation principle declared to be centred on profitability and returns.

Therefore, it cannot be said either of budgetary resources, or of bank credits that more of them is granted to the less efficient enterprises on the consideration that capital is later on invested into profitable activities.

Thus, the examination of the interrelation between enterprises' growth and economic rationality could as well be closed: *no sign of assertion of the criterion of capital efficiency has been found.* Upon this basis, the allocation of the financial means of investment by the state budget and banks as discussed in the preceding section cannot be explained.

Yet we still have some hope of discovering economic rationality: the economic interest in increasing the *exports against convertible currencies.* It is, namely, conceivable that the economic policy centring on the country's interests in improving the external equilibrium, and investment allocation reflecting this policy disregarded profitability aspects because of the necessity to enlarge export capacities. Let us see whether such an assumption is justified. (As for declared intentions, the question is, of course, justified. For the past ten years, investments aimed at increasing the production of items well exportable have been a preferred objective of the credit policy.)

Approaching the question from two sides, two different, but not contradictory, statements can be formulated. On the one hand, it is true that the enterprises transacting considerable exports accounted in convertible currencies, received higher ratios of credits and budgetary investment resources than others. In the group of enterprises gaining at least 10 percent of their returns from export sales accounted in convertible currencies, the ratio of investment credit debts is double that of the average enterprise, and their capital deriving from central resources is also 25 percent higher. In certain fields, for example, in the state-controlled engineering industry and the food-processing industry, a positive correlation is found between the ratio of exports accounted in convertible currencies in the total returns from sales, and the ratio of investment credit debts. These correlations indicate that the enterprises transacting considerable exports against convertible currencies have better chances of obtaining banking and budgetary financial resources for their development projects.

On the other hand, it cannot be demonstrated that a higher ratio of banking and budgetary resources would lead to *increased* export capacities. Neither the intensity of earlier raised credits, nor that of earlier granted budgetary development resources correlates with the *growth* of the ratio of exports accounted in convertible currencies—either in the whole of the national economy, or in its sectoral partial samples. Beyond the lack of a correlation, it can be further stated, that in the group of enterprises using investment credits the ratio of exports accounted in convertible currencies was not growing faster, on an average, than the average growth in the national economy.

In the final account, the statement can be made that *banking and budgetary capitals do have a larger share in the development projects of the enterprises exporting against convertible currencies, yet their effect towards increasing such exports cannot be demonstrated.* As a matter of fact, credits and budgetary resources went in a higher ratio to the enterprises already exporting large quantities in order not to increase, but to *maintain* the export capacities. This fact in itself is not a problem yet. But *the efforts made with the given structure of exports with a view to maintaining the foreign exchange position have deteriorated the efficiency of the capital stock of the national economy.* The original profitability, as well as the profitability according to the balance sheet of the enterprises exporting against convertible currencies remain far below the national economic average (not reaching its two-thirds). Their profitability, which serves as a basis for accounts, already reaches the average level. The enterprises realizing large exports against convertible currencies—among them particularly food-processing enterprises—are made creditworthy, if at all, practically by the subsidies granted from the budget.

I do not undertake to compare the benefit (export volume) with the sacrifice (capital efficiency). This should be the function of the market. With that missing, the computation results used for arguments in the present article are just as doubtful as the calculations of the apparatus allocating the financial means for investments. As, however, all actors in Hungarian economic life do their calculations in the same fictitious categories,these have to be accepted as measures.

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ИСТОЧНИКИ ДИНАМИЗМА НА ПРЕДПРИЯТИЯХ В ВЕНГРИИ

Е. ВАРХЕДИ

В прошедшие годы венгерская экономика характеризуется значительным замедлением роста. Именно поэтому особенно важно, чтобы сузившиеся источники капитальных вложений (инвестиций) распределялись самым эффективным по возможности способом и попадали к предприятиям, приносящим наибольший доход.

Автор статьи на основе анализа данных за трехлетний период с 1982 по 1984 гг. приходят к заключению, что бюджетная и банковская аллокация инвестиционных средств расчленяет расширение капитальных фондов от доходности капитала. Все точки зрения, играющие роль в выборе предприятий, получающих источники в централизованном порядке (секторная и отраслевая принадлежность, владение большими капиталами, количество экспорта в долларовом расчете), имеют преимущество по сравнению с точкой зрения эффективности капитала. Однако эта форма практики закономерно приводит к ухудшающейся по эффекту структуре капитала в народном хозяйстве.

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ECONOMY ON THE WAY TO DEMOCRATIZATION
The switch-over to collective management in Hungarian industry*

K. BOSSÁNYI

The paper reports on first experiences with the new forms of enterprise management: management by administrative control, enterprise council and general assembly or meeting of delegates. The changes occurring in the management of state-owned large industrial firms are traced from June 1985 to April 1986. The author analyses the composition of enterprise councils and the cause of the low representation of manual workers. The contradictory nature of preparations and the experiences of the elections of managers, of failures (rejections), are also investigated. The legal and economic obscurities in the new forms of management are highlighted, the possible causes of conflicts between the enterprise council and the trade union and the disturbances in cooperation are summed up. Also the role of the enterprise party organization, and the cooperation between the enterprise council and the manager are discussed. There is a contradiction between the elusive responsibility of the collective decision-making body and the personal responsibility of the manager who is restricted in his decisions.

In spite of the expected advantages of the new enterprise management forms, it could be seen from the start that the transformation of Hungarian industrial enterprises would not be smooth and new tensions and clashes of interests would probably emerge. On the whole, the process can be considered an advantageous one, as it helps to reveal the so far latent differences and conflicts of interests within and without the enterprise and to bring into existence the conditions and new organizational forms of the institutional reconciliation of interests. However, because of some contradictions in the legal and the economic regulations, and of certain unexplained points of principle regarding their functioning, the transformation process caused more problems in industry than had been expected. In fact, within certain spheres of the enterprise, it even led to considerable vagueness. In this study, an attempt will be made at summing up the industrial experience of the period from June 1985 to April 1986, and attention will be drawn to the results, as well as to the difficulties and tensions.

Categorization, dates of switch-over

After a multi-stage series of discussions with enterprises and supreme authorities, of the 327 enterprises directly controlled by the Ministry of Industry, 58 were placed

* The paper relies on a study commissioned by Munkaügyi Kutatóintézet (Labour Research Institute).

under administrative control (this is the traditional sectoral management type), 213 were to be managed by enterprise councils, 44 by meeting of delegates, and 12 by general assembly.* More than 80 percent of the industrial enterprises were put under a collective form of management. 50 percent of the gross industrial output comes from this sphere of the enterprises, and they represent 40 percent of the gross value of fixed capital, and 60 percent of the total labour force in industry. As for their sphere of activity, the enterprises of collective management are operating in the "competitive sphere".

The figure reflects a compromise, for, originally, less enterprises were to be left under administrative control. The heads of the Ministry wished to keep some of the of the enterprises, significant from the overall industrial policy aspect, under administrative control, whether these were functioning in the competitive sphere or not. For the purpose, the use of a modern form of trust seemed to be a good transitory form. However, the overwhelming majority of the large enterprises in question did not accept the trust form, as it ties up the managing director more than the form of enterprise council does. Therefore, it was mainly the "invalid" large enterprises that were left under administrative control, and also a "mini-trust", FORCON, was established, albeit unjustified economically and from the organizational development aspect. (The latter has a staff of only 1800, and two locations, one in the capital and one in the provinces.)

The proportions of the management forms of enterprise council, general assembly and meeting of delegates, as they developed, began to reflect an interesting process of asserting different interests, and of certain manipulations. A number of enterprises, in which the managing director could best assert his will, chose the form of enterprise council regardless of size and organizational divisions. This was based on the consideration that it is easier to work with a limited collective body, or rather, to "work on it". Yet the first failures of managing directors prove that the limited body also increases the scope of movement in a contrary direction.

Of the 269 enterprises affected, 170 adopted a new management form between June and December 1985, and 62 between January and April 1986.

Because of delayed decisions on organizational development, in the first half of 1985 the Ministry of Industry was late in determining the date of the switch-over, thus causing a high degree of uncertainty among the enterprises. The majority of the affected firms would hasten the transformation, on two considerations: *a)* it spoke for switch-over in 1985—thus the 7th five-year plan, making part of the strategic decision sphere, could be worked out collectively; *b)* acceleration was also a special interest of

* The enterprise council, the meeting of delegates, and the general assembly are the different types of the new form of collective management. Their common characteristics are the following: proprietary and employer's rights are exercised by a management body elected or delegated by the collective. The sectoral ministry only exercises legal control over the economic unit under collective management, but is not entitled to issue instructions or make decisions in questions regarding the trade or the economic activity of the enterprises. The managing director of these enterprises is elected for a limited period, and on specific conditions.

the large-scale enterprises, as they wished thus to "ward off" further organizational decentralization. In order to lessen the uncertainty, in the second half of the year the sectoral ministry changed the schedule of the switch-over, so as to be faster than the original programme.

The acceleration was, however, not preceded by any efficient preparation and consequently, a number of enterprises announced that, because of the hurry, they were unable to duly prepare the collective for their changed rights and duties (as they flowed from the new forms of management). Also, for the same reason, their Rules of Organization and Operation* were only roughly made, which further increased the functional disturbances.

In 1985, as a result of multi-stage decision-making, in the sphere of the economic units directly controlled by the Ministry of Industry, full or partial decentralization took place in 15 enterprises;

— 46 units of 36 enterprises expressed the wish to become independent; in 12 cases the higher authorities agreed to the separation;

— 18 affiliated firms were set up, mostly of those wishing to become independent.

In earlier years, organizational development had not been accelerated in industry, and in the new decisions it was not always economic, but in some cases personal, regional, and power prestige considerations that settled issues. The result: *no diversified enterprise organization needed for the strengthening of market relations came into existence,* yet slow decision-making, and the way of reconciliation of interests kept some of the industrial enterprise managers in uncertainty. On the one hand, this diverted attention from the main purpose of the switch-over to the collective form of management, and led to the appearance of new tensions in cooperation among units within enterprises.

The manifestation of the different interests in the course of the discussions of organization was especially instructive: the Ministry of Industry and large enterprises were not so much interested in decentralization. The sectoral trade unions, and the Hungarian Chamber of Commerce identified themselves with the former ones. Organizational development could, however, be in the interest of the National Planning Office and of the Ministry of Finance, on account of such factors as the market, competition, and a clear economic conception. Also joined to this "reformist block", in the first phase of the debates on organizational development, were the ministries of home and foreign trade, and the functional authorities. In the process of reconciliation, however, this community of interests broke up, and short-term or partial interests came to be emphasized. (For example, the Ministry of Foreign Trade was not really interested in decentralization, as it worried about fulfillment of its inter-state obligations; the Ministry of Home Trade made a volteface as it was worried, for its part, about its "responsibility for domestic supply". The offices of price and wage

* The *Rules* comprise the constitution of the enterprise: in it, its activities, scope of action, and decision rights are laid down.

regulation were afraid that the large number of new organizations would require additional preferences—in other words, that the rising of the original wage level would not be in proportion with the additional output to be expected from the start. The bank "crossed the path", because a number of outstanding credits ought to have been rescheduled.)

Before decision-making, the enterprises affected were consulted, or, the economic units themselves could ask to become independent. This had the following two consequences:

a) preferences granted by the Ministry of Finance also started a few such processes of becoming independent as were economically unjustified, and these were even further strengthened by regional and power considerations:

b) where decentralization did not take place, the managers of the large enterprise took subsequent personal and economic retaliatory measures against the factory units and managers who had asked for independence.

Within the new, collective forms of management the situation of the affiliated firms is unsettled. As a result of the compromising decision-making process, a number of production units that had wished to become independent have been transformed into affiliated firms. This, however, put them into a more disadvantageous position from the points of view of representation of interests and of decision-making, than if they had remained in the status of a factory unit. That is to say, the managers of factory units are members of the enterprise councils, and have a decision-making right. The manager of the affiliated firm is at most invited to assist in the enterprise council meetings, but they have no say in the affairs of the enterprise as a whole, whereas their organizational and personal dependence on the managing director and on the enterprise council have increased.

Experiences of preparation and formation

As for the interpretation of the governing principles issued by the Council of Ministers and the Central Council of the Hungarian Trade Unions concerning the process and preparation of the transformation, there had been quite an amount of confusion among the enterprises, the legal control organs of ministries, and the organs representing various interests.

At the root of the conflict lay the fact that the affected parties could not agree on whether the governing principles—with no other legal regulation available—should be considered as obligatory, or only as recommended. Although the governing principles were intended by those who issued them to serve only as a framework, thus allowing a high degree of independence for transformation, this was not carried into effect. Enterprises also turned to the Central Council of the Hungarian Trade Unions or to the sectoral ministry in such questions as could be considered the enterprises' internal affairs. Besides, the practising of the legal control* was quite uncertain, its entire sphere of functioning being unsettled, as we shall discuss later on. Therefore, enterprises consulted the interpretation committee organized in the Ministry of Justice even in cases which ought to have been settled within the scope of the enterprise or of the ministry.

Regarding the cooperation between ministry and enterprises, this situation has led to tensions as follows:

As there was no uniform interpretation of the governing principles available, the enterprises were compelled to make use of the standard rules of the control organs, or of oral instructions (even when these were sometimes contradictory). The legal control authority and the personnel department of the enterprise were not in agreement as regards the term of the managing director's mandate.

It was another debated issue between the ministry and the enterprises, whether the total staff of the given production unit, or only its effective strength must be the basis on which to elect the workers' delegates—that is, the representatives to be delegated to the enterprise councils. (The governing principles only stipulated a two-thirds presence.) This caused difficulty in the first place with the enterprises experiencing significant absenteeism due to child care allowance, assignments in the provinces, or abroad. Although it would have been more reasonable to start from the effective strength, the complete staff number was finally taken for a basis.

The Rules of Organization and Operation are the internal "constitutions" of the enterprises under collective management. Therefore, it would have been important that they be flexibly adapted to each enterprise's special character. Experiences show that the Rules either make all too general stipulations, which leads to muddled scopes of activity and of decisions and thus to the impossibility of holding anybody responsible, or, they over-regulate all the questions. (One of the enterprises had a set of Rules comprising one thousand pages and made by an organizing firm.) The latter makes economic management rigid and market adjustment inflexible. In some firms the collective management body declared (presumably because it wished to hold as much power as possible), all investments over Ft 5 million to be strategical tasks, drawing these under its own sphere of decisions. This does not only indicate that a lot of confusion prevails in separating the strategical and operational decision levels, but also that the scope of authority of the managing directors is limited without reason, while their responsibility has remained the same.

As for the management form of meeting of delegates, a contrary tendency is found. In more than one place, the meeting of delegates, relying on the Rules, transferred its rights to the managers, thus degrading the functions of the collective management to the level of formality. (The only duty left to the meeting of delegates

* Legal control is exercised by the founder over the enterprise under collective management. It is first of all observance of the Rules that is controlled, and further, the purity of the elections and the proper functioning of the Council.

was to approve the plan and the balance sheet.) It is not the best solution that, on account of the foregoing, the Ministry of Industry recommends the enterprises under collective management that they should constantly complete and amend their Rules. This inolves a risk, in which the *Rules laying down the fundamental principles of long-term activities will become instruments of daily manoeuvring.*

The role of the trade union in preparing the election

It has been a controversial fact right from the start of organizing the preparatory activities that, while—similarly to other social organizations—the heads of the various steward groups of the enterprise partake in the work of the collective management bodies only in an advisory capacity, it was their task to organize and carry through the preparation of the elections. The secretary of the enterprise party committee, that of the trade union, and of the Communist Youth Organization are not members of the collective management bodies of the enterprise, which is an other sign of the separation of economic and political decision-making and responsability. Yet, though the government authorities charged the trade unions "only" with organization, experience has shown that much more was in fact involved. According to the trade union committees, the trade unionalone was appropriate for this task of organization, as it is present in the enterprises' life as a natural agent of reconciliating interests. They have got the necessary experience and, though the shop stewards, they also dispose of channels of infosmation. This is, however, an overstressing of the trade union's role since, if the collective management bodies had been organized in accordance with the original conception, "independent" workers could have been admitted to the preparatory committees. As it happened, however, the preparatory committee was everywhere headed by the secretary of the trade union committee, and the members were representatives of the party, the youth organization, and the economic management. This duly reflected the existing structure of the enterprise management, and largely contributed to the workers' initial ignorance as to what should be, in the final account, the purpose of the new collective management.

Elections took place with a high degree of participation; trade unions demonstrated a 70–90 percent attendance in the election of the delegates. This was, however, mainly due to the organizational methods of the trade unions. This is supported by the fact that, for example, as found by the Chamber of Commerce, the workers at first considered the formation of the collective management bodies as an exclusively trade union affair. In some places it was taken for an election of shop stewards. Therefore the workers, when electing the delegates, were not fully aware that this new form of management was not another forum representing individual, or a small group's interests. (This mistaking of the role was characteristic also of a great

*Hungarian Socialist Workers' Party

number of the elected members of the enterprise councils.) Where the workers' collectives knew about the large scope of authority of the new form of management, two or more candidates were put up for a post, and it was mostly the workers' candidates, and not those of the top people that came in.

It is undeniable, in any case, that the composition of the group of the elected members of the enterprise councils was *basically determined by the trade union's influence*. According to data supplied by the Central Council of the Hungarian Trade Unions and by a few industrial trade unions, 60–72 percent of those on the enterprise councils have already held some office in the trade union, and 35–40 percent are still members of the body of shop stewards.

Composition of the collective management bodies

Enterprise councils in the most important industries usually consist of 25 members; only in rare cases are such management bodies composed of 50 or more.

80 percent of the members of the enterprise councils are men, and 20 percent are women. As compared to their proportion in employment, women's participation is extremely low. In the light industrial establishments employing mainly women, the preparatory committees were complaining that only a limited number of women could be "persuaded" to accept candidature for enterprise council membership.

In comparison with the average age of the total number of the employed, the age of the enterprise council members is high: 75 percent are between 30 and 50 years, 25 percent above 50. (In agriculture, 35 percent of the enterprise council members are below 30 years of age.) 76 percent of the members of the enterprise councils have been employed by the enterprise for more than 10 years. This rate is only 51 percent in the case of the management forms of a general assembly or meeting of delegates.

70 percent of the enterprise council members are party members; this rate is only 39 percent in the management forms of the general assembly and meeting of delegates. The high rate of party members is, in my opinion, a complex phenomenon. It is a fact that, in comparison with the full staff party members have been admitted into the collective management body in a much higher rate. The reason may be that the workers have faith in the party members, or that the system of candidature was distorted, or simply that party members could be best "persuaded" to undertake yet another duty in public life. It is assumed that the high rate of party members in enterprise councils is also closely related to the fact that the number of subordinates is low.

Division according to posts* of the members of enterprise councils formed before the beginning of 1986, shows that: 49 percent were top, 14 percent medium, and

* The division by post and occupation in the management bodies formed before the end of April 1986 has remained practically unchanged.

16 percent low-level managers, 21 percent subordinates. With regard to the profession of the enterprise council members: 52 percent have technical jobs, 10 percent are economists, 17 percent are administrative employees, 21 percent are manual workers. The latter category is, however, rather formal, as 72 percent of the manual worker delegates are shop foreman or work group leaders. In the enterprises controlled by the Ministry of Food and Agriculture, however, 58 percent of the enterprise council members are manual workers.

As for composition by occupation and post, those affected have been in dispute over the question right from the beginning. That is to say, though there is no official statistical expectation regarding composition of the enterprise councils, enterprises—primarily the local political bodies and managing directors—seem to have tacitly agreed that the rate of manual workers must be raised. Thus, encouraged by the regional party and trade union organs, as well as by the competent ministry, a number of managing directors recommended manual workers, instead of experts of the special field, into the sphere they were entitled to delegate. A more worrying question than the composition of enterprise councils, i.e. the participation of manual and non-manual workers, is the fact that *only a very small number of young, and open-minded, subordinate engineers, and economists capable of taking initiative have been admitted into the enterprise councils*. The composition proves, in any case, that the technical intelligentsia holding leading posts play the determinant role in the enterprise councils.

Dual power?

The functioning of the enterprise councils may be largely influenced by the peculiarity that 15 percent of the enterprise council chairmen elected before January 1986 are deputy general managers, 10 percent deputy managing directors, 28 percent factory unit managers, 16 percent heads of department, and 31 percent other lower-level managers.

Similar rates are found in the management forms of a general assembly and meeting of delegates, as well as in agricultural and food industrial enterprises. Therefore, though legal rules do not forbid deputy managing directors from occupying posts of chairman and deputy chairman of enterprise councils, this is *incompatible* from several aspects, and should be regulated by law. (That is why the Ministry of Industry suggested that the enterprise council chairmen should be chosen from among the elected members.)

As a matter of fact, there is an incompatibility, referred to as "reciprocal employment", which is that the enterprise council chairman exercises employer's right over the managing director, and the managing director exercises the same over the enterprise council chairman. This intertwining means that the question of responsibility is unsettled: how can the managing director call his deputy to account for the execution of an operative decision, if this same deputy—as enterprise council chairman—is in a position to call him to account for the functioning of the whole enterprise? Also "dual power" may develop within an enterprise if, because of earlier professional debates, or differences of conceptions, the two managers come into conflict in their work within the management body, or they start to compete with each other. Another reason why it is no good for the first deputy to take the post of enterprise council chairman is that in the case of a permanent absence of the managing director—for example, because of illness, travelling abroad, extension training, relieving, etc.—the first deputy will automatically take over the operative management of the enterprise, which may lead to blurring the decision spheres of the collective bodies and the management.

Further, it is an unsettled question whether the enterprise council chairman holds only administrative responsibility for the enterprise council meetings, i.e. he takes care that members receive written documents of the subjects to be discussed in time, that members be present in a sufficient number for voting, arranges for minutes to be taken, and supervises the observance of the lawful conditions of voting; or, is he a genuine head of the enterprise council and, as such, has he a decisive say, for example, in laying down the conditions governing a competition? (In a given case, is he at all entitled to enter into competition for a vacant managing director's post?) Is he personally responsible for the functioning of the enterprise council?*

The election and fall of managing directors. Experiences gathered so far

In the 232 elections held in industry, there were 14 in which the earlier managing director was not confirmed in his position. This amounts to 4 percent of the elected managing directors. Of the 180 elections in state farms, 6 did not confirm the earlier managing director's post.

The high rate of confirmation is not yet to say that the workers' collective accept for good and trust their present managing director. In several places, the following opinion was formulated: "We have confirmed him, since the party, the trade union, and the ministry all recommended him for the continued holding of his post." In other places, people said: "...this enterprise is down at the moment, so nobody would like to come here, anyway. Also, our managing director wants to perform; so now he has five years to show what he can do. We have told him what we expect of him, and also that if he fails, we shall not vote for him again..." These opinions confirm the experience that a kind of automatism asserted itself in the frequent number of cases in which there was a strengthening of the managing director's position: the new body did not wish to come into conflict with the social organizations committed to the managing director, illustrating that the collective body was not yet fully a ware of the sphere of

* The Ministry of Industry has found that in the enterprise councils formed in early 1986, first deputies were elected chairmen in fewer cases—instead, the candidature and election of factory directors became more frequent. The ministry suggested that more enterprise council chairmen should be elected from members delegated by employees.

Causes of the rejections

Causes	Order of importance established by the		
	enterprise council chairman	ministry	party organization
1. Poor management	2	6	7
2. Autocratic working method	1	4	3
3. Protectionism (representation, lobbying)	5	7	6
4. Divided management	4	5	4
5. Controversy between the organizational units	3	3	5
6. Insufficient preparation	7	1	1
7. Carelessness of the managing director	6	2	2

authority held by it. Many people do not even consider this first round of elections as a genuine one, since only a yes or no vole could be given. To choose between several candidates became possible only after a failure, following the announcement of a new competition. According to this approach, *genuine elections* will only come after expiration of the mandates of the managing directors now reinforced in their position. Also, it is only then that the collective will accept responsibility for qualifying them.

Another peculiar concomitant of the strengthening of the managing director in his position is that the enterprise councils raised the basic salary of more than 30 percent. This measure hit the Ministry of Industry rather hard, so that now they press for central intervention and legal constraint, primarily on moral grounds. The irritation of the former "owner" is controversial: an automatic rise without raising higher requirements is, in fact, questionable, as it indicates a kind of mutual "buy-off" effect. In the background of the high rates of pay rises, however, there is also the motive that the enterprise council members hold their managing director's salary to be too low in comparison with the requirements they are to fulfill and the reponsibility they bear.

The rejections

In the period examined the enterprise council has not confirmed, with a two-thirds majority and rejected 3 managers in the printing industry, 5 in the leather and shoe industry, 5 in engineering and 3 in other industries.

After collecting many-sided information, I drew up a table of the probable causes of the rejections and asked the chairmen of the collective management bodies of five enterprises concerned, as well as representatives of the ministry and of the regional party organization, to establish an order of importance of the causes.

It is a remarkable fact that the ministry and the party organizations consider insufficient preparation, carelessness and wrong working method of the managing director as determinant, whereas the enterprises concerned put these causes lower in the list.

It makes one ask, why enterprises put rejections because of poor management in second place, while the ministry and party organizations put it towards the end of the list. As most falls occurred in enterprises which were officially evaluated as well-managed ones, this fact may indicate that the tensions and faults of management are more clearly seen from within than from without. Also, it may be that individuals are not patient enough to wait for the waves of enterprise. It is a remarkable fact that the controversies about organization were placed high in the lists of both enterprises and ministry.

The political-economic aspects of the rejections

The political and economic lessons of the failures of managers that have occurred have various aspects. In particular: neither the proposers, nor the acceptors were fully aware of the consequences of rejections. The proposers reacted in the following ways:

The *Ministry* was hurt and started to search for those who voted 'no', and put pressure on the rejected managing director to enter for the next round.

The *party organizations* charged the enterprise council members with insincerity and violation of party discipline, saying that they could have openly voiced their contrary opinion before, but it seemed they only trusted a "behind the curtain" democracy. On such grounds, in one of the enterprises disciplinary actions were initiated against party members because of violation of the rules of democratic centralism. (The procedure was stopped by the superior party organization.) After almost every case of failure, the regional party organization compelled the managing director to enter in the competition for the managing director's post.

The *enterprise council* became disunited, the members started to accuse one another, and began lobbying with the party, the ministry, and potential competitors.

The workers' collective was, in most cases, shocked, and said that the enterprise council members did not vote according to the opinion of their electors, but as their individual interests required. In two places (KNER Press, and CSEPEL Motor Works) signatures were collected in support of the fallen managing director.

In analysing the causes of the failures that have so far occurred, and the controversies about them, the interpretation of the contradiction between the enterprise council decision and the opinion (real or manipulated) of the workers' collective is also to be examined. In two-thirds of the cases of failure, enterprise council members holding subordinate positions, and representatives of the Chamber of Commerce and of the Ministry of Finance, (both outsiders) expressed the opinion that, in cases where the position of the managing director was not confirmed, the determinant role was played by the divided enterprise management, earlier controversies and differences of opinions between top-level managers, and further, by the diverging interests of the managers of provincial factory units automatically admitted into enterprise councils. All this makes one think that, in these cases, the managing directors were not ousted by the elected enterprise council members, but by the managers who are on the council automatically—given their position, or status in the organization. This suggests three problems:

In the case of a divided management, which is characteristic of quite a number of enterprises, it is very difficult to reach the two-thirds majority needed for confirming the managing director in his position; it will not add up even if all the elected enterprise council members (and his own delegates) vote 'yes'. This may become critical in the next round—when applications are judged—since, in most cases there are, besides the external competitors, also the "ousters", e.g. the deputy managing directors. As a consequence of the division, however, if the enterprise council is consistent in its voting, the election of the new managing director may have too many rounds, i.e. be protracted in time. That is why a simple majority is not enough to elect the managing director.

In the case of a division within the enterprise, a certain section of the enterprise council may manipulate and monopolize the interests of the entire body. This fact calls attention to the unsettled question of relations between the interests of the enterprise council members and the partial interests of the workers' collective (direct electors), and further, the interests of the enterprise as a whole. Is the enterprise council member bound to vote in compliance with the real or alleged interests of his electors—a section or a small group of the enterprise—or is he to represent the interests of the enterprise as a whole—or is he perhaps allowed to express his subjective opinion?

In five of the enterprises which rejected earlier directors I have had the opporunity to gather extensive information on the workers' opinion. Many asserted that they either did not know that the managing director's position was at stake, or they claimed that their opinion was not asked for, or maintained that their standpoint was not represented. All this points to the conclusion that *the election of the managing director*, of decisive importance in the enterprise's life, *should be placed on wider democratic grounds.*

Another question: what conduct is expected of the managing director prior to an election? In the cases of failures, one of the objections of the workers, and even more so of the ministry and social organs, was that the managing director had not given a policy speech. I talked about this with several rejected managing directors, including some who had been confirmed in their position. Each said that they had been heading the enterprise for some time, thus people knew their opinions and ambitions.

If they now started a campaign for their own sake, it could well seem a manipulation. Therefore, they preferred to wait until after they have been confirmed in their position before delineating their conceptions and their expectations. Such conduct by the manager, however, obviously does not correspond to the expectations of the workers' collectives. This leads to the conclusion that, besides other things, *the* *majority of the workers do not know and are not acquainted with the enterprise's strategy—not even with the direct decisions and plans—in spite of what the managers believe.* It is a characteristic fact that, after the first failures, the managers of the state farms launched large-scale campaigns: these included many things, from advanced wage rises to production conferences combined with a banquet. Industrial enterprises demonstrated less skill in this field. They left campaigning to the social organizations and the ministry, and yet this was exactly what raised antipathy in the enterprise council members.

According to experience, in the case of a rejection or a manager's retirement on pension, the announcement of a competition, the judgement of the applications, and the election of the new managing director generally took too much time. In the enterprise without a "master", chaotic conditions may easily develop: decisions producing contrary effects born on the grounds of divided management may be implemented, factions may be formed, and attention gets concentrated on things other than work. The rejected director gets into an extremely painful situation. During the interval, whatever he decides, he is an object of criticism. If he "lets go", people will say: see, it's all the same to him now; if he is strict, he is charged with wanting to make up for something, yet at too late a stage. His scope of action is considerably narrowed, and he is put into an impossible situation both as an individual and as a specialist. (No wonder that several managing directors in such a situation immediately took their—for several years accumulated—vacation, or asked for sick leave which was more or less justified.) The following unsettled points are found in the legal-economic regulation of the status of the rejected managing director:

If rejected, he is not in a position to decide whether to stay in his place till his successor is elected, or to charge his first deputy or the enterprise council with management. In fact the latter could also, transitorily, charge the deputy managing director with this duty.

The representation and protection of interest of the managing director also present an unsettled issue. Although the function is assumed by the Hungarian Chamber of Commerce, the legal channels, and especially those of the law of labour have not yet developed.

It ought to be laid down that the managing director cannot be compelled, either by reference to party discipline, or on account of the ministry's expectations from the professional aspect, to enter a second round of the elections.

All this shows that a decent way of retirement of managers has not yet been found, and no institutional settlement has been made so far.

Difficulties related to the "birth-throes"

In most industrial enterprises, the enterprise councils started genuine work when the medium-range and yearly plans were approved, and when the balance sheets of the year 1985 were evaluated. What can be clearly seen today is that the finctional difficulties can be traced back to the way in which enterprise councils were formed, to the deficiencies of legal regulation, and the lack of cooperation.

The Ministry of Industry objects, for example, to the lack of legal regulation concerning interpretation of the right of approval and scope of action of the founding organization; the judgement of the authority and responsibility of the managing bodies and directors; the control of the rules, and interpretation of the relations with social organizations; the election of a deputy managing director for the post of enterprise council chairman, and the use of titles. It is often heard that the financial incentive of council members and the safeguarding of the managing directors' interests are still unsettled issues.

The Chamber of Commerce referred to the same questions, adding that a few outsiders ought to be admitted into the council, such as representatives of the bank, the Ministry of Finance, the National Planning Office—these would be paid by the enterprise council. Further, the question of establishing small control organizations independent of the enterprises is to be considered; but these would have no legal control authority. In vain does the Chamber of Commerce take charge of the safeguarding of the managing directors' interests, yet at the moment this is not functioning, because of the lack of regulation in the law of labour. The "social partner" relations with the SZOT (Central Council of the Hungarian Trades Union) are also unclear. The five-year election term for the enterprise council and the managing director is a short-term incentive. The managing director's one-man responsibility and the collective decision sphere also conflict.

It can be seen that the obscurities in the legal regulation are rooted in the delegation of the employer's rights. Some are to be traced back to the discrepancy between the Enterprise Act and the Labour Code. Most conflicts are about the strictly separate decision levels, and the managing director's one-man responsibility. As a result, most of the conflicts arise in connection with the representation and safeguarding of the managers' interests, the criteria of competition, decision, qualification, the severance pay, and the bringing about of the long-term interest of managers. In its present capacity, the Hungarian Chamber of Commerce only undertakes the safeguarding of interests of managing directors. It is to be feared that the labour arbitration courts will not be appropriate for settling disputes that may arise between the managing director and the enterprise council chairman, and between the managing director and the members of the council, nor will it be able to put up a defence against reprisals. Therefore, an institutional safeguarding of the members' interests should be provided. If this fails, it will become general practice that settlement of debated issues will be regarded as the task of a ministry that has ceased to exercise professional supervision over the collective management bodies, or perhaps a job for the higher party organs—which do not undertake the arbitrator's role in daily questions of economic management either. All this "smuggles back" the dependence on external organizations into the new management system, impeding efficient collective decisions in their evolvement, and thereby also the desirable democratization process of society.

The Ministry of Industry sees the following points as unsolved: conflicts between the industrial policy efforts of the sectoral control serving "national economic interests" and the short-term decisions of the collective bodies; the means of "intervention"; exercising of the right of market surveillance, with special regard to the directive authority, and the interpretation of the enterprises' responsibility for supply—theoretically non-existent, but practically expected; the sphere of legal control: authorities such as the post office, the army, the NEB (People's Control Committee) will discuss with the Ministry only, and this compels them to maintain a system of information which is at variance with the legal rules (double information).

Further, it is not clear, whether courses and extension training are supplied to enterprises under collective management in the form of services, and if participation can be made obligatory. As for the difficulty arising from the delegation of the employer's right, the spheres of authority of the various cadres seem to conflict, as well as the interpretation of the rights of preliminary approval of the Ministry and of the regional party organizations.

It is not clear what the founder's rights exactly cover. In the cases of establishment of a new enterprise, merger, or of applying the different forms of capital flow, is it necessary to ask for an *ex-ante* opinion, or not?

Fundamental problems of establishment and functioning, and the role of trade unions

Although as far as I know no clash has actually occurred yet, the opinion shared by the enterprises, the representatives of SZOT, the Ministry, and the chamber bodies is that the most conflicts and debated issues will arise between the collective management bodies and the local trade union committees. This problem does not only refer to conflicts on the enterprise level, but it clearly shows the lack of institutional reconciliation of interests, and raises the urgency of updating the political institutional system. Therefore, the problems are not to be considered as "internal affairs" of the trade union, but instead, they suggests that, if the consequences of pursuing the reform and of updating the system of enterprise management are thoroughly considered, the result must be the *separation of political from economic decision-making*—not merely in declarations, but in daily practice.

The unsettled issues of cooperation between the new forms of enterprise management and trade unions appear on three levels:

a) *the enterprise level:*

The enterprise council is a strategical decision-making organ, in which the delegate of the local trade-union has no right to vote. Nevertheless, by virtue of the legal status of the trade unions, the local trade union committee has a right of opinion of eleven points regarding the short- and long-term economic management of the enterprise, and the right of approval in three questions: wages, welfare funds, employment. It can be unambiguously stated that, where the trade union has only a right of stating its opinion, the decision of the enterprise council will be determinant in case of a disagreement. It remains a question, however, how things stand with the subjects in the sphere of the right of approval. In fact, the right of approval is equal to the right of veto. Whereas the enterprise council often qualifies the majority of wage, welfare, and employment questions as strategical, saying that, if the trade union bases its considerations only on short-term, daily interests—and the representation of the workers' interests obviously carries trade unions into such direction—it may prejudice the assertion of the enterprise's long-term interests. Also, improved economic efficiency, expected from the "owners' licence", may be impeded. On the other hand, the trade union may justly argue that strategical decisions made with a view to long-term development are not to suppress the short-term assertion of the workers' interests. In this dispute, the social mechanisms of mediation and reconciliation of interests are not yet functioning. (Earlier, if such a controversy arose, the managing director could turn to the ministry, and the local trade union committee to the regional or occupational trade unions. The ministry is, however, not the "master" of the enterprise council, and it is hardly conceivable that the slowly emerging social partner functions of the Hungarian Chamber of Commerce could later be extended to enterprise affairs.)

The question is even more serious with regard to the cooperation of enterprises managed in the form of general assembly or meeting delegates, and the local trade union committees. In this sphere it is not only the decision-making levels, but also the people that are identical, as the general assembly and the shop steward body have the same members.

b) *medium level*

It is not clearly stated in which way the regional and occupational trade unions influencing the economic management of autonomous enterprises and the sectoral ministries are to cooperate. Also, it is not clear what authority they have in getting their decisions accepted. (These unelucidated points are especially serious in relation to the employment and labour management problems of one or another region, and with the reorganizations which search for a more efficient management of capital.)

c) *macro level*

Within the framework of the further development of the economic control and management system, the cooperation between government and the SZOT has assumed an institutional form in recent years. However, its legal regulation—for example, in the Constitution—remains on the level of generalities, and may therefore be considered rather formal. The local trade unions raise the objection that the SZOT does not represent the workers' interests in the course of the disputes about the regulatory measures, the size of profit tax, updating the taxation system, maintaining the real value of pensions, and general social welfare policy (child-care allowance, welfare funds, travels, rewards).

All this leads to the conclusion that the deficiencies of trade union activities have nothing to do with the collective management of enterprises, it has merely given a long-felt complaint of society greater publicity.

In the future, therefore,

— trade unions will have to separate the representation of workers' and owners' interests, i.e. to divide the representation of interests on the enterprise level. The enterprise council should represent the owner's (the whole enterprise's) interests, and the body of shop stewards those of the employed. It follows that trade unions are not obliged to identify themselves with the long-term interests of the enterprise economy, but to take only the workers' interests into consideration.

— It follows from the division of roles that trade unions concentrate their activities on the traditional safeguarding of interests on all three levels of reconciliation and mediation of interests. This necessitates that their armoury connected with the right of veto, and their assertion of interests be completed.

— As they do not take charge of the owner's interests, organization and promotion of production, and campaigning will not be among their duties.

If this division of activities becomes institutional, trade unions will be able to better fulfil their basic function, which is the safeguarding and assertion of the workers' interests. The clarification of the trade union's sphere of activity and, as a result, the institutionalization of the reconciliation of interests, are today more than just a trade union affair. If the shop steward bodies called upon to represent the employees' interests securely find their place, it also means that the place, role, and scope of action of the "other side", i.e. of the collective management bodies representing the owner's rights and interests, will become more unambiguous.

The role of the party organization

In a few cases of election or failure of a managing director, controversies arose between the factory party committee and the regional pa ty organization on the one hand, and the enterprise council on the other. Most of these were confined to questions of authority regarding different cadres, and rights of approval and of opinion; they started mainly because it had not been clearly stated before, whether enterprise council members who were at the same time party members were obliged to vote in accordance with the party organization's preliminary position, or they could represent the opinion of their electors, even if the latter was contrary to the party position.

It is a question of importance, how much freedom the party members of collective enterprise management bodies will be given in these respects. Namely, it is to be feared that, if the position of the party organization is not to be interpreted as an orientation, but as an obligatory attitude, the enterprise councils can use their employer's rights only to a limited extent, which is contrary to the purpose of their establishment. In the enterprises under collective management, conflicts may mar the relations and the division of labour between the enterprise council and the party organization, as well as those between the party organization and the trade union. Also, although top party documents clearly state the role and the scope of enterprise party activities in economic organization and control, in practice this is fraught with numerous contradictions, according to enterprise reports. It is not always that the local party organization wishes to wantonly interfere with economic questions, or to make decisions instead of the collective body. It often happens that the economic managers who feel unsafe are anxious to get back under the political "shelter"—although in the enterprises managed by collective bodies the separation of economic and political management is meant to promote the independence of the economic sphere, and the clear outlining of the spheres of decision and responsibility. Further, the central party documents make it clear that the "delegation" of responsibility necessitates that the working method of the party should change in the enterprise: its organization and control activities should be modernized. Namely, if the spheres of action are separated only in the legal rules, while "double power" tacitly persists in practice, it will not only impede adjustment to market conditions, but may also frustrate the most important objectives that follow from the delegation of the owner's rights: more efficient management of the social capital, and the development of an 'ownership' mentality.

Relationship between the enterprise council and the managing director, their responsibilities

Owing to the present composition of enterprise councils, and their unclarified function, the managing directors as well as the members of the collective bodies are today uncertain as to whose interests the enterprise council represents in fact. Although the legal rule specifies it as a collective strategic decision-making body, it also assumes, logically, certain functions of interest mediation and reconciliation. One might say this is the great advantage and asset of collective decisions as against the one-man decisions. Yet most of the elected enterprise council members think they have to represent the interests of those who directly elected them (workshop, group). Shop-managers automatically admitted into the enterprise council lay emphasis on representing the interests of their own section. The management—headed by the managing director—could in principle represent the enterprise's interests, yet it is well known that, for regulatory, incentive, and private reasons, the interests of the management and those of the enterprise as a whole do not always coincide. Theoretically, it may be assumed that, as a result of the emergence of conflicts, genuine discussions, and consideration of alternatives, the assertion of the various partial interests will lead to a continuous reconciliation of interests, which will then contribute to the reaching of advantageous compromises and to the enterprise's progress. That is to say, the somewhat elusive enterprise interest will be asserted. Yet enterprise managers' fears so far formulated indicate, without denying the positive features of the above-mentioned process, that management may gradually become even more divided, decisions disorganized, and the result of the implementation and the mechanism of calling to account will be totally blurred. In this fear, a certain role must be played by a dislike of the continuously controlled corporate decisions. On the other hand, it is a logical objection that in the enterprise of a divided organization, having several plants, the presence of the shop-managers (holding important votes in the enterprise councils) works towards discord, and weakens the efficiency of long-term decisions.

With whom does responsibility lie?

The question is, one may say, rhetorical, as it is laid down in the legal rule: *the elected managing director is alone responsible for the enterprise yet the decision authority of the managing director is limited, as strategical decisions are made by the collective management body.* The latter largely determine the enterprise's short- or long-term functioning progress. One of the significant features of establishing enterprise councils is, in principle, that they should put an end to the hierarchical dependence of the enterprise (and its managing director) on the administrative bodies, especially dependence on the sectoral ministry. This is based on the consideration that in many cases decisions were made "on the top level", and the enterprise had to bear the consequences and the managing director the responsibility. Now the decision level has come lower down: in principle, the collective management body vested with owner's rights makes its decisions with regard to the interests of the enterprise as a whole. Is, however, any responsible decision-making conceivable without really holding anybody responsible for the decisions? It seems there is now an insuperable discrepancy between the managing director's unlimited responsibility and his limited scope of action, as well as between the wider scope of decision of the enterprise council, and its "collective irresponsibility".

Obviously, it would be difficult to call the members of the collective management body—registered as a social corporation—to account for their decisions. This is made even more difficult by the fact that the enterprises under collective management function as the economic undertakings of the state, which is to say, the enterprise council does not risk its own property, but that of the state.

It is therefore not directly interested either in the scope of its own decision or in responsibility. The indirect interest of the employed (which is that in the case of making the right decision the enterprise profit will be bigger and thus his own income position may also improve) is a rather loose link. It would not be so, if enterprises were made interested in capital (in increasing the firm's assets), but the prevailing regulation acts against it, declarations notwithstanding. Without it, strategic decision-making is questionable, as the enterprise's interests also tend to be short-term.

Two assumptions may be made on the basis of the preceding:

If a body established with a view to making strategical decisions functions as a social body, it is only with reference to its "consciousness" that it can be expected to make well-considered decisions.

If, however, it is to be held responsible for its decisions, it is not to function as a social organization. This raises the question, what payment it is, similarly to supervisory committees, entitled to against its activities. Which external, unbiassed experts can they rely on for controlling their work? What should be their position (or their share?) in the distribution of the enterprise's extra income or, to what extent can the results of a more efficient management of the social capital be spent on increasing personal income? (Is it the enterprise or the enterprise council that will be interested in the capital?)

Therefore, I see the main problem of the present switching-over to collective forms of management in the fact that the responsibility of the enterprise council is not clearly delimited—failing which, I believe, neither the ownership attitude, nor a genuine collective management can evolve.

ДЕМОКРАТИЗИРУЩАЯСЯ ЭКОНОМИКА

К. БОШШАНИ

В статье анализируется первый опыт перехода к новым формам руководства предприятиями на крупных государственных промышленных предприятиях. Подробно излагаются споры в связи с определением формы руководства (сохранение государственно-административного управления, совет предприятия, общее собрание или собрание выборных представителей), проблемы, связанные со сроками перехода на новые формы. Рассматриваются результаты и проблемы совершенствования организационной системы, предшествовавшего изменению форм руководства, компромиссный процесс обеспечения самостоятельности предприятий и отношения правовой и хозяйственной зависимости, вытекающие из статуса дочерних предприятий. Прослеживаются изменения в руководстве предприятиями в период с июня 1985 по апрель 1986 г. Анализируются состав доминирующей формы руководства — советов предприятий, а также проблемы выбора председателя совета и причины слабого представительства в них рабочих. Особое внимание уделено противоречиям в ходе подготовки перехода, а также опыту и неудачам при выборе директоров. Указывается на нерешенные правовые и хозяйственные проблемы новых форм, а также возможные причины конфликтов и трудности сотрудничества между советом предприятий и профсоюзами. Автор рассматривает также роль партийной организации предприятий и сотрудничество между советом предприятий и директором. Автор подчеркивает, что имеет место противоречие между неопределенной ответственностью коллективного органа принятия решений и личной ответственностью ограниченного в приятий решений директора.

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HUNGARIAN ENTERPRISES SURVIVING CRITICAL FINANCIAL SITUATIONS
(A retrospective analysis)

G. PAPANEK

After a break of almost forty years, a law on bankruptcy has been enacted in the Hungarian economy. The article shows the financial mechanisms replacing this legal regulation in the past decades, and their efficiency as well. It explores the causes of the financial difficulties of firms in detail, and reviews the methods applied to solve them. The discussion relies on a wide empirical investigation of the affected firms. The author also gives a brief evaluation of the new legal regulations.

The firms which got into a critical situation between 1985–1986

Efficiency is a typical indicator of the performance achieved by economic activities and it can be qualified by comparing the inputs and results from an economic viewpoint. Efficiency is a basic requirement towards any economy. On national economic level efficiency can be improved if the workshops, plants, enterprises utilizing their resources effectively develop at a higher than average rate and those expected to yield low performance decline [1].

The methods of evaluating economic performance are different in the various countries. In the advanced capitalist economies, e.g. mostly and ultimately the development of profit is deemed the main criteria, both when qualifying the effectiveness and when making decision on enterprise development projects (even in decisions on disinvestments). On the other side, insolvency and bankruptcy of the enterprises (or the danger of these) are considered as institutional characteristics reflecting the lack of efficiency. [2] In the latter cases the expression "critical situation" also found in the title of this paper as well as the term "crisis of the enterprise" are often used. [3, 4] In the traditional planned economies, however, the most important yardstick of measuring economic performance is the fulfilment of the plan in terms of physical units of measurement. Of course, the term "critical financial position" is also used in these countries, in case certain financial prescriptions are violated. In such countries, however, the consequences drawn from an unfavourable financial qualification are, in the majority, only secondary.*

* The subject matter and its problems are clearly dealt with in [5].

In the course of the 1968 reform of the economic mechanism various indicators were used as the main measures of economic performance,* since it had been decided to introduce ways of solution somewhat differing from the conventional ones of planned economy. As a result, in industry a specific—but ever debatable—way of judging and treating the financial troubles of enterprises came into use. Namely, it frequently occurred thet enterprises and cooperatives were said to be in a critical financial position** where certain financial indicators established by some provision of law (but ultimately quite artificial) developed unfavourably. The consequences of getting into such a situation were also regulated administratively. The possible methods of dealing with these difficulties were prescribed by decrees, and in extreme cases even the liquidation of the enterprise may have been raised.

The 1968 provisions qualified the *loss* of the enterprise (according to the balance sheet) as the indicator of an unfavourable financial-economic situation.

From the mid-1970s on the *deficit* of the sharing and the development *funds*—from 1985 on of the so-called interest(edness) fund—have practically been acknowledged as further important characteristics of the problematic nature of economic performance; from 1981 this criterion has appeared in a decree, too.

In 1983, in addition to the foregoing the criterion of "permanently low efficiency" came to be listed among the indicators of the failure in economic management. This measuring technique did not prove adequate, hence it has not been used since 1984.

In 1986 all the above mentioned legal provisions were abrogated and *permanent insolvency* has been declared as the legal justification of liquidation, because of shortage of performance. This amendment undoubtedly brought the Hungarian legal provisions closer to the international practice and created the possibility to assert also the opinion of the economic sphere based on business viewpoints in the financial "appraisement" of the enterprises and cooperatives. The loss-making enterprises and/or those short of funds were also, in the majority, insolvent. Advantages may be expected from changing the qualification criteria first of all because insolvency can foreshadow, often one or two years earlier, the development of financial troubles.

The aim of our study was the analysis of the actual situation and the perspective of the enterprises and cooperatives of the Hungarian industry being "in critical financial position" between 1975–1985. Our work had to commence with drawing up the list of the industrial firms making loss, having deficits of funds and those which, owing to their permanently low efficiency, were granted subsidies by some individual central measures.*** We have found that not only public data on the subject are

* See e.g. [6].

** See this description in [7].

*** The list is contained in *Appendix 1* of the Research Report [8]. At this place I wish to express my gratitude to the competent executives of the Ministry of Finance and Dr. P. *Sárkány* for their kind assistance.

missing* but analyses summarizing the data of some recent years and destined for official use are not available, either. Therefore, we partly used annually compiled reports about the enterprises and cooperatives in question and partly relied on other information received for the purpose of the research work.

The number of the industrial firms declared to be in a critical financial position was rather high in the course of the last decade. Though major part of deficits occurred always at a few large firms, the troubles spilled over to a great number of further enterprises and cooperatives.

In the mid-seventies the sphere of the enterprises and cooperatives rated as being in a critical situation amounted to 3–5 percent of the firms. By the turn of the decade this number lessened for a short time, but in recent years it has risen to a level higher than ever before. On the whole, every third firm of the socialist industry faced financial troubles at least once during the analysed 11 years. The information about the character and the date of emergence of the troubles** are summarized in *Table 1:*

Table 1

Number of state-owned industrial enterprises and industrial cooperatives faced with financial difficulties between 1975–1985 in Hungary

Year	Loss	Deficit of the sharing fund	Deficit of the develop-ment fund	Deficit of the interest-(edness) fund	Permanent low efficiency[b]	Total[a]
1975	3	42	1	—	—	46
1976	10	11	41	—	—	59
1977	9	11	43	—	—	61
1978	7	20	41	—	—	63
1979	5	11	31	—	—	41
1980	5	1	22	—	—	25
1981	7	3	19	—	—	23
1982	20	19	34	—	27	68
1983	30	17	43	—	10	65
1984	23	31	61	—	—	82
1985[c]	29	—	—	135	—	149
Total[a]	108	134	253	135	37	475

[a] Since the enterprises may simultaneously be afflicted by various financial troubles and the problems may have occurred with the same enterprises in the course of years the sum of the particular data is higher then the totals.

[b] Only those were listed which required central measures.

[c] Without trusts and small-scale enterprises.

* In the developed capitalist countries, for instance, firms are obliged to publish a report on the results of their economic activity and statistics are also given about the number of bankruptcies.

** M. *Laki* also published similar data of a few years in his paper [9]. The data regarding the frequency of deficit of the development fund differ from those above, since he presented the "expected" data stemming from the "preliminary" reports of the Ministry of Finance, while we registered the *actual* ones.

The economic activity of several companies was qualified repeatedly—sometimes even permanently—as financially deficient in the analysed period. The frequency of repetitions is demonstrated by the data of *Table 2.**

Table 2

Firms[a] getting repeatedly into critical financial position

Number of years characterized by critical situation	Firms afflicted by troubles at the given frequency	
	their number	their distribution (in percent)
1	341	71.9
2	87	18.3
3	29	6.1
4	13	2.7
5	3	0.6
6	—	—
7	1	0.2
8	1	0.2
Total	475	100.0

[a] State enterprises and cooperatives.

To interpret the critical position of enterprises has always been a difficult question. In Hungary the discussions are focused on two types of questions:

— Can the *critical financial position be considered as the result of low enterprise performance* (efficiency), i.e. the sign of failure in economic management, the symptom of a serious lack of performance?

— *Are the sanctions and measures* ordered by the legal provisions or adopted by Hungarian practice *appropriate for coping with the economic and financial troubles* and for improving efficiency?

In the following I shall try to respond to these questions by presenting some of the facts.

The causes of financial difficulties

The views about the role and significance of the financial difficulties have always been various and divergent. In the past decade several authors discussed the sources of the serious economic difficulties arising from the crisis of the world economy even in

* There were several firms where the number of repetitions was substantially reduced by their reorganization. Some further firms do not appear in our above list merely because of subventions.

the capitalist countries, primarily the causes of the numerous bankruptcies. The respective findings of certain studies can well be characterized by the results of a major survey in France, presented in *Table 3*.

Others consider the causes of bankruptcy listed in the table superficial phenomena or symptoms. They make attempts in their publications to explore the *roots* of the financial troubles. Such were the intentions of e.g. the following classifications:

Table 3

The ten most frequent causes of enterprise bankruptcies

Causes	Frequency, in percent
Clients went bankrupt	21
Excessive inventory	11
Cancelling of bank capital participation	11
Cost of too many employees	10
Illness or death of the chief executive of the enterprise	10
Unreliable accounting, the lack of knowledge of production costs	9
Unfair or illegal actions realized at the expense of the enterprise	8
Expropriation, moving to another plant, dividing the enterprise	8
Declining turnover because of hard competition	8
Inadequate organization of the enterprise	8

Source: Bulletin de la CNME, No. 73, Paris, 1976.

1. *economic factors:* declining competitiveness (excessive competition by the developing or the CMEA countries, rising prices of raw materials, unfavourable changes in the áates of foreign exchange, increasing burdens of environment control, etc.) and productive capacities and investments adjusting to the opportunities not fast enough;

2. *human factors:* deficiencies and improper faculties of the managers, inadequate regulations of competency, detrimental workplace atmosphere, mistakes in the development of external relations (with banks, suppliers or customers);

3. *financial factors:* the lack of own development resources, excessive indebtedness, concealing the beginning of difficulties by accountancy, inflation, taking too high risks (unduly large sales on credit, the lack of credit guarantees), late liquidation of loss-making plants [3].

In Hungary the following opinion is wide-spread, too: "... the financial position of enterprises is determined by their links with the state budget rather than by their actual performance." [a] According to others, however, this can also be traced back to real economic reasons, such as the unfavourable effects of market conditions, or to some mistakes of enterprise management.

In order to reveal the economic reasons we organized interviews with more than twenty financial managers of enterprises. Monitoring the dailies also proved to be a rich source of data. We found three hundred detailed reports about the troubles of approximately eighty industrial state enterprises and cooperatives—often quoting the statements of competent executives word-by-word.*

In the concrete cases the problems could never be traced back to a single reason. *In the Hungarian industry*—like anywhere else in the world [10]—a *financial crisis of enterprises is a chain of problems in close interdependence with one another*. The "links" of this chain are probably some factors of the world economy, of central interventions and of enterprise management.** We had the impression that the troubles were connected also with the ultimate causes: weak interestedness, the weakness of incentives and tė paternalism of the economic leadership.

Changes in the world economy

The adverse effects of the processes of the world economy in the past decade were felt in the *majority* of the enterprises and cooperatives. Declining demand, increasing competition and low selling prices were all significant factors in both the domestic and the export markets. Press reports were repeatedly dealing with the troubles of Hungarian metallurgy stemming from such causes. It was also reported that, owing to the serious lack of orders, the engineering industry was often producing for its own stocks, or staffs of complete plants were compelled to go on holiday. The financial difficulties in the building materials and the wood-processing industries stemming from the slowdown of the development rate of the national economy and from the fall in demand for construction could also be traced back to world economic influence. But a broad range of financial difficulties were also caused by the lack of demand and increasing competition of the developing countries in the cotton, wool, and silk industries. The excessively high—and during the whole analysed period rapidly growing—energy- and raw material prices considerably reduced the efficiency of industry as a whole, too.

The power of the world economic effects is also demonstrated by the fact that throughout the decade in question first of all the same sectors were struggling with financial difficulties in Hungary as in any other country of the world.

* All quoted examples referring to firms were taken from the Hungarian daily press. Those interested in details can find the exact bibliographic data in the Hungarian version of the present article, published in *Közgazdasági Szemle*, 12. 1986.

** It must be mentioned here that the average share of the small and big enterprises within the sphere of those getting in trouble was the same during the whole analysed period as it was in the whole of industry. The influence of the high share of exports on the financial position, however, could not be analysed, owing to the lack of the necessary data.

Misallocating of the factors of production

Mistakes in the allocation of the factors of production were often sources of serious economic problems, too. The numerous examples, in many respects different from the international practice, are worth considering.

(Troubles in material supply.) The well-known import difficulties as well as the problems of cooperation also appeared with most of the analysed companies. For instance in the case of castings frequently a multuple of the permissible allowances had to be paid for and machined off by the engineering companies. Skilled workers often had to disassemble and reassemble complex equipment (produced for stock) because this was the only possible way to obtain components needed for the machines to be finally sold from the earlier finished ones.

(Difficulties connected with labour.) According to our information, excessive shortage of labour, seriously afflicting certain specific trades and leading to financial troubles occurred first of all in coal mining, metallurgy and the textil industry (in both enterprises and cooperatives) and in big companies of the engineering industry. It also often happened that in certain plants of the enterprises in Budapest modern machines were at a standstill because of labour shortage while in plants located in the provinces abundant manpower were employed, using low-productivity equipment.

(Problems of capacity.) Among the reasons of the studied troubles obsolete production technology and equipment were mentioned in a broad sphere. For instance, coal mining, the greatest enterprise of metallurgy and other huge establishments, investing otherwise tens of thousand million forints were unable to spend enough money in order to replace outdated equipment. In an other group of enterprises—frequently owing to oversized investment projects—superfluous capacity or low utilization of capacities caused severe economic difficulties.

The effects of central interventions

Half of the enterprises listed the interventions of economic control agencies among the most important reasons of their financial troubles, others mentioned them as factors helping them to avoid the difficulties.

Beside the effects of certain elements in the *price system* disturbing the financial conditions the changes of the regulatory system heavily modified the financial situation of firms. The annual fluctuation that can be seen in the data of *Table 1* is primarily the result of this factor. The decreasing number of the firms in critical position between 1980–1981 was presumably connected with switching over to the competitive price system. On the other hand, the increased severity of the regulators in 1982 because of the difficulties of the country's international payments substantially extended the range of the firms in trouble. But a great number of enterprises and cooperatives came into a critical position also because of the highly selective changes of certain regulators, as well as because of the redistribution levelling the incomes. Thus, we often received press information on the one hand about over-taxation and on the other about the fact that "...based on higher level decisions... the situation of several companies where... the development of financial shortages had to be expected... had been settled in advance." [11]

This happened in the mid-seventies with the Hungarian Shipyards and Crane Factory, the Factory for Driving Gear and Painting Equipment, the Csepel Vehicle Factory and the GANZ-MÁVAG Locomotive and Railway Carriage Manufacturers. Later on, in the eighties, similar measures were taken with the successors of certain big companies (which had been divided into smaller ones) in order to create the financial conditions of independence, and as a rescue operation following the emergence of troubles.

The intricate interactions of the about three hundred types of *financial bridges* [12] applied in the Hungarian economy and the frequently lacking data made it impossible to assess the true balance of these influences.

In about one-third of the investigated cases the *direct* interventions also led to a decrease of profits. Losses caused by the protracted settlement of economic problems could often be proven, like—among others—in the case of the Hat Factory. And even the failure of enterprise reorganizations independent of economic processes was not an exceptional phenomenon. Initiatives and/or approvals of state bodies linked to large investment projects could also often be found among the factors giving rise to critical situations.

Mistakes of measurement and qualification

In some cases the reported financial difficulty was simply a result of the mistake of measuring or the inaccuracy of the terms used and not the sign of unsuccessful economic activities. The recently abolished criterion of deficit in the sharing fund was a merely artificial indicator of the financial problems. Among the economic organizations struggling exclusively with the shortage of the sharing fund—which were, according to *Table 4,* relatively numerous,—we often found some where the depletion of an artificially separated financial source did not demonstrate a low standard of economic activities as a whole. In certain cases, however, the same finding applied to the shortage of the development fund, too.

The methods of identifying the economic troubles did not take into consideration the (relative) extent of the loss or the deficit of funds, some firms were also classified as being in critical position even if they could settle, without difficulty, the condemned problems from their own resources.

Table 4

Distribution of firms by the type of financial problems

The given financial trouble	Number of the firms struggling: with only the given trouble	in addition to the given trouble with: loss	deficit of the: shar-ing fund	deficit of the: devel-opment fund	deficit of the: interest-(edness) fund	low effi-cien-cy[a]	Total[b]
Loss	31	—	47	51	23	16	108
Deficit of sharing fund	62	47	—	50	18	10	134
Deficit of development fund	158	51	50	—	38	16	253
Deficit of interest fund	84	23	18	38	—	10	135
Permanently low efficiency	11	16	10	16	10	—	37
Total[b]	346	77	72	95	51	26	475

[a] Only those requiring central measures were listed.

[b] Since in certain enterprises more than two types of troubles occurred, "Totals" are not the result of adding up the rows or the columns.

Problems of development and investments

Investments made either as a result of enterprise decisions or on central initiative very often became sources of economic troubles. This is clearly shown by *Table 4*, according to which the most frequent among the financial troubles was the deficit of the development fund.

With more than three-quarters of the studied enterprises and cooperatives investments which were expressly large from the viewpoint of the firm in question were found as important antecedents to the economic difficulties. In every third case faults of the investment itself had led to the financial deficits and in a great number of further ones financing tasks exceeding the potential of the companies were the major sources of problems.

Hence, it is worthwhile to digress on certain examples presented by the press. In the framework of the 'Eocene Program'* even the technical design of certain projects was criticized. The recession of the 1980s (and sometimes the shortage of raw materials) in metallurgy resulted in a lower than desirable capacity utilization in several investment projects of the 1970s, the values of which amounted to thousands of million forints. Neither the market foundations, nor the volume and implementation of the twelve-thousand-million forint restructuring project of GANZ-MÁVAG were justified by life. The investment project of the Bycicle Factory of the Csepel Works

* Related to the opening of coal mines.—Ed. note

(called currently JÁKÓ) has turned out a failure by our days and the investment policy of Tungsram Ltd. proved to be short-sighted, too. The investment project of the Industrial Instrument Works, Iklad was found to be an undertaking exceeding the strength of the enterprise. The conveyor belt in the Salgótarján Iron Foundry and Stove Factory made by HAFE (the Factory of Driving Gear and Painting Equipment) was unusable, in the new automatic plant of the Enamel and Tub Factory, Kecskemét the machines could not go into the hall because room was not enough and the capacities of the particular production stages were not coordinated with one another either. The Brick Factory in Bakonyszentlászló of the Mid-Transdanubian Brick and Tile Industry Works often produced broken bricks only and was for a long time referred to as a typical example of mistaken investment projects. In the cement industry the difficulties of several investments, among them those of the Cement Factory in Bélapátfalva which was unable to achieve the specified volume of production, compounded the problems of DCM (the Cement and Lime Works of Vác) which, though not too old, is in bad need of reconstruction. In the case of the Romhány Tile Factory investment project of FIM (the Fine Ceramic Industry Company) no part of the original investment program was implemented according to the plans, thus, a great many operations were carried out which further on proved to be unnecessary. Owing to the falling prices of PVC neither the ten thousand million forint PVC project of the BVK Chemical Combine of Borsod, nor the investment of Hungária Plastic works, also amounting to thousands of millions, could be recouped. Several similar problems of the textile industry could be mentioned, especially from the experiences of restructuring that industry, where the cases of the Knitwear Factory of Halas and the Hat Factory can be mentioned as examples.

We can emphatically recommend any Hungarian enterprise or cooperative commencing greater investment projects to keep in mind the close connection between financial problems and oversized investments as well as our experience gained in this relation. The troubles arising in the financing of development projects are often linked to the poor capital supply of the firms and to the growing severity of regulations originally valid at the time of starting the project to a level proving exorbitant, and to the unforeseeable changes in the regulation of prices, taxes and financing.

The faults af management

In more than half of the investigated enterprises the faults of enterprise management (leading to bankruptcy even in international practice), explained to a great extent the recent financial difficulties. Some parts of the faults may be negligence in material supply, mistakes of labour management, defects of organization, failures of investments. Sometimes the lack of a realistic company strategy, at other times the so-called "negative marketing" (the case when the first delivered equipment was such a failure that it excluded the opportunity of further deliveries) could be counted among these. Neglecting the principle of working together with the personnel, ignoring the opinion of the collective of the enterprise may be illustrated with the case of the Budapest China Factory of FIM where the senior executives of the company decided without hearing the employees' opinion to close down an almost new plant and to transfer production to a plant which was completely outdated and might have only been suitable in the Middle Ages. The general standard of management can also be characterized here and there by keeping no records of costs and in some cases by the penalty paid for the high level of stocks or by the interests on credits owing to excessive indebtedness. Reports on incompetent leadership were also published. [13] But we must also mention some examples of violating the legal provisions, such as manoeuvring with the balance sheet or corrupt practices for the leaders' own benefit.

Too optimistic predictions regarding the expected efficiency of management were also typical faults often contributing to the development of the enterprise's troubles. And it is also typical that the leaders of *every third* firm promised a few years prior to the actual emergence of troubles—even publicly—high profitability of their economic activity for the near future. For instance, according to the evaluation made by the general manager of the Hungarian Iron and Steel Industry Union in 1977 "...our metallurgy can be efficient... the industrial branch... is able to compete and to remain in competition." [b] Papers about the SZIM Machine Tool Works were published every two years under titles as "Outward from the Mess"; "The trouble of SZIM has been solved"; "They were in trouble—but recovered"; "Fall and refuge". The general manager of the GANZ-MÁVAG still believed in 1978 that the twelve thousand million Ft investment project of restructuring would be paid back within five years. The newspapers, based on enterprise information, wrote—and did so in headlines—that "bycicles are excellent export commodities." [c] The financial manager of BVK (Borsod Chemical Combine) envisaged that the results of the PVC investment project would be "hard commodities", profitable exports. The chief engineer of the Hat Factory also prognosticated profitable production in 1979 for the near future.

Our sources repeatedly referred also to the fact that the unreliable forecasts of successfulness could not be traced back exclusively to wrong methods of developing them. The publications often queried the sound foundations of the declarations only subsequently. One could read the following: "Who had thought earnestly in knowledge of the investment burdens—and with the forecast on the prices of coal—that the enterprises will be able to explore the new Eocene mines with minor bank credits and their own resources?" [d] The last series of studies regarding SZIM ended directly with the statement: "...the informations given by the executives speaking about the enterprise were not true pictures of the facts." [e] It also happened that some kind of explanation of the phenomena came to be published. For example, regarding an agreement between GANZ Electric Works and the bank the information could be found that "...in the course of bargaining the data were subjected to gymnastic exercises until they seemed acceptable whereas both parties knew that the revenues were not based on realistic calculations."[f]

The "final" causes

I think that only limited consequences may be drawn from the multifarious, contradictory and often incomplete picture drawn up so far. I must admit that those who were of the opinion that the system of qualifying enterprises on the basis of financial indicators was fairly inaccurate, were, in many respects, right. *Year by year some companies were ranked by mistake among the financially deficient ones* and there always were some left out of this sphere without any realistic economic reason. But I must acknowledge that in the majority of the enterprises and cooperatives which were condemned *the troubles were connected with the actual development of efficiency* and were often consequences or causes of unsatisfactory performance.

During the first professional discussion of the findings of this research project there were many who questioned this standpoint. They emphasized that in the economy financial troubles can be traced back to very general reasons, namely to the problem of the system of interests (incentives), the mechanism of economic regulation and to the problems of society. As a matter of fact, the unfavourable effects of the world economy dealt with in the foregoing were made increasingly serious by the slow adjustment to the changes. The above-mentioned problems of supply were related to the mistakes of management, sometimes to the missing readiness of the enterprises and cooperatives to cooperate or with their finished product-orientation (that can be an explanation of the latter), in other cases to other elements of economic control, allowing the emergence of an economy of shortages. The problems of investment were enhanced by insufficient capital supply and the lack of a capital market. The weakness of enterprise management was often attributed to the deficiencies in selecting the executives and in their system of incentives. Too intensive and frequent central interventions as well as the sophisticated proceedings of qualifying the companies were obvious consequences of the paternalistic character of economic control. A consideration of these reasons reveals that in the past years economic control has often exerted a decisive influence on the performance of the firms. I believe, however, that the number of the enumerated examples was appropriate for throwing light on the other side, too, namely that the responsibility for the troubles of those concerned cannot, in its totality, be laid upon others.

Attempts and chances of a solution

Owing to the large number of enterprises struggling with financial difficulties significant forces were mobilized worldwide to reduce and eliminate the troubles.

In market economies it is considered a basic task of the enterprises to avoid bankruptcy and bankruptcy proceedings are, in general, entrusted to the micro sphere. In the solution of the critical situations the main task is to correct the investment which proved to have low effectiveness most rapidly. Under the impact of the emerging employment problems, however, everywhere government measures were taken. Hence, in several countries the law on bankruptcy was amended, so that it should not only provide the traditional protection to creditors but, as far as possible, should also help the incidental efforts at recovery in the case such are made by the enterprises which went bankrupt. In most of the countries opportunity was offered to grant central subsidies to the re-training of labour in the critical branches and, here and there, subsidies were also granted to the restructuring endeavours of the enterprises. In exceptional cases, also large firms were "saved" by the state [3, 4].

In the last decade the Hungarian "treatment" of the enterprises' financial problems differed in many respects from the standard methods followed by other countries. In Hungary, the subventions, the central saving of enterprises was the widespread method. In the second half of the 1970s this was often applied in advance in order to prevent the problems from coming to light. From 1978 on, when a resolution of the Council of Ministers prohibited the preliminary settlement of expected financial problems, a declaring of the difficulties generally preceded the saving actions, such as the permission to use the reserve fund in a special manner, temporary suspension or re-scheduling of credit or payment commitments or the cancelling of debts, etc. The reasons for the described practice were given by the head of the department for supervising the enterprises of the Ministry of Industry as follows:

"To close a factory gate is a great loss not only for those working in the factory but for the national economy, too. Therefore, we keep this measure until the very end, until we shall have attempted everything else. In our opinion the difficulties of the majority of firms in trouble are only transitory and they have their own means to have them straightened out." [g]

Literature has always contested such remedy of the problems. This solution *conserves the sources of the troubles,* i.e. low efficiency production. Two additional types of treatment were also frequently used: on the one hand the mobilization of the enterprise's internal reserves and on the other the imposition of more severe sanctions in the case of (chronic) financial problems.

Several enterprises based their recovery on raising their selling prices and obtaining central subsidies. *Efforts (at times resolute and at times undoubtedly weak) aimed at mobilizing their internal resources* also showed up in a significant part of the enterprises. A comprehensive action plan for implementing an *enterprise strategy* has been found with approximately half of the enterprises (later on it became obligatory t draw up one). Smaller or greater efforts in order to improve the product structure—i.e. market research, attempts at market extension, endeavours for product development or diversification—were found in a wide range of the companies. Similarly frequent were some measures for updating the production capacities: technological development, investments, work organization. Many enterprises tried to reduce costs, rationalize the consumption of materials and energy, simplify the administrative processes, improve stock-keeping practices and to lend out the non-utilized means of production. All these attempts of getting through, of course, often did not reach their objectives, proved sometimes insufficient and at other times mistaken. But even some successfül instances could be found.

There were some examples of suppression or liquidation of enterprises, too. In the early 1980s the companies concerned introduced disinvestment often by themselves. For instance, in almost twenty percent of the studied firms (among them in Gábor Áron Works, SZIM, Machine Tool Works, the Hungarian Silk Industry Company, BUDAPRINT Hungarian Textile Printing Company) the selling of significant production equipment, what is more, of certain plants contributed to remedying the financial troubles. In other cases, in the 1970s the whole company or cooperative was liquidated. The respective data are presented in *Table 5*.

In the 1970s the liquidation mostly afflicted some industrial cooperatives (since by that time the problematic situation of the large enterprises in trouble had been settled centrally well in advance). The firms in question were often merged into enterprises falling under more favourable judgement. From 1980 on, in turn, even some big companies in critical situation came to be wound up. The most frequent form

Table 5

Firms earlier in critical position and liquidated by 1984

The last time the difficulties emerged	Firms in critical position at the given time and liquidated since that time	
	their number	their share[a]
1975	16	34.8
1976	13	22.0
1977	11	18.0
1978	8	12.3
1979	1	2.4
1980	2	8.0
1981	1	4.2
1982	2	2.9
1983	2	3.0
Total	56	15.1

[a]In percent, compared to the total number of enterprises and cooperatives in critical situation in the given year (period).

of winding up in such cases was reorganization, or, more accurately, division; this happened to the Csepel Works, the Enamel Industry Works, and the Fine Ceramics Works. This was the period when the aforementioned selling of the Knitwear Factory of Halas, the winding up of IGV (Enterprise for Office Machines and Mechanical Instruments) without appointing any successor and the merger of the Hat Factory and HTV (Company for Telecommunication Techniques)—which meant a complete change of their range of products—took place.

More often we found sanctions applied against the executives of the firms in difficult financial position. Senior management was dismissed in almost half of the studied enterprises and cooperatives. In certain cases, however (e.g. in that of the director of the Hat Factory), we could read about former managers (executives) assigned to other important posts.

In the past years industry found various solutions for coping with financial difficulties. *But the presented process of "settlement" and the situation resulting from it became one of the most criticized characteristics of the Hungarian economy.* Some critics condemn the penalizing of enterprises, referring to the mistakes of qualification or the requirements of supply. It has often been suggested that central influence on enterprise activities is rather powerful in the industry, yet many people think that company management alone is responsible for the consequences. The protracted suppression of the poorly performing firms, the large number of which is attributable to the average low efficiency of the economy has been sharply criticized. Regularly saving the companies with financial deficit deteriorates the average performance and entails that people become more complacent. Another concern is that the slower than desirable structural transformation of the enterprise sphere inhibits regrouping in favour of the successful units, hence it is one of the direct hindrances of progress. All this makes it urgent to modify the practice developed up to now.

The solution of the troubles connected with financial deficits of the enterprises could mostly be promoted by eliminating the centrally controlled, administrative character of financial qualification and treatment of the deficits and if such activities were adjusted to the indirect mechanisms working in other areas of the economy. We were unable in the past decade to make decisions on which of the trouble-making production sections should be reasonably saved and which should be disinvested or closed down. No reliable forecasts could be made about which the enterprises and cooperatives are where one may hope for the future profitability of operations. And the ultimate question has ever been what to do with the firms which will undoubtedly continue making loss even in the future. The main reasons for these difficulties have to be found not in the method and process of management but among the basic problems of incentives, interests and of economic regulation. Certain measures within the framework of streamlining the economic control and management were already aimed at solving the problems mentioned above. Enterprises were allowed to buy and sell their property. Measures were taken to create a two-level banking system, and by establishing new banks the sphere of possible creditors extended to about thirty organizations. Attempts were made in the course of granting loans to assert the viewpoints of return, for this purpose prescriptions were made to test liquidity and the repayment potential when granting a loan. To issue and negotiate bonds and commercial bills of exchange was permitted. The development of a capital market is in progress.

In the next time measures have to be taken in order to fit the tasks of identifying the critical financial position and its treatment into the framework of the economic processes. The 1986 legal provisions of liquidation and financial rehabilitation also fit into the range of such measures. All this may substantially contribute to reducing the role of the state limiting its role to saving only the firms indispensable for the national economy.

Among our further tasks it is necessary to improve the order of *establishing the lack of performance of the enterprises*. According to the new provisions in the future it will be the permanent insolvency of the firms that will entail interventions accompanied by sanctions. For the desirable operation of this method, however, it is unavoidable to solve two tasks under any conditions whatsoever. By radically reducing the number of financial bridges amounting to about fifty for each company (and to about three hundred altogether), by drastically decreasing the number of exceptions, the normative character of the pricing, taxation and subsidizing systems has to be significantly strengthened. [12] Similar emphasis must be laid on the further development of the enterprises' financial statements and on the introduction of more accurate balance-sheets. The firms e.g. may at present place the unusued part of their depreciation allowance or the countervalue of some of their assets sold into the interest(edness) fund, independent of their financial situation (i.e. even if the real value of the state- or social property managed by them decreases). Even the indicators showing the liquidity troubles will not work better than the former indicators if the firms will be able to keep up their solvency in a broad sphere with the aid of state subsidies or at the expense of consuming or selling out their property.

For settling their difficult financial situation from own resources enterprises also need to improve their crisis strategy. The efforts carried out on the basis of such strategy often proved to be insufficient to cope with the emerging difficulties. One of the reasons for this was that they planned the strategy merely in response to central instructions, it was thus necessarily only formal. In other cases, however, the overestimation of chances of getting out of the mess became a source of the troubles.

The methods of implementing the crisis strategies could also be enriched. Examples of several actual measures and efforts could be found in the course of the attempts to weather out the crisis. Nonetheless, a broader and more conscious application of such techniques is highly recommended. Our case studies demonstrated that the firms of the light industry searched for the solution to their problems within their own frameworks much more intensively than did the great enterprises of metallurgy. Instances of laying insufficient market foundations for commencing restructuring efforts (product development, diversification) in order to eliminate financial troubles were found in several sectors. It had to be often established that the endeavours at cost reduction (rationalization, stock management, labour organization) were aimed at utilizing only fragments of the "reserves" existing in this field.

The methods of *saving* the enterprises and cooperatives in troublesome situation have to be renewed. The new decree on liquidation shifted several tasks from the central bodies on to the sphere of the firms. Hence, central economic management must only weigh the necessity of economic-financial rehabilitation in the case of those units which have been left to their own fate by the micro sphere. Further requirements can also be formulated in regard of the new processes of financial rehabilitation. I deem it, for instance, advisable that in future years such interventions should infringe the normative nature of the regulation system only to the least possible extent. The true objective of the saving actions is not the artificial sustenance of certain organizations but the realization of some national economic goals—connected with employment and supply—and these goals can usually be achieved through the collaboration of several different organizations. Let us, therefore, strive to offer the favours granted for the purposes of financial rehabilitation every time to the widest possible range of the firms (e.g. in the framework of competitive bidding).

Finally, we also need to update, with smaller or larger measures, the domestic practice of disinvestment and liquidations of enterprises.* It would be desirable to keep a record of the industrial plants (locations) with some body or agency in order to organize the trade of the plants becoming free (not operating) by possessing a good grasp of the whole situation. A commercial network could be set up for trade in the used means of production. Managers of enterprises and cooperatives could be stimulated to sell the superfluous assets of the firms under their guidance. An advisory and mediatory network supporting the selling and buying of industrial plants and means of production could be set up.

*

In my opinion, the significance of the measures described and similar ones could hardly be exaggerated. Namely, the methods applied for the selection and treatment of enterprises in a "difficult financial position" will ever be basic elments in the whole of the economic mechanism. They reflect the substantial features of the *existing* mechanism but also have a certain feedback effect of economic control. The expedient treatment and sanctioning of management with lack of performance may not only reduce our concern with the financial deficits of enterprises but may also contribute to the renewal of economic regulation and management as a whole.

* A detailed analysis of the question can be found in [14].

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APPENDIX

Dailies and weeklies whose articles were used in this study:

Figyelő
Magyar Hírlap
Magyar Közlöny
Magyar Nemzet
Népszabadság
Népszava

Direct quotations are from the following numbers:

[a] Figyelő, 5. Sept. 1985.
[b] Magyar Nemzet, 22. March, 1977.
[c] Magyar Hírlap, 1. Oct. 1978.
[d] Figyelő, 9. Febr. 1984.
[e] Magyar Nemzet, 21. Febr. 1986.
[f] Figyelő, 10. Febr. 1983.
[g] Népszabadság, 29. Oct. 1982.

ВЕНГЕРСКИЕ ФИРМЫ, ПЕРЕЖИВШИЕ ТРУДНОЕ ФИНАНСОВОЕ ПОЛОЖЕНИЕ

Г. ПАПАНЕК

Со времени хозяйственной реформы 1968 г. законным критерием низкой эффективности в венгерском народном хозяйстве считается убыточность хозяйственной деятельности или дефицит основных фондов. В статье на основе данных широких эмпирических исследований показывается, как функционировала эта система оценки производительности на практике.

В последнее десятилетие количество предприятий и кооперативов, попавших в трудное финансовое положение, в венгерской промышленности было весьма велико и составляло из года в год от 3 до 5%. На многих предприятиях финансовый дефицит имел место неоднократно, иногда постоянно. Эти трудности всегда вызывались цепью тесно связанных друг с другом проблем. Множество конкретных примеров подтверждает, что важнейшие «звенья» этой цепи — неблагоприятные воздействия мировой экономики, трудности, связанные с использованием производственных факторов, проблематичные последствия централизованного вмешателства, трудпости, связанные с развитием и капиталовложениями, недостатки руководства, а также трудности, измерения. Кроме того, трудности связаны с отдельными «конечными» причинами, слабостью заинтересованности и стимулирования и также с чрезмерной централизацией руководства экономикой.

В последние годы как конкретные хозяйственные единицы, так и центральные органы направляли значительные усилия для ликвидации финансовых трудностей. В случае крупных пердприятий наиболее частым решением было предоставление субвенций. Однако повсюду были предприняты и усилия, направленные на мобилизацию внутренних ресурсов предприятий (иногда решительные, иногда безусловно слабые). Кроме этого, в 1970-е годы многие мелкие хозяйственные организации были в результате финансового дефицита слиты с другими предприятиями, а в 1980-е годы распускались и ликвидировались и более крупные предприятия.

Однако данную практику решения проблемы финансовых трудностей предприятий можно оценить как низко эффективную, поскольку она давала слишком широкие возможности для сохранения хозяйственной деятельности с неблагоприятной эффективностью. Поэтому в венгерском народном хозяйстве с 1. сентября1986 г. вступили в действие новые законы для регулирования этого вопроса. Они ставят в центр оценки хозяйственной деятельности платежеспособность хозяйственных единиц и устанавливают более строгие условия предоставления субвенций убыточным предприятиям.

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ECONOMIC DEVELOPMENT IN SMALL COUNTRIES

B. BALASSA

Owing to the increasing role of economies of scale, the benefits of international trade are especially important for small countries, like Hungary. The paper introduces the distinction between outward- and inward-oriented development strategies and leads to the conclusion that the economic performance of the outward-oriented countries has been uniformly superior to that of inward-oriented countries. This conclusion leads to recommendations for policy reform in inward-oriented countries. The proposed reforms include the adoption and maintenance of realistic exchange rates, import liberalization, export promotion, as well as positive interest rates and improvements in financial intermediation.

The title of the paper* suggests several interrelated questions. What is meant by a small country? In what way do the economic issues facing small countries differ from those facing large countries? What has been the policy experience of the small countries? What are the appropriate policy recommendations for economic development in small countries?

These questions will be addressed in the present paper. In the discussion of policy experiences in the postwar period, I will further introduce the distinction between outward- and inward-oriented development strategies and will draw on the empirical results of my earlier work.

Defining smallness

Smallness should be defined in economic terms. A country may have a small territory but nevertheless possess a domestic market large enough that it cannot be considered "small" in terms of economic variables. In turn, a large geographical area does not necessarily translate into a large market.

These considerations lead one to define smallness in terms of market size. But market size will hardly matter for agriculture, where economies of scale in particular products can be captured in any country of the world, however small. In turn, market size will assume importance for manufacturing industries, where a large market is needed to ensure competition among efficient-size firms and even for the establishment of a single efficient-size firm. Market size will also matter for modern—as compared to traditional—services, such as telecommunications, where costs decline with size.

* Invited paper presented at the Conference on Small Countries in the World Economy, held in Budapest on August 25–27, 1986. The author is consultant at the World Bank. He is alone responsible for the opinions expressed in this study that should not be interpreted to reflect the views of the World Bank.

The distinction made between modern and traditional services indicates the increasing importance of market size in the services sector. Similar considerations apply to manufacturing industries. For one thing, growing mechanization and automatization means that efficient size has increased in long-existing industries. For another thing, new industries have been established that require a large market.

These conclusions pertain to traditional economies of scale, related to plant size, as well as to product specialization (reducing product variety) and vertical specialization (manufacturing parts, components and accessories in different establishments). While plant economies of scale are relevant for standardized commodities, economies of scale through product specialization dominate in the production of differentiated goods.

The textile industry provides an example of increases in efficient size through mechanization and automation. Owing to the introduction of new technologies, efficient plant size has also increased over time in the production of intermediate goods, ranging from petrochemicals to paper. This has further been the case for steel made from iron ore and coking coal, although not for steel made from scrap by the electrolytic process.

Horizontal (through reductions in the number of models) and vertical (through the decentralization of the production of parts, components, and accessories) specialization have assumed particular importance in engineering products. A good example is automobiles where the efficient size of production has increased more-or-less interruptedly since the establishment of the industry. At the same time, it has been shown that in developing countries the excess cost of car production ranges from 50 to 300 percent, depending on production volume and the share of domestically-produced parts, components and accessories [1].

Market size matters even more for new, technologically advanced industries. In these industries, economies of scale extend not only to production but also to research and development. It has been said, for example, that Japan does not have a sufficiently large domestic market to establish an aircraft industry and that IBM can spread research costs more widely through exporting.

Over time, then, exploiting economies of scale and ensuring competition has required increasingly large markets. This may have contributed to the new movement towards economic integration in Western Europe, although European countries have been largely unsuccessful in establishing a common market for high-technology products.

At the same time, for purposes of the analysis, there is need to distinguish between actual and potential market size. Using demand for manufactured goods as a measure of actual market size, Brazil and India will come in the same size class as the Netherlands, for example, although they differ greatly in terms of population.

The distinction between actual and potential market size has particular relevance if one considers that inappropriate policies will not permit a country to reach its potential market size. This has been the case, for example, in India where the policies applied during the first post-independence generation have not permitted exploiting the advantages of a large potential market.

As its title indicates, this paper is concerned with small countries. The question remains how to define smallness. The definition proposed here is formulated in terms of potential size; i.e. I will exclude countries that potentially have a large market even though the actual size of the market may be small.

Defining market size in terms of potential permits one to use population as a measure. This was done by *Kuznets* [2], who defined small countries as having a population of less than 10 million. With the increasing importance of economies of scale in traditional industries, as well as in high-technology goods and services, the dividing line should be drawn at a higher level, however.

In the following, a population of 16 million will be used as the benchmark. Apart from Canada, there is no developed country with a population between 16 and 38 million while, among developing countries, Venezuela and Peru, with a population of 18 million each, and Kenya, with a population approaching 20 million, are just above the dividing line.

The policy implications in country size

As noted above, market size will matter in manufacturing sector and in modern services, where economies of scale are of importance. A small country cannot have a diversified industrial structure without foregoing economies of scale. Also, a small country will tend to specialize to a considerable extent in standardized commodities, rather than differentiated products where the availability of a large domestic market offers advantages.

As to the first point, it has been shown in a sample of eighteen developed countries that the diversification of the industrial structure is correlated with the size of population. A similar result has been obtained for U.S. regions, although for a given population size the extent of industrial diversification is considerably greater internationally than interregionally, owing to the establishment of industries behind trade barriers [3].

Linder [4] suggested that the availability of a large domestic market provides advantages for the production of differentiated products, but not for standardized goods which have internationally accepted specifications and can be sold at the world market price. In specializing in the exportation of steel, glass, and cotton textiles, Belgium fits the pattern while such is not the case for the Netherlands [5]. However, a statistical test of the hypothesis for eighteen developed countries has showed the existence of a positive correlation between country size and specialization in differentiated products [6].

In fact, it appears that small developed countries have generally foregone specialization in differentiated products, where economies of scale are of particular importance. This has been the case in the automobiles industry, for example, where Sweden is the smallest developed country producer. And while the domestic market, accounting for about one-half of output, serves as a basis for the Swedish car industry, exports are a *sine qua non* for capturing economies of scale. Furthermore, competition with foreign producers in domestic as well as in export markets gives inducement for technological improvement.

It follows that the benefits of international trade are particularly important for small countries. It is through trade that they can compensate for the disadvantages of their limited domestic markets, which do not permit exploiting economies of scale and ensuring competition in a variety of industries and modern services. At the same time, the anti-export bias inherent in protection would discourage the very export activities that are necessary for a small country to maximize the advantages it can derive from international exchange.

Protection will thus be especially costly for small countries and the cost of protection will decline with the size of the domestic market. Furthermore, in large countries, some of this cost may be offset through improvements in the terms of trade, attendant on the imposition of protective measures, while the optimal tariff for small countries will approach zero.

Evidence for developed countries provides support for this proposition. Thus, at the beginning of the 20th century, protection levels were the highest in the two largest countries, the United States and Russia. In turn, the small European countries, including Belgium, the Netherlands, and the Scandinavian countries, have traditionally been free traders.

This conclusion does not carry over to developing countries, however. Among large countries, India has long been protectionist whereas Brazil introduced important economic reforms in the mid-1960s and, despite a turn towards protection after 1973, the extent of the bias against exports has remained considerably less than in most other Latin American countries.

In turn, two small Latin American countries, Chile and Uruguay, maintained high levels of protection until the mid-1970s, when the external shocks suffered induced them to change their policies. Also, levels of protection are high in a number of small African countries. Thus, unlike the case of the developed countries, there does not appear to be evidence of a correlation between country size and protection levels in the developing world.

Policy experiences during the postwar period

1. Defining inward- and outward orientation

In examining the postwar experience with alternative policies, distinction may be made between inward-oriented and outward-oriented development strategies. Inward-oriented countries have applied various measures of protection, including tariffs and quantitative import restrictions, to protect their domestic industries. The application of these measures has biased the system of incentives in favor of import substitution and against exports. In turn, under outward orientation, similar incentives have been provided to import substitution and exports, with export subsidies offsetting, on the average, the effects of import protection.

At the same time, outward-oriented countries have generally maintained realistic exchange rates, and avoided variations in real exchange rates (nominal exchange rates, adjusted for changes in relative prices at home and abroad) over time, so as to encourage exports. Conversely, under inward orientation exchange rates have often been overvalued, with the degree of overvaluation varying over time, as intermittent devaluations periodically caught up with domestic inflation, thereby creating uncertainty for exporters.

Apart from variations in the extent of overvaluation leading to changes in incentives over time, there has been considerable variation in incentives among economic activities in inward-oriented countries, reflecting the neglect of interindustry relationships. This has not generally been the case under outward orientation; also, relatively low protection has ensured competition in their markets.

The stick and the carrot of competition under outward orientation have benefited buyers and have given inducement for technological improvements. In turn, with high protection limiting competition from imports, countries applying inward-oriented development strategies have been characterized by the prevalence of sellers' markets, which provide little incentive for catering to the users' needs and for improving productivity.

Also, whereas interest rates tend to be determined in the market place under outward orientation, inward-oriented countries historically have kept interest rates artificially low. With real interest rates (nominal rates adjusted for inflation) often being negative, they have failed to provide a benchmark for choosing among alternative investments. The principal beneficiaries of the resulting credit rationing have been import substituting industries, favored by the governments of inward-oriented countries. These governments have also influenced the allocation of investment funds more directly through the control of private investments and the establishment of public enterprises, which have played a lesser role under outward orientation.

The described characteristics of outward-oriented and inward-oriented development strategies are exemplified by the experience of the last four decades. In the early postwar period, the policies applied by middle-income primary exporting countries offer particular interest. In the subsequent period of rapid growth in the world economy, a contrast may be drawn among three groups of countries: countries pursuing outward-oriented policies, inward-oriented countries undertaking policy reforms, and countries characterized by continued inward orientation. The choice between outward- and inward-orientation has further relevance in the period of external shocks, owing to increases in oil prices and recessionary conditions in the world economy. In the following discussion of the experience of the postwar period, comparisons will also be made with a small socialist country, Hungary.

2. The early postwar period (1950–60)

Among small countries, Chile in Latin America, Denmark and Norway in Western Europe, and Hungary in Central Europe reached relatively high income levels in the interwar period based largely on primary exports. Considerable policy differences were observed, however, in the early postwar period, leading to very different outcomes [7].

These differences pertain largely to the choice between inward- and outward-orientation, rather than to the choice of capitalist and socialist economic systems. Thus, while the measures applied by inward-oriented capitalist and socialist countries may have been different, their general policy orientation was broadly similar, contrasting with the case of countries that adopted an outward-oriented development strategy.

Chile, among capitalist countries, and Hungary, with its newly-established socialist system, provide examples of inward-oriented policies. Both countries attempted to develop their industries behind high protection; in Chile, this was done by using a mixture of tariffs and import controls whereas Hungary relied largely on import prohibitions. And although the infant industry argument calls for temporary protection until an industry becomes internationally competitive, in the two countries protection was regarded as permanent. Thus, there was a tendency towards what has been described as "import substitution at any cost" and there was little inducement for technological change.

Furthermore, in both countries, interindustry relationships were neglected and rates of protection varied to a considerable extent among economic activities. Also changes in the extent of the overvaluation of the currency created uncertainty in Chile while in Hungary policy changes occurring every two or three years had similar effects. Finally, real interest rates were kept below the inflation rate in the two countries.

The policies applied led to the establishment of high-cost manufacturing industries which discriminated against primary exports and primary activities in general, and discouraged the establishment of manufactured exports. Thus, between the mid-1930s and the early 1970s, Chile's share fell from 28 to 22 percent of the world exports of copper, which accounted for three-fifths of the country's export earnings. Also, notwithstanding its climatic advantages, Chile failed to develop its agriculture, thereby forestalling the expansion of exports and contributing to increased food imports. Similar developments occurred in Hungary, whose exports of several agricultural products declined in absolute terms while slow increases of production necessitated the importation of cereals and meal that had earlier been major export products.

In turn, Denmark and Norway not only eliminated quantitative restrictions but reduced tariffs below the level observed in most developing countries, with little inter-industry differences in tariff rates. These countries also adopted realistic exchange rates and interest rates.

As a result of the policies applied, Denmark doubled its market shares in primary exports and Norway, too, made considerable gains. These countries also rapidly expanded their manufactured exports, whose share in total exports increased from 19 to 42 percent in Denmark and from 10 to 32 percent in Norway during the 1950s, while this share did not reach 5 percent in Chile's and in Hungary's trade with capitalist countries.

Export expansion was concentrated in manufacturing industries where Denmark and Norway had comparative advantages by reason of the availability of certain raw materials and a highly educated labor force. This compares to the lack of exploitation of the comparative advantages of Chile and Hungary, which have several agricultural and non-agricultural raw materials and an educated labor force.

The slowdown in the growth of primary exports and the lack of emergence of manufactured exports did not provide the foreign exchange necessary for rapid economic growth in countries following an inward-oriented development strategy. The balance-of-payments situation of these countries was further aggravated by the rising import needs of domestic industry. At the same time, high-cost, capital-intensive production raised the investment requirements of increment in output (incremental capital-output ratios) in the two countries while increases in savings were limited by negative real interest rates.

Correspondingly, the growth of per capita GNP declined in Chile and Hungary. By contrast, low incremental capital-output ratios associated with resource allocation according to comparative advantage, together with high savings ratios, led to rapid increases of per capita incomes in Denmark and Norway.

3. The period of rapid world economic growth (1960–73)

In the early 1960s, a new group of outward-oriented countries entered the scene. They included a large country, Korea, a small economy, Singapore, and one on the borderline, Taiwan. In turn, the largest developing nation, India, and two small countries, Chile and Urugay, continued with an inward-oriented policy stance throughout the 1960–73 period.

An intermediate position was taken by several large Latin American countries, including Argentina, Brazil, and Mexico. These countries followed inward-oriented policies but undertook policy reforms in the mid-1960s, reducing the extent of discrimination against agriculture and, in particular, against manufactured exports. As discussed further below, policy reforms were also undertaken in Hungary [8, 9].

At the same time, there were several important differences between the policies applied by the three Far Eastern countries and the three Latin American countries. These differences largely reflected the fact that the latter group of countries endeavoured to maintain the high-cost industries they had earlier established after the policy reforms.

To begin with, exporters in the Far Eastern countries were free to choose between domestic and imported inputs; they were exempted from indirect taxes on their output and inputs; and they paid no duty on imported inputs. The same privileges were extended to the producers of domestic inputs used in export production, thus providing essentially free trade treatment to their export sectors. With additional subsidies and low import protection, exports in the manufacturing sector received, on the average, similar incentives as import substitution in the three countries. Furthermore, there was little discrimination against primary exports, and against primary activities in general, and the system of incentives was quite uniform.

In reforming their system of incentives, the three Latin American countries reduced the extent of import protection. They did not provide, however, exporters with a free choice between domestic and imported inputs. Rather, in order to safeguard existing industries, exporters were required to use domestic inputs produced under protection. To compensate exporters for the resulting excess cost, the countries in question granted export subsidies, but these did not suffice to provide producers with export incentives comparable to the protection of domestic markets. Thus, there continued to be a bias in favor of import substitution and against exports, in particular traditional primary exports, albeit to a lesser extent than beforehand.

In turn, Hungary undertook a comprehensive economic reform (commonly called, new economic mechanism) that aimed at increasing the outward orientation of its economy. Domestic prices were linked to international prices through a uniform exchange rate and tariffs; quantitative import restrictions were liberalized; and, in the pursuit of measures taken in the preceding years, agricultural prices were raised to a considerable extent, effectively eliminating discrimination against agriculture.

Among countries that continued with a policy of inward-orientation, Chile traditionally had the highest level of import protection in Latin America and, after brief experimentation with import liberalization, reimposed quantitative restrictions in the early seventies. Protection levels also remained high in Uruguay and little effort was made to promote exports. In turn, the introduction of selected export subsidies in the mid-sixties was far overshadowed by the continued use of import prohibitions and investment controls in India.

The incentives applied importantly affected export performance in the three groups of countries. The share of exports in manufactured output rose from 1 percent in 1960 to 14 percent in 1966 and to 41 percent in 1973 in Korea, from 11 percent to 20 percent and to 43 percent in Singapore, and from 9 percent to 19 percent and to 50 percent in Taiwan. Notwithstanding their poor natural resource endowments, the three Far Eastern countries also had the highest growth rates of primary exports, and hence of total exports, among the three groups.

In the 1966–73 period, the growth of manufactured exports accelerated in the three Latin American countries that reformed their system of incentives during this period. In particular, the share of exports in manufactured output rose from 1 percent in 1966 to 4 percent in 1973 in both Argentina and Brazil, with smaller increases occurring from a higher initial level—explained by its common border with the United States—in Mexico. But, the share of exports remained much lower than in the Far East. And, while they made gains in non-traditional primary exports, the three Latin American countries experienced a continued erosion in their traditional primary exports.

Hungary made gains in the markets of capitalist countries in agricultural as well as in manufactured goods following the introduction of the new economic mechanism. As a result, its market share in the imports of these countries increased from 0.22 percent in 1965 to 0.28 percent in 1973.

Finally, Chile, Uruguay, and India, which continued with an inward-looking development strategy, did poorly in primary as well as in manufactured exports and experienced a decline in the share of exports in manufactured output between 1960 and 1973. India lost ground in textiles, its traditional exports, and was slow in developing new manufactured exports. As a result, its share in the combined exports of manufactured goods of the nine countries declined from 69 percent in 1960 to 12 percent in 1973. In the same period, Chile's share fell from 4 percent to 1 percent, while Uruguay's share never reached one-fifth of one percent of the total.

The experience of the countries in question provides evidence of the favorable effects of outward orientation on economic growth during the period preceding the 1973 oil crisis. To begin with, income increments were achieved at a considerably lower cost in terms of investment in countries that consistently followed an outward-oriented development strategy. Thus, in the 1960–73 period, incremental capital-output ratios were 1.8 in Singapore, 2.1 in Korea, and 2.4 in Taiwan. At the other extreme, these ratios were 5.5 in Chile, 9.1 in Uruguay, and 5.7 in India.

The three Latin American countries that undertook policy reforms represent an intermediate group, with incremental capital-output ratios declining after the institution of policy reforms. These ratios declined also in Hungary that experienced a doubling in its total factor productivity, i.e. the combined productivity of capital and labour.

Outward orientation also appears to have been associated with higher domestic savings ratios. This result reflected in part higher than average savings ratios in export activities and in part the response of domestic savers to positive real interest rates tended to be negative in inward-oriented economies, although the rates were raised in the three Latin American countries that undertook policy reform.

Correspondingly, the three Far Eastern countries had by far the highest GNP growth rates throughout the period; the three Latin American countries as well as Hungary improved their growth performance to a considerable extent after the reforms were instituted; whereas Chile, Uruguay, and India remained at the bottom on the growth league. For the 1960–73 period, taken as a whole, per capita incomes rose at rates ranging between 6 and 8 percent in the first group, between 3 and 5 percent in the second, and between 1 and 2 percent in the third.

4. The period of external shocks (1973–85)

Developing countries experienced substantial external shocks between 1973 and 1983. In the first half of the period, the quadrupling of oil prices was accompanied by a world recession and followed by a slow recovery; in the second half, oil prices increased two-and-a-half times, the industrial countries again experienced a recession, and interest rates rose to a considerable extent. At the same time, policy responses to these shocks in the individual countries varied greatly [10, 11].

Korea, Singapore, and Taiwan continued with their outward-oriented development strategy and were joined by Chile and Uruguay which, however, again introduced price distortions after mid-1979 when their exchange rates became seriously overvalued. In turn, after earlier efforts made to reduce the bias of the incentive system against exports, Argentina, Brazil, and Mexico, as well as Hungary, increased the degree of inward orientation while India continued with its inward-oriented stance.

Outward-oriented countries in the Far East maintained realistic exchange rates, with little variation over time whereas exchange rates were generally overvalued in inward-oriented countries, with the degree of overvaluation varying during the period. Correspondingly, outward-oriented countries gained export market shares whereas inward-oriented countries experienced losses in foreign markets.

Maintaining realistic exchange rates further contributed to import substitution in countries following an outward-oriented strategy. Also, the exploitation of economies of scale in their export industries permitted replacing imports in these industries by domestic production. Finally, raising petroleum prices led to considerable energy savings in the countries in question.

Outward-oriented countries thus undertook domestic adjustment through output-increasing policies of export expansion and efficient import substitution. By contrast, inward-oriented countries lost export market shares and experienced little import substitution. They also undertook highly capital-intensive projects that by-and-large avoided under outward orientation.

The differences in the policies applied explain the superior performance of outward-oriented countries. Furthermore, positive real interest rates favored domestic savings in the former, as compared to the latter, group of countries.

Thus, while external shocks were considerably larger in outward-oriented than in inward-oriented countries, owing to their greater exposure to foreign markets, these differences were offset several times by differences in economic growth rates. While per capita growth rates increased from 5 percent in 1963–73 to 6 percent in 1973–79 in outward-oriented countries, they declined from 4 to 2 percent in inward-oriented countries (apart from Argentina, Brazil, Mexico, and Hungary, the latter group is defined to include Israel, Portugal, Turkey and Yugoslavia).

The results obtained even though inward-oriented countries borrowed heavily abroad, because the borrowed funds were generally not utilized efficiently. In particular, slow increases in exports led to a substantial rise in the debt-export ratios of these countries while the ratio remained approximately unchanged in outward-oriented countries.

Correspondingly, increases in world interest rates bore heavily on inward-oriented economies, necessitating the application of deflationary policies that led to a decline in their per capita GDP growth rates to an average of 1 percent in the 1979–82 period. And while outward-oriented countries also applied deflationary measures on a temporary basis, with their per capita GDP growth rates decreasing to 2 percent in 1979–82, they rebounded again in subsequent years. Between 1982 and 1985, per capita GDP growth rates averaged 4 percent in outward-oriented economies as compared to nil in inward-oriented economies that had to pay the price for their excessive indebtedness.

The overall conclusions reached in regard to the two groups of countries neglect the variety found within each. While Chile and Uruguay were classified as outward-oriented on the basis the reforms undertaken in the mid-1970s, the subsequent overvaluation of their exchange rates led to losses in export market shares and to subsequent poor economic performance in the early 1980s. In turn, among inward-oriented countries, the economic reforms introduced in Turkey in 1980 permitted moving from virtual bankruptcy to creditworthiness for bank lending within a few years. Finally, Hungary began the application of deflationary policies earlier than the Latin American countries and reached per capita GDP growth rates of 2 percent in the early 1980s.

Policy recommendations for the future

The review of the postwar period shows the superiority of outward orientation over an inward-oriented development strategy. The experience of this period thus indicates the need for policy reform in inward-oriented economies in order to accelerate their economic growth. This would involve the adoption of realistic exchange rates, import liberalization, export promotion, and financial liberalization. The proposed recommendations are of particular importance for small countries that have the most to gain from international trade.

1. Exchange rate policy

Adopting a realistic exchange rate is the *sine qua non* of a policy package for economic growth as it will simultaneously contribute to export expansion and efficient import substitution. In highly-indebted developing countries, a devaluation in excess of that indicated by real exchange rate calculations will be necessary in order to allow for the servicing of the debt.

Once an appropriate exchange rate is established, there is need for a credible commitment on the part of the government that the rate will not get out of line again. Such a commitment may be provided by establishing an automatic decision rule for changing the exchange rate in the future. The rule should be based on relative rates of inflation at home and abroad, with adjustment made if structural changes occur in the country's balance of payments (e.g. a sudden large change in oil prices).

2. Import protection

Although a devaluation will provide incentives for exports, rapid export expansion may not ensue if high profits (and a quiet life) can be obtained in highly-protected domestic markets. At the same time, the adoption of a realistic exchange rate provides an opportunity for lowering import protection. This may take the form of a compensated devaluation, with reductions in rates of import protection offsetting the effects of a devaluation (e.g. a devaluation of 20 percent would be accompanied by a 20 percent reduction in rates of import protection).

Such a measure will promote exports as well as efficient import substitution (by 20 percent in the above example). Also, the prices of import substitutes will increase whenever the rate of devaluation exceeded the initial rate of protection (e.g. domestic prices will rise by 12 percent if the initial rate of protection was 8 percent).

In turn, the domestic prices of import substitutes, in the case of which the initial rate of protection at least equalled the rate of devaluation, will not change under the proposal as reductions in protection will compensate for the effects of the devaluation on domestic prices. But, in order to ensure the efficient allocation of resources, including that of new investment funds, there will be need for further reductions and rationalization of import protection.

Import liberalization should proceed according to a well-conceived program, designed to minimize the difficulties of adjustment and to surmount the opposition of vested interests that benefited from high protection in the past. Such a program would include the replacement of quantitative import restrictions by tariffs, reductions in the average level of import protection, and greater uniformity in rates of protection among sectors.

The replacement of quantitative import restrictions by tariffs should be given first priority. While quantitative restrictions may be used to advantage in emergencies, their continued application imposes a cost on the national economy that tends to increase with the level of industrial development.

To begin with, quantitative import restrictions provide practically unlimited protection whose effects are difficult to ascertain whereas the rate of tariff *ipso facto* indicates the extent of protection. Also, case-by-case decision-making in providing import licenses creates uncertainty for the user that is not the case with tariffs whose application is automatic. Moreover, tariffs have a lower administrative cost and contribute to government revenue while the difference between the domestic and the foreign price accrues to the recipients of import licenses. Such quota profits, reflecting the scarcity of imports, may lead to 'overcrowding' in the industry so as to share in the profits and provide inducement for bribery to obtain import licenses.

The elimination of quantitative import restrictions should be undertaken according to a time-table determined in advance, so as to provide sufficient time and notice for adjustment. The first priority should be to free the imports of inputs for export production, including raw materials, intermediate goods, as well as machinery. This may be followed by the liberalization of the importation of inputs used in production for domestic markets, with consumer goods left to the end.

The period of elimination of quantitative import restrictions may be set at three to five years, depending on the conditions existing in the country concerned. It should be complemented by tariff reform, aimed at reducing the level, and rationalizing the structure, of tariffs.

The reform would involve, first of all, setting a tariff ceiling at a level that does not provide excessive protection to domestic industry. Depending again on the conditions existing in the country in question, the ceiling may be set at 10 to 15 percent, to be reached over a period of, say, five years. At the same time, interindustry differences in tariffs should be reduced, the objective being to equalize the protection of value added (effective protection) across industries.

Additional protection may be provided to infant industries on a temporary basis. Such protection should be granted on a declining scale, so as to provide inducement for improvements in operations and reductions in costs. If budgetary considerations permit, infant industries should receive production subsidies that provide equal incentives, irrespective of whether production is destined for domestic or for export markets; otherwise, temporary tariff surcharges may be employed.

3. Export incentive

Even tariffs of 10 to 15 percent represent discrimination against exports, however. To reduce this discrimination, export incentives would need to be granted. At the same time, such incentives should conform to GATT rules, lest retaliatory measures are taken by the importing countries.

GATT-conforming measures include the duty-free entry of imported inputs for export production and the reimbursement of import duties and indirect taxes paid at earlier stages of fabrication. It would be desirable to give exporters the right to freely import all inputs even if domestic substitutes are available and to extend this privilege to the domestic producers of inputs for export production (indirect exports).

The freedom of choice between domestic and imported inputs for direct and indirect exporters would put them under free trade conditions. A bias against exports and in favour of import substitution would remain, however, owing to the protection of domestic markets. There is need, therefore, to provide additional incentives to exports, chosen with a view to avoid retaliation on the part of developed countries.

Measures of export promotion in the form of the establishment of information services, the financing of trade fairs, and the favourable tax treatment of marketing expenditures may also be undertaken without invoking retaliation. Furthermore, export credits and guarantees can be provided within the limits acceptable under international rules. Export credits may take the form of prefinancing, the discounting of export bills, medium-term loans for the sale of capital goods, and long-term credits for investment in export activities.

4. Financial liberalization

As part of a program of financial liberalization, there is need to establish positive real interest rates for lenders as well as for borrowers. This will contribute, on the one hand, to increases in savings and, on the other, to the choice of investments according to their profitability. It will also discourage the use of excessively capital-intensive production methods and capital-intensive activities in general that are promoted by negative real interest rates.

There is further need to improve the efficiency of financial intermediation and to increase the choice of financial assets. This would require ensuring competition among financial intermediaries and regulating their activities. Inducements would further need to be provided for the development of stock and bond markets.

Concluding remarks

The paper has addressed itself to issues that are particularly relevant for small countries, defined as having a population of less than 16 million. It has been noted that, owing to the increasing role of economies of scale, the benefits of international trade are especially important for small countries.

The paper has introduced the distinction between outward- and inward-oriented development strategies and has reviewed the experience of countries applying different strategies after the Second World War. The analysis of the early postwar period (1950–60), the period of rapid economic growth (1960–73) as well as the period of external shocks (1973–85) has led to the conclusion that the economic performance of outward-oriented countries was uniformly superior to that of inward-oriented countries.

This conclusion has led to recommendations for policy reform in inward-oriented countries. The proposed reforms include the adoption and maintenance of realistic exchange rates, import liberalization, export promotion, as well as positive interest rates and improvements in financial intermediation.

The policy recommendations should be considered as a package as the proposed measures reinforce each other. Thus, financial liberalization is necessary for fully exploiting the benefits of trade liberalization and *vice versa.* At the same time, the reforms should be carefully prepared, with their time table announced in advance, in order to minimize dislocation and to prepare firms for the changes to be made.

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ЭКОНОМИЧЕСКОЕ РАЗВИТИЕ МАЛЫХ СТРАН

Б. БАЛАШША

Статья посвящена особенностям, характерным для небольших стран, к которым относятся страны, имеющие население менее 16 миллионов. Указывается, что вследствие повышенной роли эффекта масштаба производства для небольших стран особое значение имеет выгода внешней торговли.

В статье определяется различие между стратегией, ориентированной на внутреннее и внешнее развитие, и рассматривается опыт стран, применяющих различные стратегии после 2-й мировой войны. Анализ послевоенного периода (1950–60), периода быстрого экономического роста (1960—73), а также периода нарушения внешнеэкономического равновесия (1973—85) приводит к выводу, что экономические результаты стран с внешней ориентацией были как правило выше, чем стран с внутренней ориентацией.

Это позволяет сделать вывод о необходимости реформы экономической политики в странах с внутренней ориентацией. Предлагаемые реформы включают приспособление и введение реальных валютных курсов, либерализацию импорта, поддержку экспорта, позитивные процентные ставки и совершенствование финансовой сферы.

Политические рекомендации должны быть разработаны в комплексе с тем, чтобы предпринимаемые меры взаимно усиливали друг друга. Так, финансовая либерализация необходима для полного использования эффекта от либерализации торговли и наоборот. В то же время реформа должна быть тщательно подготовлена и ее срок должен быть объявлен заблаговременно для того, чтобы свести к минимуму неблагоприятные последствия и дать фирмам возможность подготовиться к изменениям.

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REVIEWS

JOB-CREATING CAPACITY OF THE PRIVATE SECTOR IN HUNGARY BETWEEN 1981–1985

G. J. KOVÁCS

1. Labour proportions between the economic sectors

The number of active earners* in the Hungarian national economy has been decreasing year by year. The employment figure of 5 014 300 persons registered on January 1, 1981 declined to 4 892 300 by 1986, i.e., the decrease was about 2.5 percent [1]. The decrease can primarily be explained by demographic causes. The population of the country decreased in 3 years by 73 thousand persons, within which the number of those in working age became 68.4 thousand less. The number of people working after their age of retirement decreased by 65.6 thousand [2].

Between the sectors of the national economy a certain shift in proportions can be observed. In the analysed period the number of active earners in the state-owned sector decreased by 113 thousand, i.e. 4 percent (from 3 554 to 3 441 thousand), in the cooperative sector by 38 thousand, i.e. by 3 percent (from 1 280 to 1 242 thousand). In the meantime the number of *those working in the private sector increased by 48 thousand, from 180 to 228 thousand.*

On the basis of the data two statements can be made: 1. Though the share f the private sector is rather small within the total of the active earners (5 percent), it came to play an increasing part in employment in the early 1980s, however neglected it had earlier been by labour management. 2. The decrease occurring in the labour force of the socialist sector was in its majority the result of demographic factors, hence—owing to the employment proportions between sectors—the effect of migration to the private sector was of slight significance for the decrease.

The data reflecting the composition of employment by social sectors show the division only *based on the worktime* spent in the full-time job. Thus, according to the data illustrating the division by classes and strata of the active earners, the number of artisans and small shopkeepers (which includes practically the full-time workforce of the private sector) was 138.2 thousand in 1980 and increased in five years to 217.1 thousand.

In the private sector part-time employment is significant. *The total number of persons employed full-time and part-time* already exceeded 200 thousand in the early

* In Western terminology: gainfully employed — (Ed. note.)

Table 1
Distribution of active earners by classes and strata

	Thousand persons	
	1980	1985
Those belonging to the workers' class	2886.8	2723.2
Those belonging to the cooperative peasantry	608.3	657.0
Members of intellectual professions	1435.5	1315.6
Small scale producers of commodities, retail shopkeepers	138.2	217.1
Total	5068.8	4912.9

1980s, while by the end of the period under survey this number increased to *more than 300 thousand.* Hence, the private sector helps in providing income for a population of about 340 thousand persons. Of this about 180 thousand are employed full-time, and 160 thousand—while keeping up their job in the socialist sector—work in the private sector in their free time (according to the established Hungarian statistical terminology they pursue complementary activities). This means that about 7 percent of the active earners utilize their full or partial worktime in the private sector and that the labour-absorbing capacity of this sector is continually growing—as opposed to the employment tendencies on the level of the national economy.

The phenomenon can be explained by two major factors:

1. The limits of the private sector have expanded. Since 1982 new forms of organization have appeared (first of all the economic workteams of private persons and the various forms of civil-law associations) and the sphere of activities that can be pursued in the small-scale industry has also been expanded. The frameworks of the latter have also been widened: more persons (employees) are allowed to work in the shops of artisans than was the case earlier.

2. A considerable part (almost half) of those employed in the private sector can maintain their job in the socialist sector, providing a safe basis of existence, independent from the more uncertain relations of demand and supply in the private sector; the private activities performed part-time play a role of supplementing incomes.

The fact that the number of people employed in the private sector is slowly but continuously growing and that *this sector has a capacity for further absorption of labour,* make it justified to review their effect on employment through the last five years.

A detailed and reliable statistical analysis of labour relations in the private sector has so far been missing. The reasons for this are most likely that

— a definition of the constituents of the private sector, especially from the viewpoint of employment, has only been established by and large; the recently legalized forms and activities could not yet be fitted into the (statistical) recording system;

— the system of statistical observation is partial and incomplete, since it is limited to taking into account some particular categories of employment. It is incomplete also because the order of magnitude of the other categories is determined by estimates and not by recording (e.g. individual farmers, assisting family members, etc.);

— the official organs supervising the private sector only keep partial records serving merely for their own purposes. Certain groups are everywhere missing. Even the data available are not regularly summarized.

The present study is aimed at filling up this gap. In the course of the survey the author has collected data from various sources.* Even so, in certain cases he had to rely on estimates and very likely certain spheres (forms of activity), though being legally pursued, have remained hidden further on.

2. The limits of the private sector

The private sector is the group of economic organizations, classified on the basis of forms of ownership, which includes those persons who possess trading or merchant's licence, or other types of legal permits allowing them to produce commodities or perform services on their own. [3]

According to the Hungarian statistical system the following belong to the sphere qualified as the private sector:

— private farms,
— artisans, private freighters, small (retail) shopkeepers, domestic servants, etc.,
— self-employed members of intellectual professions,
— economic workteams (except the workteams in enterprises—operating after legal worktime),
— other private organizations.

Statistical recording covers—even if not according to a very strict logic—the basic units of the private sector, the *economic units.* (Exceptions are the domestic servants and the self-employed intellectuals who cannot be considered as economic units.) In our opinion, when analysing the economic processes, the limits of the private sector have to be drawn narrower than the enumeration above. First of all, we must exclude the non-economic organizations (such as churches, sport clubs, hunters' associations, angler's societies, etc.) from the survey, since—although having certain links with economic life—their aims are not typically economic. [4]

Those individual forms of employment providing opportunities for earning where the employer is *not* an organization belonging typically to the private sector,

* Where more than one source was found, the data of the Central Statistical Office were taken into account.

also have to be left out of consideration; such are e.g. domestic servants and self-employed professionals.

The various employment relations connected with the private sector are as follows [5]:

independent (self-employed) persons are the individually working peasants, the artisans and shopkeepers working on the basis of trading or other licences, furthermore the members of joint ventures (associations, partnerships, etc.);

employees are those who are regularly working for independent people or other entities and are paid wages (salaries) for their work;

assisting family members are the persons who regularly participate in the activities of self-employed artisans, retail shopkeepers, etc. without establishing employment relations and without being paid for it.

It is questionable whether those working illegally with legal entities should be included in this sphere. According to our opinion, as far as possible, they also have to be taken into account, since from our point of view they are *in fact participating* in the activities of the legal private sector and this circumstance is more important than the question whether their contribution is formally documented or not.* At the same time the organizations the activity of which is illegal (which can also be personal undertakings) can by no means be fitted into the framework of the legal private sector.

The present system of statistical recording does not reckon with the number of employees who are not registered with the authorities.

According to a conservative estimate of ours the number of people regularly performing illegal work in the private sector is approximately 120–130 thousand, i.e. the capacity in terms of working hours of the illegal helpers equals the worktime of so many full-time workers. The estimates based on experience indicate that the breakdown of this capacity by the particular forms of organization is the following:

— private farms	30 thousand
— small-scale industry	60 thousand
— retail trade	20 thousand
— joint ventures (associations, workteams)	10 thousand

This means that at least 120 thousand persons earn money or receive supplementary earnings illegally within the framework of the private sector.

The statistical recording of the labour force distorts the figures in both directions. Namely, a small part of those qualified as belonging to the private sector—in our opinion not more than 4–5 thousand people—may be taken into account more than once if they undertake a second (part-time) job beside their main occupation in another sphere of the private sector (e.g. an artisan may also be recorded as a member of an economic workteam beside his or her main job).

According to what has been said earlier, distortions in the opposite direction—to the effect of lessening the number of the participants—are much more significant.

* This is the practice also followed by the Central Statistical Office, when e.g. they work on the basis of estimating the labour force and also include the non-registered assisting family members.

3. The forms of organization

3.1 Personal undertakings

3.1.1 Individual farmers

Even after the nationwide reorganization of agriculture in 1959–1962 there have remained some small-scale producers who pursue animal husbandry or plant cultivation within the frameworks of their individual farms. They have nobody to represent and protect their interests and the state organs keep no records about their number and the characteristics of their activities.

As reflected in the information given by the officials of the Ministry of Agriculture and Food Processing* the provisions of law set no special conditions for commencing an agricultural undertaking (as e.g. professional qualification). No licence is needed for pursuing such activities. Legal regulations do not delimit the sphere of activities nor the size of capital invested (the area of land, number of buildings, livestock, tractors, etc.).

The number of the individually farming peasants can be judged from the estimates the Central Statistical Office made on the basis of data collected in the course of the last census.

Table 2

Number of individual farmers in agriculture

1981	1982	1983	1984	1985
33 000	31 000	29 200	27 400	29 000

No data are available about the proportions between the various branches of farming (e.g. plant-cultivation *versus* animal breeding) nor regarding the shares of farmers and assistant workers. It may be assumed with good reason that the average number of the assisting workers at last equals that of the farmers, consequently it must currently be about 30 thousand.

3.1.2 Artisans

The artisans are engaged in consumers' and other services, furthermore carry out small-scale industrial activities, including the production of commodities, maintenance and repairs and even construction.

* The Department for Household Plots and Auxiliary Farming.

There are two major groups of small-scale industry: activities which require and those which do not require professional qualification. The first group includes those trades for which skilled workers are trained. According to the data of the National Federation of Artisans currently there are 198 such trades pursued by artisans.

Any activity for which no professional training exists can be pursued as an unskilled trade (i.e. for which no professional qualification is needed). The number of these activities amounts to several hundreds.

Before 1982 the legal provisions contained an itemized list of the activities allowed in the framework of the small-scale industry. Since 1982 this has substantially changed and at present any industrial type of activity may be pursued which is not prohibited by some regulation of law. Hence, the range of these activities has significantly expanded.

For any activity of the small-scale industry an official permit called trade licence is needed in Hungary. Before 1982 the official bodies were authorized to weigh* whether or not to grant a licence if an application was submitted. Since 1982 obtaining a trade licence is a right of the citizens. Licensing can only be denied if the permission would violate some provision of law.

As regards employment relations, the exercising of a trade allows several types of labour relations:

1. The artisan pursuing his activities in his main worktime is an *artisan by his chief profession* (self-employed). In the course of his activities he is allowed to engage employees, assisting family members, outworkers and apprentices, too. The maximum number of these may be simultaneously

— 6 employees (or outworkers);

— 6 assisting family members;

— 3 apprentices.

Thus, the number of those regularly working in a shop of the small-scale industry may be maximum 16 (including the artisan himself)**

2. The *part-time artisan* (being at the same time a worker of a state-owned firm or a member of a cooperative) is allowed to employ exclusively assistant family members.

3. Essentially the same applies to the *retired artisan,* with the modification, however, that he may train apprentices, too.

In the early 1980s the number of artisans increased with a dynamics not experienced since 25 years.

The increase of the labour force was especially rapid in the first two years of the studied period. As a result of the extended sphere of activities open for the small-scale industry an inflow of new enterprising groups took place. By the end of the period

* Considering e.g. the viewpoints of supply.—Ed. note.

** There is an important sub-category: widows may carry on the trade of the decreased artisan; in trades where a qualification is needed they must employ a skilled worker.—Ed. note.

Table 3
Number of the artisans by forms of employment between 1981 and 1985
Capita

	1981	1982	1983	1984	1985	Increment
Full time (self-employed)	68 915	73 048	76 518	76 113	77 281	8 366
Part-time (also keeping up their main job)	30 837	35 417	40 945	47 204	51 159	20 322
Pensioners	12 208	12 935	14 340	15 633	17 143	4 945
Total	111 960	121 400	131 803	138 950	145 583	33 623

Source: A kisipar fontosabb adatai (Major data of the small-scale industry). Central Statistical Office, Budapest 1985.

dynamics were strongly reduced because the "extensive reserves" had become exhausted and other forms of small-scale undertakings increasingly offered alternatives for choosing organizational forms.

The increase in the number of workforce was mainly produced by those who applied for and were granted trade licence beside keeping their earlier job. The number of those choosing small-scale industry as their main occupation grew significantly only for a short time and has been practically stagnating since 1983. As a result of this, the internal structure of the small-scale industry is intensively changing: the share of the part-time workers has increased from 28 to 35 percent and the relatively small number of retired craftsmen remained essentially unchanged (11 percent).

The structural transformation entails that the work-time potential (number of available man-hours) of the small-scale industry is not growing proportionately to the number of workers. According to a possible method of calculating the worktime capacity, the daily worktime of full-time artisans is 8 hours while that of those belonging to the two other categories is 4 hours each. Reckoning annually with 230 workdays, the worktime capacity of the small-scale industry (leaving out of consideration the employees and assisting family members) increased within 4 years by only 23 percent (from 166 to 205 million man-hours).

For understanding the process of changing labour in the small-scale industry further data are provided by breaking it down by national economic branches. In the years between 1981–1985 it was only in the transport branch that the number of those working full-time substantially increased (approximately trebled). In the construction and other industries there was a decrease of about 5–8 percent. Growth was also the greatest (about 17-fold) in the sphere of transport as regards part-time workers. Round 50 percent of the increase in the number of part-time workers appeared in this sector of the national economy.

In spite of the transport branch pushing relatively forward, the most populous are the industrial trades (44 percent of the artisans are engaged in them), while the share of construction is invariably significant (30 percent). The attractive power of the service trades is gradually declining.

The analysis of professional rearrangement shows that the workforce in the traditionally populous trades (masons, electricians, house-painters, tailors) is invariably high but not increasing. The trades where the workforce increases are: lorry-transport, personal transport (taxi), car repair, engine fitting. It must be noted that in the first two the signs of saturation began to show up in 1984–1985.

The division of the small-scale industry by *types of settlement* shows that though a significant part of them are working in villages, their number has been stagnating in the last few years, since the 34-thousand increase of artisans took place in the towns (first of all in Budapest). This phenomenon is also an indication that on the level of small communities the traditional activities are losing their attractiveness further on.

The vast majority of artisans (82 percent) are men; the number of woman artisans is—traditionally—low. Typically female trades are: dressmakers, hair-dressers, or knitting.

Two contradictory movements are hidden in the background of the global growth of labour in the small-scale industry. For a long time the *rate of fluctuation* has been very high. This is also reflected by the data of 1985.

Table 4

Fluctuation in the number of artisans by forms of employment in 1985, relative to 1984

	Trade licence			Fluctuation in percent
	newly issued	terminated	returned	
Full-time	21	18	1	40
Part-time	31	22	1	54
Pensioners	23	14	0	37
Total	25	19	1	45

Source: KSH (Central Statistical Office).

Almost half of the artisans leave the borders of small-scale industry every year. Taking into account the annual movements, it can be seen that every fourth artisan comes from the "beginners", while one-fifth of them terminates his work in the small-scale industry.

In addition to the artisans a great number of subsidiary workers are working in the small-scale shops. The breakdown of and changes in their number are summarized in the following table.

The number of employees grew by 26 percent, faster than that of their employers, of the full-time artisans (where growth was 12 percent). Despite this growth, the

Table 5

Number of employees, apprentices and assistant family members engaged in the small-scale industry between 1981–1985

	1981	1982	1983	1984	1985	Increment 1981–1985
Employees	18 224	18 471	20 562	21 242	22 966	4 742
Apprentices	4 018	4 664	5 343	5 687	6 009	1 991
Assisting family members	15 662	16 750	18 412	19 485	20 523	4 861

Source: A kisipar fontosabb adatai (Major data of the small-scale industry). Central Statistical Office.

proportion of employees to full-time artisans is still 0.3, i.e. far below the highest possible level.

Only about 17 percent of the self-employed (full-time) artisans engage some employees. (The share of those having at least three is hardly 2 percent!)

The trades employing the most employees are: masons, house-painters, engine fitters, car repair fitters, electricians.

The number of the employees is based on the records of social insurance, yet it may be supposed that the artisans regularly engage (and pay) not a 23 but at least 70–80 thousand employees.

The situation with the number of assistant family members is similar, their number is estimated by the Central Statistical Office at 20.5 thousand. The trades employing the most family members are: masons, the miscellaneous petty industries, dressmakers, knitters.

Taking finally into account the full-time jobs, between 1981–1985 the number of the self-employed artisans grew by 8366 persons and that of full-time employees by 4742, i.e. altogether 13 108 new jobs were created in the small-scale industry.

3.1.3 Retail shopkeepers

Similarly to the small-scale industry, retail trading activities may only be pursued on the basis of official licences. The authorization of the state organs for weighing the granting of licences ceased to exist here, too, hence, if the (professional and other) conditions are fulfilled, obtaining the licence is a right by citizenship.

Keeping private shops is only allowed in certain—officially listed—spheres of profession. The number of these is today, in 1986, 117.

An independent private merchant may, in general, engage 5 employees and 3 apprentices. In certain fields (such as restaurants, campings, cook-shops, boarding houses) the number of employees that may simultaneously be employed is 9. But it is a general rule that the number of employees and assisting family members together must not exceed 12.

The number of private shopkeepers was steeply increasing between 1981–1985, from 13 to 28 thousand, i.e. by 110 percent. The new full-time jobs created in private commerce (of merchants and employees) amounts to about 12 thousand. In opposition to the small-scale industry, the growth of the labour force was intensive both in the first and the second half of the period.

The number of employees and assisting family members working in private retail shops is relatively higher than the corresponding share observed in the small-scale industry. This may be owing to the fact that the vast majority (about 80 percent) of the private shopkeepers pursue their activity as a *full-time job*, the live-labour-intensity of which is higher than in most of the small-scale industrial branches. Despite this, even here

1. the number of employees is far below the level allowed by legal provisions,
2. the employers register with the authorities at most half or one-third of the actually engaged employees.

3.2 Common ventures

3.2.1 Economic workteams

From among the new forms of organization of the private sector the economic workteam* is the most widespread one. Such types of organizations can be found in most of the industrial branches and sub-branches.

An economic workteam may be run by at least 2 but maximum 30 private persons. The number of employees may vary between 0 and 10, depending on the number of members.

The economic workteams may perform consumers' and other services, small-scale production and complementary tasks to the activities of economic organizations. The range of the activities that may be chosen is very broad; practically anything allowed for the cooperative sector may be practised, with the exception of trading. If pursuing some activity is dependent on some professional qualification the workteam may engage in it if there is someone among its members who meets the professional requirements.

Both the members and the employees may contribute to the activity of the collective as full-time or part-time workers. The latter may only take part in the

* In some English publications also the terms *economic working community* or *working panel* may be found.—Ed. note.

economic workteam's activities with the previous approval of their employers in their main job.

In addition to the members and employees the economic workteams may also employ assisting family members (without limitation) as well as apprentices (under conditions similar to those in the small-scale industry).

The form of workteam has been continuously spreading since 1982. By the end of 1985 the number of such associations was 10 118 in Hungary, that of their members 55 436, 25 percent of whom were working full-time, i.e. this was their main occupation.*

During the 3-year period between the end of 1982 and 1985 the number of the economic workteams increased 5.5-fold, and that of the members 6-fold.

The proportion of 3:1 between the part-time and the full-time workers did not change. This demonstrates that—similarly to the small-scale industry—the majority of those undertaking work in the private sector do not want to abandon their job in the socialist sector, either. On the other hand, the range of workers is gradually expanding who take the risk of becoming independent and utilize their skills in some special sections of the market.

Especially many economic workteams can be found in three branches of the national economy: about 50 percent of them work in the field of personal and economic services and 25 percent each in the building and in various other branches of the industry. Those working full-time are engaged mostly in the productive sectors. The average number of members in these associations is slowly but permanently increasing. (From 5.6 in the beginning to 6 persons.) More than half of the economic workteams came into being in the capital of the country and in its gravitation sphere. 45 percent of them operate in the capital but the share of those working in Pest county is also significant (7 percent).

The number of people employed by the economic workteams is growing in direct proportion to the increasing number of the teams. Despite this fact, engaging employees is not widely popular, maximum one-fifth of the 9 312 teams work with at least one employee.

Almost 60 percent of the employees can be found in the teams with premises in the vicinity of Budapest. The number of persons engaged in other forms is negligible: altogether 131 persons were registered as such even in 1985. The total workforce engaged by the economic workteams is: 14 251 full-time members, 3 824 full-time employees, adding up altogether to 18,075 persons who positively earn their living in the workteams. A further 42 372 members and employees are engaged part-time by the economic workteams.

* There are as yet no all-embracing and detailed statistical records regarding the economic workteams. For this reason we had to rely on the data of the Ministry of Finance which—though only covering the workteams connected with the state budget—enabled us to perform a more detailed analysis. Hence, about 8 percent of the economic workteams are left out of observation, those which fill out no tax returns in the given year; this distorts the analysis to a verv small extent.

We have no overall view of the extent and directions of the fluctuation. According to the available data 10 percent of the organizations have been liquidated (approximately 1 000 of them within 3 years), indicating that these small organizations fulfil actual demand. The movement of members (entering and quitting) is rather frequent. But no data are available which would show which the sector of the economy is where the people changing their job find new employment.

The average number of the members and employees of the economic workteams demonstrates that jobs involving full-time work are only created very cautiously, depending exclusively on real demand. The limits of permitted employment are in themselves broad enough, so that engaging new employees is a matter depending—even in the present structure—merely on the market relations and the conditions of interestedness.

3.2.2 Civil-law associations

The institution of civil-law association established by legislation some decades earlier has been playing an actual part in the organizational structure of the economy since 1978. This form of small enterprise has not become very popular, owing to the tax burden which is much more unfavourable than that of the other forms. Nevertheless the form still exists.

From a legal point of view the civil-law association is a category much more comprehensive than the economic workteam. Yet, as regards the operating conditions, the civil-law association's degree of freedom is more limited: it may exclusively undertake activities which are not licensed trades or subject to special permits (i.e. widening the range of the small-scale industry has automatically reduced the range of activities allowed for the civil-law associations). In principle, the civil-law associations must not engage employees and assistant family members—the number of the members is, in turn, not limited. Beyond independent economic organizing activities the civil-law associations were destined by the regulations for renting certain units in state ownership or to operate such units on the basis of lease contracts. Lease contracts, however, came into existence only in very few cases. At the same time the regulation endeavoured to rally the retail shopkeepers in civil-law associations and in 1985 more than 500 retailers' civil-law associations were in operation.

Obviously, most of the civil-law associations operate in those sectors of the national economy which are lying far from the sphere of industry, i.e., in the fields of services and retail trade. In 1985, for instance, 72 civil-law associations were engaged in personal and economic services with 469 full-time and part-time members and employees and only 15 in the sphere of industry with altogether 62 members and 4 employees.

The civil-law associations only created a few new jobs. There are 1,278 members and 506 employees working full-time, amounting together to 1,784 jobs. Part-time members (980) and assistant employees (89) come to more than thousand people who are granted supplementary work and income.

3.2.3 Other workteams

In the range of the joint undertakings some other formations than those dealt with in the foregoing may also be found; part of them have traditions of several decades (such as the lawyers' associations), relatively new are the workteams for training drivers, other teachers' teams, legal advisors' and solicitors' workteams. A common characteristic of theirs is that their sphere of activities is rather limited, hence they will never become targets of job-seeking masses. Their staff hardly changed during the analysed period.

4. Summary

In the early 1908s the total number of those working in the private sector increased by about 120 thousand. As regards the breakdown by forms of employment the number of full-time workers increased in the priv ;ector by 46 thousand.

Table 6

Breakdown of the jobs created between 1981–1985 in the sphere of small-scale enterprise by forms of organization and employment relations

	Self-employed	Employees
Small-scale industry	8 400	4 700
Private retail trading	12 800	3 000
Economic workteams	14 200	3 800
Civil-law associations	1 300	500
Other undertakings	1 000	300
Total	1 000	12 300
Total number of new jobs		50 000
Decrease in agriculture		4 000
Total increase of jobs in the private sector		46 000

The number of those working part-time (second job) and of assistant family members also increased by 75 thousand. In another division, half of the growth in jobs came about owing to the spreading of the new forms of organization, while the other half appeared in the traditional forms. The increase of employment did not uniformly affect the various forms of organization. Small-scale industry has remained and continues to be the most populous form of private enterprise, though its hegemony—

measured by the number of workforce—has been broken, owing mainly to the decrease of the new generation who might establish small-scale industrial workshops as their main occupation. In the eighties it was the number of the economic workteams that increased most conspicuously. By 1985 this became the second most populous form of organization in the private sector. In the private trade, too, an above-average increase of the workforce took place. It is worth of attention that the proportion of those working full-time, as a main occupation, is the highest in this branch. The labour force in the private sector of agriculture seems to be stagnating though this opinion is based on expert estimates. The significance of all the other forms of organization not mentioned here is small in employment, even if measured by internal yardsticks of the private sector. Their significance is considerable not so much from the viewpoint of employment but rather for meeting demands.

The fact that the number of units which are able to employ some labour has considerably grown in the private sector is a phenomenon more important for the Hungarian employment policy than the increasing number of the workforce itself.

From the approximately 210–220 thousand organizational units to be found in this sphere about 120 thousand are suited for creating new jobs, these are the job-creating basis of the private sector. In principle, their ability to absorb labour may even be of a magnitude of a hundred thousand new jobs. It is also a fact worth of attention that the job structure of the private sector is able to employ workforce of any professional skill, in any of the national economic sectors already with the current limits.

This capacity to absorb labour in terms of both quantity and quality is—under the present circumstances—unutilized, since the state regulations and market conditions exert a restrictive influence.

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BOOK REVIEWS

KÖVES, A.: *The CMEA countries in the world economy: turning inwards or turning outwards.* Akadémiai Kiadó, Budapest 1985. 248. p.

This book by András *Köves* is devoted to East–West trade, the foreign economic policies of the CMEA countries and their economic development strategies. He introduces the discussion on selected aspects of relations between the socialist economies and the world economy with a question which represents the focus of the problem: should the socialist countries pursue lasting and active participation in the worldwide division of labour or should they refrain from this participation and isolate themselves from the world economy?

We know that in the development of economic policies in the socialist countries it is possible to observe stages in which an orientation towards self-sufficiency, isolation and autarky predominate. The inertia of such long-term trends is still felt at present and among some economists it survives in a modified version, as an orientation towards regional self-sufficiency of the CMEA. András Köves's reply is unequivocally in favour of an opposite, alternative economic strategy which strives for an open economy. The author arrives at the conclusion that the necessity for increased participation in the international division of labour and an opening up towards the world economy has become inevitable in view of the requirements of domestic, social and economic development in each CMEA member country. This is the basic message of the book and the manner in which it is argued is all the more valuable since the author writes with a full awareness of the fact that "opening" is a long process, demanding difficult economic policy decisions. Substantial changes in the external environment have created a number of obstacles to an orientation towards an open economy. There are also those who during the seventies (and they can still be heard occasionally) declared the impossibility of implementing effective economic policies of this kind. While Köves does not underestimate the limitations and difficulties connected with the alternative of turning outwards, his analysis of the new situation created in the seventies and eighties leads him to the conclusion that the problems of how the economies of individual countries should join the world economy, how they should participate in the worldwide division of labour, and what broad strategy of economic development they should choose is now more pressing than ever before. In the author's opinion the future economic development of the CMEA member countries will depend, to a great extent, upon finding solutions to these difficult problems, which will becomc integral components of a new, effective economic strategy and an alternative *modus operandi* of the socialist economy.

Köves derives his concept from an analysis of new, often unexpected and negative aspects of the world economy and their influence on the economies of the smaller CMEA member countries. He also takes into consideration the ineffectiveness of previously chosen economic policies and the methods by which they strove to acquire a stable supply of raw materials and energy within the framework of the CMEA in the seventies.

Köves's study may be considered to be a highly competent and qualified contribution to the worldwide discussion taking place on those problems dominating the field of international economics. Specialists in this field are giving particular attention to the effects which new conditions in foreign trade and in international finance are having on the unexpected slowing down of growth in the CMEA member economies—including symptoms of stagnation and the tardy and ineffective reactions of policy-makers in centrally planned economies. Köves's analysis is factual, open and has the form of a polemical discussion on the—as yet unresolved—problems of economic policy. He does not avoid the pressing problems connected with the existing situation and with the future orientation of mutual relations among the CMEA member countries, which have often been considered taboo in the writings of many economists in the socialist countries. This is one of the most positive aspects of his arguments in favour of a new, more effective economic strategy.

The author organizes his analysis into four parts and 14 chapters.

Part one ("An active foreign economic policy or seclusion? Some historical antecedents") provides a historical background to the current dilemma facing policy-makers and provides an understanding of the complexity of choosing among alternatives in foreign economic policy. The author describes *selected* periods in the development of East–West trade, which have been characterized by the alternatives of an inward or outward turned orientation in the development of the socialist economies. Immediately after 1917 and during the twenties in the USSR, we encountered the first attempts of an active foreign economic policy. This was specifically implemented in the form of a policy which granted concessions, created mixed companies and established contracts for technical aid. This policy lasted until 1928, when, during the first five-year plan, it was completely abandoned. The radical reduction of imports after the year 1931 made it possible in the course of the next five years, to achieve equilibrium in the balance of payments and to solve the problem of foreign debt. Import restrictions became a component of long-term development strategy in Soviet foreign economic relations. Köves considers the change towards an essentially autarkic economic policy to be the manifestation of political priorities in a given political and economic situation. This inward looking policy entailed substantial costs in terms of economic development. The reduction of economic relations with Western countries is not considered by the author to have been the only possible alternative or a warranted solution.

In this historical digression Köves specifically analyses the impact of Western restrictions on East–West trade after World War II. In his opinion a policy of embargo contributed to a situation where the small countries started to implement the same type of economic development strategy as that used in the USSR, including the autarkic trends of the thirties. This "individual" autarky in the small socialist countries was, moreover, accompanied by an orientation towards regional autarky within the CMEA. However, developments since then have shown that this inward-turning tendency did not reduce their sensitivity and vulnerability to foreign trade.

Part two ("East–West trade and the foreign economic policy alternatives of the CMEA countries") analyses changes which occurred in the course of the seventies and discusses contemporary problems in East–West trade. In this fundamental section of the book, the reader will find some unconventional conclusions, which differ from the opinions of some economists in the socialist countries. Köves's opinions are especially relevant from the point of view of the alternatives open to central policy-makers. The author first analyses the consequences of an orientation towards self-sufficiency. In the middle of the seventies a turnabout in the preceding trend occurred for, since the second half of the sixties, there had been a tendency towards a faster growth of East–West trade in comparison to the development of total trade among OECD members. However, during the period between 1975–1983 the share of small CMEA member countries in exports from the OECD countries dropped sharply and was lower than in 1965.

An analysis of the long-term changes in the distribution of the CMEA regions' trade with the West (by examining the separate socialist countries) in the period between 1965–1983 reveals new important features in East–West trade: the growing foreign trade orientation of the Soviet economy on the one hand, accompanied by a decline in the share of small socialist countries in the total trade turnover of the CMEA region with the West on the other (in the case of Hungary this decline is relatively moderate—its greatest significance is in the most developed countries, the GDR and Czechoslovakia, whose shares in 1983 were lower than in 1965). An orientation towards a radical restriction of imports in the eighties unavoidably contributed to stagnation or to very small rates of growth and, in the final analysis, also to low export efficiency.

Köves finds that the trade surplus—achieved in an emergency situation in the course of the eighties on the basis of a restrictive import policy—did not indicate a turning point in the economic position of the socialist countries.

Köves, together with a number of other economists, stresses the asymmetry of East–West trade: in the total trade of the CMEA member countries the share of developed Western countries is much higher than the share of the CMEA member countries in the trade of OECD member countries. This phenomenon, which is independent of the slow or more rapid development of trade, was already apparent before the eighties. Köves notes that this is testimony to the fact that East–West trade is more important for the economies of the CMEA member countries than for the OECD member countries.

Köves analyses the potentialities of the Hungarian economy in the context of the negative influences of the world economy. He shows, with a marked polemic bias, that development and the existence of economic tensions cannot be explained in a satisfactory manner exclusively with the impact of external, "objectively existing" factors. An investigation of the causes of the clear deterioration of the terms of trade leads the author to distinguish externally determined factors from those which can be influenced by adapting to new conditions. He uses persuasive arguments to illustrate that world economic changes brought a number of economic problems to the surface, i.e. the sharp and aggravating tensions that had existed in the Hungarian economy earlier, but had not been obvious. For the economic policy-makers it follows that changes on world markets appear to be external conditions which cannot be influenced, unless the economic structure is transformed and adequate changes are made in the economic mechanism and in economic policy attitudes. Most important, in his opinion, is that the modernization of the economic structure should not be reduced merely to the problem of investments, because an economic decision is also an integral component of the necessary conditions for the transformation of the structure of the economy. The author rejects the possibility of defining a generalized, modern structure which would suit every country. Modernity can best be measured by the efficiency of participation in the world economy—by export performance.

Köves also critically analyses Hungarian development policy in the seventies. He shows that a satisfactory solution to structural problems and modernization does not involve machinery imports and the transfer of technology from the West—especially when this progressive technology is then implemented within the framework of an inefficient institutional framework and such imports are closely subordinated to plans aimed at improving the internal supply of raw materials and energy within the CMEA region. In the author's opinion, in spite of the fact that the need for an active export policy oriented towards Western markets is generally acknowledged, this strategically important problem continues to remain on the periphery of long-term development strategy.

It is in this context that he also assesses the often discussed problem of the "large-scale, excessive imports" of machinery and technology by the CMEA member countries from outside the region. However, statistics indicate that the CMEA member countries imported less machinery and technology than, for instance, the developing countries. The essence of the problem is that the transfer of technology cannot serve as a substitute for the operation of an efficient internal economic mechanism.

Köves also makes an interesting contribution to the on-going discussion concerning the situation and orientation of CMEA cooperation and East–West trade when he analyses the results achieved by the small CMEA member countries in replacing imports from the West by cooperation and regional imports among the CMEA countries. He demonstrates, using Hungary as an example, that not only have imports from the socialist countries not helped to ease the burden of trade with the non-socialist countries, but directly or indirectly they have become the source of a significant demand for imports from world markets. Specialization in intermediary products continues to be one of the weakest links in regional cooperation, while mutual trade in machines within the region has not reduced the size of the technological gap.

The traditional, bilaterally-balanced trade and unchanged mechanism of cooperation have not contributed to a decrease in the content of Western imports or an improvement in the cooperation relations between the CMEA member countries. Nor is the practice of non-rouble trade among CMEA member countries an alternative solution. It is for this reason that Köves places such great stress on the need to formulate a long-term economic and political concept in this area as a high priority task. The legitimacy of this point of view is also confirmed by an analysis of the unbalanced credit-raising policy pursued. Experiences from the seventies indicate that when an active credit-raising policy is not accompanied by a change in the whole approach of economic policy, it not only fails to lead to the expected results, but can even lead to a confrontation of economic pressures and difficulties in controlling the debt-service process. In Köves's opinion one of the most important experiences gained during the seventies in the socialist countries has led to the knowledge that the debt burden has taken on huge dimensions, primarily because economic strategies have not changed. In polemics with some economists in the socialist countries he shows that an inward-looking strategy striving for regional self-sufficiency has proved to be unworkable, as far as a number of assumed effects is concerned. When discussing the continuation of an obsolete import-substituting strategy, the author stresses the danger of an increasingly large technology gap and the unsatisfactory growth of labour productivity and living standards. Finally, he stresses that such an orientation becomes an obstacle to cooperation within the CMEA member countries.

Köves realistically assesses the nature of the difficulties which make a reorientation towards an outwardly-turning economy difficult. However, he does not share the scepticism of some Western scholars who think it is impossible to carry out changes towards a new strategy. On the contrary, he derives the need to abandon obsolete orientations, which are unrealistic and dangerous, from an analysis of effective solutions to problems. This critical analysis is completed by constructively formulated comments on the assumptions required for a transition to a really export-oriented economic policy.

Part three deals with some aspects of the Soviet Union's position in East–West trade. The share of the Soviet Union in world exports is less than 5 percent. This has helped to keep alive the conventional wisdom that foreign trade relations are only of marginal importance for the development of the economy of this large industrial power. Köves, however, turns his attention to one of the significant characteristics of East–West trade during the last fifteen years: the Soviet Union has increased its trade with the West more rapidly than the other CMEA countries. He convincingly shows that the previous generalized conclusions concerning an outward-looking orientation for shaping and developing a modern economy are also valid for the Soviet Union. The need for such a reorientation is strenghtened by the slowing down of economic growth, which has appeared in the Soviet economy earlier and with greater intensity than in the majority of the CMEA member countries. In this context the author, however, again stresses that the effects of technology transfers primarily depend on the effective functioning of the economic mechanism in the domestic economy and on the existence of an adequate economic policy. Political factors which are subject to substantial fluctuations have so far not had the required stabilization effect for increasing economic relations between the Soviet Union on the one side and the West, including the USA, on the other.

The final, fourth part of the book contains two chapters on the CMEA member countries and the international division of labour. The author examines the prerequisites required for and the obstacles to the development of compensation, cooperation and joint ventures in East–West trade. He finds a number of barriers to the development of these new forms of economic relations. So far they have played a smaller role in accelerating innovations and supporting exports than had been expected. It is significant that joint enterprises are unable to play a more positive role under the existing economic policies because they give priority to import substitution and self-sufficiency and rely on traditional or only partially modified instruments of economic management. Cooperation difficulties are not only an expression of the weakness of cooperation forms but also of the fact that successful cooperation assumes the existence of certain conditions with regard to economic mechanism and economic policy, including their outward-looking orientation.

The final chapter of the book deals with unsolved problems of mutual relations between CMEA member countries and the Common Market. Here the author recommends that the negative effects of protectionist policies and discriminatory obstacles directed at the CMEA member countries on the part of the EEC be overcome by the CMEA countries themselves—that is, by increasing their own export ability. He points out that a weak exporter will always have difficulties, if he does not adjust to the requirements of world markets. He also stresses the close correlation between developing economic relations with international organizations at the enterprise as well as government level and the opening up of the national economies of the CMEA members towards the world economy.

A. Köves's book is an important contribution to the on-going discussion in the field of foreign economic policy; it provides an informed survey of the complicated contemporary development of socialist economies from the inside. The author's detailed familiarity with literary sources and his critical assessment of various opinions and points of view, as well as his own interpretation of the facts of economic reality, make it possible for him to take an independent stand concerning the subject at hand. The author's analyses and comments belong to that school of economic thought which is characterized by a markedly analytical approach to the causes of the steady erosion of competitiveness of the Eastern economies on Western markets. A. Köves formulates a number of important and constructive stands in which he strives to overcome the present unsatisfactory development of efficiency by the creation of a new economic strategy and an alternative framework of functioning of the national economies of the CMEA countries.

K. KOUBA

LAVIGNE, M.–ANDREFF, W. (Eds.): *La réalité socialiste. Crise, adaptation, progrès*. (Socialist realities. Crises, adaptation, progress). Ed. Economica, Paris 1985. 230 p.

Among Western researchers of the Eastern European socialist economies an eminent place is taken by Marie *Lavigne* and her research group at the University of Paris. Their earlier research works concentrated on the theory of planning and of economic regulation. In the present publication, their starting-point is the daily realities of the socialist economy. Each study relies on the results of thorough research work and statistics. The ten analyses published in the volume do not aim at drawing coordinated conclusions: in some cases they take different standpoints.

The authors of the first chapter: W. *Andreff* and G. *Graziani* examine the interactions of foreign economic constraints and adjustment policy. In evaluating the role of the foreign economic constraints, they deem it necessary to determine which external variables may be hindering economic development, and further, what it is exactly they hinder.

The major external variables are: foreign trade deficit, the weight of imported goods on the domestic market, world market prices, international rates of interest, and changes in the debt stock. According to most Western opinions, the basic question is that of foreign debts or domestic adjustment. According to the authors, however, there is no such clear alternative: indebtedness completes rather than replaces the process of domestic economic adjustment. By the latter they understand industrial policy, anti-cyclical policy, and trade policy.

They make, of course, a distinction between the effect of external constraints on each socialist country, and such consequences of East–West (CMEA and Western) economic relations. For example, Poland is one of the least open economies, while in its Western relations it is the most open one, together with Hungary. Obviously, the Soviet Union is much less exposed to the foreign economic developments than the Six of the CMEA (the book was written before the oil price drop). At the same time, also in respect of relations within the CMEA, the Soviet Union appears as creditor and the Six as debtors. As for the necessity of economic adjustment, this is not the most important circumstance. Unfortunately, the authors do not examine the quantity problems of Soviet raw material deliveries, though in our days this is exactly the field where real external constraints may develop within the CMEA trade.

At the end of their study, the authors present each socialist country's economic policy reaction on the foreign economic impacts of the late 1970s and early 1980s in detail. With the exception of the Soviet Union, all reacted on their worsening economic situation by some austerity measure.

In the following study M. *Drach* examines the interrelations between cyclical economic growth in the socialist countries, and their investment rate.

According to him, centrally planned economies are unable to manage their investment efficiently, over-investment is generally characteristic of them, which the author illustrates with the Polish economic policy of the 1970s.

In her study, B. *Rogulska* searches for the roots of the crisis phenomena found in the Eastern European socialist countries. She tries to demonstrate that, in spite of widely spread views, it is not politics that is dominating in producing the crises, but economy. She holds this opinion to be generally true of the socialist countries. According to her, the main field of social conflicts is industry, and within it, enterprises. To prove this, she quotes a series of examples taken from Poland, from the strikes of the 1970s to the movements of the 1980s. On the basis of the economic solutions qualified by her as only symbolical. She challenges the viability of the Hungarian-type reforms, if asserted only in the field of economy.

After these global analyses, the second part of the book starts analysing empirical and statistical data. G. *Duchene* is here the first to try to determine the weight of defence costs in the national economic accounts of the Soviet Union. This is, as is well known, one of the favourite subjects of kremlinologists. Several contradictory results have been produced, for example, the data of the CIA repeatedly—and to no little extent—modified, based on computations with dollar and rouble prices. The other main way is to assess residuals, i.e. to deduct the figures of civilian final consumption from the output figures of the Soviet national economic balances and to compute, from the residuals received, the presumable defence costs. The correctness of the results is doubtful in both cases, because of the insufficiency of basic data. Therefore, the author uses the data of the national income (Net Material Product) available in more detail and continuously. An additional advantage of this is their compatibility with the data of the input-output tables. Of course, the basic data carry several uncertainties from the aspect of the computation, the pieces of information must be completed with various estimations; certain estimated coefficients cannot be dispensed with even with the author's method.

The author of the next study, B. B. *Vilá* investigates the Soviet budgetary data between 1965 and 1982 in his attempt to demonstrate periods of recession. He separately examines the scientific-educational, health, social insurance, and social welfare items. Since he finds no decrease, he infers the periodical breaks in Soviet development from the sudden increases, or mainly from the decreases, of the growth rates.

The following analysis of the second part of the book (J. *Boncœur*) is less an analysis than a highly detailed presentation of data, let us add, of data not without interest. The data show the development that took place in housing construction, in the CMEA countries and Yugoslavia between 1960 and 1983, including periodical recessions. The value of the statistical tables and charts is enhanced by the fact that comparisons are also made with the corresponding data of the West European countries, which, in a certain sense, put the sets of figures in context.

The study by D. *Redor* analyses income distribution tendencies in the socialist countries, with special regard to relations between personal incomes (wages) and the national income. As for the latter, the determination of two factors present serious difficulties: assessment of the national income itself and, because of the differences of Eastern and Western statistics, determination of the price indices and within them, those of consumer goods give rise to many disputes. The author presents the changes in the personal incomes part of the national income between 1962 and 1980 using the example of three countries (Hungary, Poland, GDR). Finally, he examines central wage regulation, capital accumulation, the development of productivity and, through all these, the structural crisis phenomena of the 1970s and 1980s in their interactions.

The third part of the volume starts with X. *Richet*'s study, presenting the development of the Hungarian economy and of its control and management system. By the early 1980s, the growth rate of Hungarian economic development had fallen to between 0–1 percent from the earlier values of about 6 (1967–1973), and 3 percent (1976–1980). Among the causes, there are the sudden increases of primary energy prices and the wrong reaction on them, as well as the continuous worsening of the terms of trade. The problem of indebtedness is also emphasized by the author; that the debt stock became impossible to increase further was a direct cause of the same importance.

The economic turn of 1978 was in any case of a decisive importance in Hungary. Priority was then given to foreign economic equilibrium and to preserving the living standards to the prejudice of growth and investment. The maintenance of the foreign economic equilibrium still increased in importance in 1982, as a consequence of the well-known liquidity difficulties. At that time, in addition to the earlier introduced strong restriction of investment and of the competitive price system, import quotas were introduced, and currency devaluations also occurred. The hard restriction was followed by stagnation, but the creditworthiness of the country was maintained, the balance of trade was successfully restored and even turned into a surplus.

The institutional reforms introduced since the late 1970s have produced considerable changes in Hungarian economy. Among other things, sectoral ministries have been liquidated, trusts have been broken up, the second economy has been legalized, private enterprise has been facilitated, and the monopoly of foreign trading enterprises eliminated, etc. These have been highly important steps, which have contributed to easing certain economic tensions. However, according to the author, individual initiative is still limited by the lack of a full assurance that a change in the political-economic management does not again make it impossible for small enterprises to function. At the same time, rather great social inequalities have emerged, and the development of a dual structure also presents difficulties.

At the end of his study, the author asks the question what can be expected in the Hungarian economy: simple, short-term adaptation, or continuation of the reforms? Apart from political inertia, he still judges the institution of further reforms as uncertain, the three main objectives being incompatible. That is, it is difficult to reconcile, in a rational way, the maintenance of foreign trade equilibrium, the preservation of political stability and confidence, and thereby to prepare for a restart of economic growth.

H. *Sachter* selects one of the numerous components of the Yugoslav economic crisis and analyses it in detail. This component is in fact one of the important features of Yugoslav economy: a, one might say exaggerated, regionalization. Through a careful presentation of the Yugoslav literature, he shows the distortions caused by regional autarky in energetics or in the banking system, which then further aggravated the already existing structural, debt, and growth difficulties of the Yugoslav economy.

The closing study of the volume, written by K. *Szymkewicz,* analyses the crisis of the Polish economy. It goes back to the suddenly increased growth rate of the Gierek period of 1971 to 1980, which was based on extremely high foreign debts. The immensely increased investment projects relied on foreign deficit, and at the same time, the high wage increases led to a disorganization of the domestic market, economic recession, and indirectly to the fall of the political leadership.

Also the well-known political events of the early 1980s caused a fall in the national income, inflation rose above 20 percent, shortages grew worse, etc. The country was unable to fulfil its debt service. This rendered trade with the West extremely difficult. A strong reorientation towards the CMEA countries is to be seen. This was not yet changed by the economic reform officially introduced in early 1982. Setting forth certain characteristic features of the reform, the author suggests a few ideas regarding the future. In his opinion, one major dilemma of the Polish leadership will consist in that while Western exports ought to be increased with a view to the debts, the same thing ought to be done in the CMEA trade (with special regard to the Soviet Union), with a view to keeping the trade balance in equilibrium.

To sum up: though not quite on the same standards, the volume elucidates a great many interesting points of the difficulties found in the socialist countries at the turn of the 1970s and 1980s. For the reader interested in the Eastern European socialist countries, it will be by all means useful to get acquainted with the book.

A. TÓTHFALUSI

SCHNEIDER, G.–TRÖDER, M.: *Zur Genesis der Kombinate der zentralgeleiteten Industrie in der Deutschen DR* Berichte des Osteuropa-Instituts an der Freien Universität Berlin, Reihe Wirtschaft und Recht. Heft 137. Berlin 1985. 157 S.

The economy of the GDR has justly come to the foreground of interest in the past years because of its exceptional growth rate in Eastern Europe. While according to official data the GDR's national income showed the slowest growth rate among the

European socialist countries in the first half of the seventies, after the lapse of one decade it managed to achieve the highest rate of growth. In the GDR the official views and the rather close assessment of the economists attribute this achievement i.a. to the so-called combine-effect, i.e., to the special form of central economic management which characteristically regards the combines to be the basic units of central management, the "addresses" of the compulsory plan tasks.

Thus the publication of the Berlin Osteuropa Institute, with long tradition in GDR-researches, hit the bull's eye already by selecting its subject.

The book written by Gernot *Schneider* and Manfred *Tröder* ventures to present the history of evolution of the combine system which plays a crucial role in the GDR's economic strategy, and the decision-making processes concerning the organizational structure of the enterprises in the course of changes in the system of central economic management. The book starts with the definition of the notion of combine as used in the GDR and, subsequently, the history of the setting up and evolution of the combines are studied, until they became the basic link in the chain of central economic management. The treatise ends with the analysis of the probable developments of the near future.

It emerges from the chapter that reviews the notion of combine that the (scientific) definition has gradually been changing parallel to the waves of combine forming. In the sixties the term combine used to mean a big plant amalgamating branches of industry or stages of production in close technological and economic connection (p. 18). By the mid-seventies this definition was modified and since then it has covered factories manufacturing the same products or using similar production technologies (ibid). Thus it became possible to unite e.g. several breweries (at different, remote locations) into one single combine of beer production. According to the 1979 definition the combine is the primary unit of physical production and a modern form of the central economic management in the industry as well as other fields of the national economy. Thus the setting up of combines developed from a possibility into a must. Summing up, G. Schneider, the author of the chapter, states the following: 1. the notion of combine as used in the GDR is not identical with the classic concept used in industrial business economics. 2. The GDR economic literature does not contain any scientific support for this difference. 3. In the GDR, unlike the other East-European countries, the combine system precludes alternative forms of enterprise organization.

In the next chapter of history of the development of combines is discussed in two stages. The first stage lasted from the beginnings—actually from the division of Germany into zones of occupation—till the early seventies. It is worth to quote the developments of the 1940s and 1950s in more detail because the author, M. Tröder, presents useful data to complete our knowledge about this very important period of the GDR's economic history. Till 1948 the state-owned industrial plants named VEB (Volkseigener Betrieb) functioned in subordination to the local (county) authorities of administration (Landeverwaltungen). The Soviet Military Authority's order, issued in February 1948, provided for the setting up of a so-called German Economic Commission (Deutsche Wirtschaftskommission, DWK), thereby establishing the condition of uniform planning and central management of the economy in the Soviet zone of occupation. Thereafter, the first enterprise unions, the VVBs (Vereinigung Volkseigener Betriebe) were developed on the level of counties or the zone. Only the VVBs were autonomous legal entities and pursued their activities on the basis of independent economic accounting. After the creation of the GDR the role of the DWK was transferred to the government. The next reorganization of the nationalized economy started at the end of 1950. The VEBs of national importance were directly subordinated to the sectoral (branch) ministries of increasing number, and authority, and they became autonomous legal entities. Later on this was granted to all the VEBs. Owing to this step and to the extension of independent economic accounting the VVBs existence was no longer justified. They were replaced by the directorates of factories (Verwaltungen Volkseigener Betriebe) which, similarly to the Hungarian industrial directorates, supervised the VEBs belonging to their spheres of competence, in principle without the right to issue orders. These formations were functioning till 1958. Then industrial control underwent significant reorganization in the course of which a number of sectoral (branch) ministries and departments were abolished and the enterprise unions (VVBs) reappeared. This time, however, each VVB amalgamated factories of identical type from the technological points of view (irrespectively of regional locations) which enjoyed enhanced economic and legal autonomy. Parallel to that, but from the economic and legal points of view independently of that, the first wave of setting-up combines took place, mainly in connection with the new grand investment projects of the basic materials industry. The second wave of combine forming coincided with the last stage of the NÖS (Neues Ökonomisches System, i.e. New Economic System) period between 1968–1970. From the point of view of modes of supervision, three types of combine have developed: those directly supervised by ministries, those belonging to VVBs and those supervised by local (county) economic councils. The NÖS guidelines recommended the setting up of combines in the case of subsequent stages of production of different branches of industry, and in the case of small and medium factories under county control. As a result of the newly formed combines those belonging to the first category already yielded one third of industrial commodity production in 1970. The author analyses the changes in the organizational frameworks of the central economic management of the industry, moreover, he gives a detailed review of the whole system of central economic management (of the changes that took place in the systems of planning, plan indicators, etc.). He refers to the reform efforts towards decentralization hallmarked by the names of *Behrens* and *Benary*, and makes a painstaking study of the NÖS, the so far most comprehensive reform attempt of the GDR (which may not be considered a reform in the sense that it *did not* wish to go beyond the system of plan directives in its objectives). The picture is completed with the case study by G. Schneider, describing the formation of the textile combine of Cottbus (Textilkombinat Cottbus).

The second stage in the history of the combine system was the decade of the 1970s. Measures liquidating the remnants of the NÖS stage and increasing the role of the central authorities of economic management were characteristic of the beginnig of this decade. The period of consolidation was followed by a third wave of combine foundations in 1977–80 which apparently meant the final conclusion of the organizational problems of the central economic management in the industry. Along with the division of the entire industry in about 130 combines, significant changes happened also in legal regulations. As against the old statutes the new decree on combines, which is still effective, strongly decreased the combines' legal and decision-making rights against those of the competent sectoral ministries. This time the setting up of combines was no longer based on industrial business economical, sectoral etc. considerations, but on the political, economic and ideological thesis assuming that the socialization of the forces of production objectively works in this direction and this is the only way to guarantee a higher degree of national economic efficiency. For this reason the common characteristics of the combines are related not to production technology or product pattern but to their position in the organizational system of economic management: the combines are the basic economic units of industrial production, directly supervised by the sectoral ministry, the general directors are at the same time directors of the basic (central) factory and thus they discharge enterprising/entrepreneurial functions as well. (p. 136). Quoting also official statements, the author interprets the setting up of the system of combines as a political decision in the first place, that is, an endeavour to enhance the role of the party in the system of central economic management. This may no doubt have played a role in reorganizing the combines, but its primary importance may be challenged. In the last wave of combine-formation, namely, the sectoral (branch) ministers and VVB general directors, regarded non-competent were replaced by general directors of combines who are closer to actual enterprise. This served to avoid loss of time and information and to eliminate unnecessary levels of decision-making, i.e. they were rationalizing measures characteristic of the GDR's central economic management and, partially, of its economic policy in the eighties. (pp. 92–93)

The closing chapter of the book deals with the expectable impacts and conflicts of the system of combines in the period between 1986–1990. One of these conflicts originates in the dual function of the general managers of combines (being also directors of the central factory). Another source of tension is that factories of the combine are located in different administrative regions and, therefore, conflicts are common between the local party leadership and the combine's economic leadership.

As a third unsolved problem, the seclusion from foreign markets, and the conflicts arising from the dual subordination to the foreign trade and branch ministries are stressed. These conflicts actually do exist, but it would require deeper analysis whether the last wave of combine formation has worked towards sharpening or easing them—as a possible result of rationalization measures. In spite of the fact that no convincing answer is given to this question, the book is an important one among those discussing the central economic management system and, particularly the organizational structure of the GDR.

L. G. TÓTH

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* We acknowledge the receipt of the enlisted books. No obligation to review them is involved.

** To be reviewed in Acta Oeconomica.

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