ACTA OECONOMICA

PERIODICAL OF THE
HUNGARIAN ACADEMY OF
SCIENCES

EDITORIAL BOARD

M. SIMAI (Chairman)
M. AUGUSZTINOVICS
T. BECK
A. BRÓDY
CS. CSÁKI
B. CSIKÓS-NAGY
P. ERDŐS
T. ERDŐS
F. FEKETE
J. FEKETE
I. HETÉNYI
R. HOCH
J. HOÓS
I. HUSZÁR
B. KÁDÁR
J. KORNAI
F. KOZMA
A. NAGY
V. NYITRAI
Z. ROMÁN
M. TIMÁR

EDITOR
T. FÖLDI

AKADÉMIAI KIADÓ, BUDAPEST

VOLUME 39
NUMBERS 1–2
1988

ACTA OECONOMICA

ECONOMIC PERIODICAL OF THE
HUNGARIAN ACADEMY OF SCIENCES

Editor:

TAMÁS FÖLDI

Editorial office: H-1112 Budapest, Budaörsi út 45. Hungary
H-1502 Budapest, P.O.B. 262

Published in two volumes a year. Orders can be placed with Kultura Foreign Trading Company (H-1389 Budapest, P.O.Box 149) or Akadémiai Kiadó (H-1363 Budapest, P.O.Box 24).

CONTENTS

Editorial 1
A. KÖVES: The External Economic Environment and Programme of Stabilization in Hungary 3
A. NAGY: Why Does Not it Work? 23
A. INOTAI: International Competitiveness and Imports 45
M. TARDOS: Can Hungary's Monetary Policy Succeed? 61
G. OBLATH: Exchange Rate Policy in the Reform Package 81
B. GRESKOVITS: Western Technological Policies and the Approach of Hungarian Industrial Policy 95
I. SCHWEITZER: Will the Industrial Pyramid Be Set Afoot? 111
K. LÁNYI: Enterprise Behaviour in the 1980s: Beliefs and Reality 123
L. CSABA: Restructuring of the Soviet Foreign Trade Mechanism and Possibilities for Interfirm Cooperation in the CMEA 137
T. BAUER: Deceleration, Dependency and 'Depaternalization'. Some Considerations Concerning the Chances of the Soviet Union and Eastern Europe in the Coming Decades 155
É. PALÓCZ: Services in the World Economy 171

REVIEWS

R. SALLAI–I.SCHWEITZER: World Economic Environment and the Hungarian Economy – A Conference 185

BOOK REVIEWS

L. SZAMUELY (ed.): The Development of Economic Thought in Hungary: 1954–1978. Research of the Mechanism of a Socialist Economy *(Á. Török)* 189
F. SETON: Cost, Use and Value. The Evaluation of Performance, Structure and Prices across Time, Space and Economic Systems *(A. B.)* 192
W. ANDREFF: Les multinationales *(A. Tóthfalusi)* 194

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.

© Akadémiai Kiadó, Budapest

ACTA OECONOMICA

PERIODICAL OF THE
HUNGARIAN ACADEMY OF SCIENCES

EDITORIAL BOARD

M. SIMAI (Chairman), M. AUGUSZTINOVICS, T. BECK, A. BRÓDY,
CS. CSÁKI, B. CSIKÓS-NAGY, P. ERDŐS, T. ERDŐS, F. FEKETE,
J. FEKETE, I. HETÉNYI, R. HOCH, J. HOÓS, I. HUSZÁR, B. KÁDÁR,
J. KORNAI, F. KOZMA, A. NAGY, V. NYITRAI, Z. ROMÁN, M. TIMÁR

EDITOR
T. FÖLDI

VOL. 39

AKADÉMIAI KIADÓ, BUDAPEST
1988

ACTA OECONOMICA
VOL. 39

CONTENTS

Editorial 1
A. KÖVES: The External Economic Environment and Programme of Stabilization in Hungary 3
A. NAGY: Why Does Not it Work? 23
A. INOTAI: International Competitiveness and Imports 45
M. TARDOS: Can Hungary's Monetary Policy Succeed? 61
G. OBLÁTH: Exchange Rate Policy in the Reform Package 81
B. GRESKOVITS: Western Technological Policies and the Approach of Hungarian Industrial Policy 95
I. SCHWEITZER: Will the Industrial Pyramid Be Set Afoot? 111
K. LÁNYI: Enterprise Behaviour in the 1980s: Beliefs and Reality 123
L. CSABA: Restructuring of the Soviet Foreign Trade Mechanism and Possibilities for Interfirm Cooperation in the CMEA 137
T. BAUER: Deceleration, Dependency and 'Depaternalization'. Some Considerations Concerning the Chances of the Soviet Union and Eastern Europe in the Coming Decades 155
É. PALÓCZ: Services in the World Economy 171
A. SIPOS—P. HALMAI: Organization System and Economic Mechanism in Hungarian Agriculture 199
F. FEKETE: The Performances of Hungarian Agrarian Production Systems and the Income Producing Capacity of the Partner Farms 231
T. LAKY: Half-Hearted Organizational Decentralization: the Small State Enterprise 247
K. BALÁZS: Market-Oriented Scientific Research and Development after the Economic Reform 271
R. ANDORKA: Economic Difficulties—Economic Reform—Social Effects and Preconditions 291
T.A. WOLF: The Simultaneity of the Effects of Devaluation: Implications for Modified Planned Economies 303
J. KOVÁCS—T. TARJÁN: Cycle and Replacement 325
L. SZAMUELY: The After-Life of NEP 341

REVIEWS

R. SALLAI—I. SCHWEITZER: World Economic Environment and the Hungarian Economy—A Conference 185
GY. SZŐKE: A Chapter of Recent Economic History—Mergers of Agricultural Cooperatives over Two Decades in Hungary 357
O. LUKÁCS: Hungarian Trade in Consumer Goods—Some Questions Related to Changes in Enterprise Structure 369

BOOK REVIEWS

L. SZAMUELY (ed.): The Development of Economic Thought in Hungary: 1954-1978. Research of the Mechanism of a Socialist Economy *(Á. Tōrōk)* 189
F. SETON: Cost, Use and Value. The Evaluation of Performance, Structure and Prices across Time, Space and Economic Systems *(A. B.)* 192
W. ANDREFF: Les multinationales *(A. Tóthfalusi)* 194
J. KORNAI—X. RICHET (eds): La voie hongroise. Analyses et expérimentations économiques *(W. Andreff)* 385
K.A. SOÓS: Plan, Campaign, Money—Regulation and Business Cycles in Hungary and Yugoslavia *(J. Szabó)* 388
J. SZALAI: The Diseases of Public Health *(É. Ozsvald–A. Kiss)* 395
P. MARER: East-West Technology Transfer. Study of Hungary, 1968-1984 *(A. Tóthfalusi)* 398
Y. TOLONEN: On Macroeconomic Consequences of Trade with Centrally Planned Economies *(Á. Tōrōk)* 401
T.I. BEREND—GY. RÁNKI: The Economy of Europe in the 19th Century (1780-1914) *(É. Ehrlich)* 404

BOOKS RECEIVED

EDITORIAL

To publish a selection of papers presented at the conference on "World Economic Environment and the Hungarian Economy" organized by the Institute of Economic and Market Research was topical for two reasons. The Institute itself was thirty years old in 1987. In the past decades it has acquired good reputation both at home and abroad. The conference itself was one of the most significant scientific events in Hungarian economics of the year 1987. Owing to wide interest in the question how the Hungarian economy can cope with the present unfavourable situation as regards foreign and domestic equilibrium, the subject of the conference was in the limelight. The opportunity given by the conference prompted several well-known economists as well as many of the younger generation to present valuable contributions to the unavoidable reorientation in both foreign and domestic economic policies of the country, what becomes more urgent day by day. These contributions try to push public and economic thinking forward in the direction of the necessary radical changes. The papers speak for their merits themselves.

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

Acta Oeconomica, Vol. 39 (1–2), pp. 3–22 (1988)

THE EXTERNAL ECONOMIC ENVIRONMENT AND PROGRAMME OF STABILIZATION IN HUNGARY
(Thoughts After the Preparation of a Forecast)

A. KÖVES

The paper reviews certain findings of a longer-term forecasting project commissioned by the National Planning Office and made by the Institute for Economic and Market Research. Particular attention is paid to the international economic relations which are highly important for Hungary's programme of evolvement, above all to the characteristics of the CMEA environment of the country.

Commissioned by the National Planning Office, a major research team of the Institute for Economic and Market Research – in which a number of research divisions were involved – prepared a long-term forecast for the world economy within the framework of preparations for the economy-wide plan for the period until 2005. In this paper I wish to present some of the conclusions drawn in the course of this work which involve urgent tasks, equally important both for research and ecomic policy.*

Expected growth in the world economy

In general, the world economic environment we envisage for the next 20 years is one in which the very slow economic growth experienced during the recent ten years or so is going to continue. The average annual rate of growth is likely to be between 2–3.5 percent in the developed countries and between 3.5–5 percent in the developing countries. As for the first – presently foreseeable – stage of the forecast period, the growth rate of the developed countries is most likely to be in the range of 2–3 percent, while that of the developing world will probably remain below 4 percent. There is little ground for assuming a long-lasting and significant difference in growth rates between the major regions of developed market economies. The economic growth overseas will only be slightly faster than the average in Western Europe (Japan: 2.5–4 percent, USA: 2.0–3.5 percent; Western Europe: 2–3 percent). Much bigger differences may be expected in the economic growth of the developing world. The newly – and more newly – industrialized countries of the Far East could show an average annual growth of around 6–7 percent, or even more in the next 8–10 years; in India and China, rates of 4–5

*On major features of the forecast, especially the interpretation of the change of world economic era, the expected dynamics and geographical structure of demand, the problem of relative prices of natural resources or raw materials and manufactured goods, and the consequences of the debt crisis, see [1]

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

percent and 5–6 percent can be envisaged, respectively. Due to these circumstances the role in the world economy of the world's two most populated countries will increase dramatically, thus making it necessary to revalue the importance of relations with them. In the Western Hemisphere economic growth will be about 2.5–3.5 percent in Latin America. In the Middle East and Northern Africa an annual growth of 1–2 percent seems to be feasible (although in the medium run further decline cannot be excluded either), while in Equatorial Africa any speed-up in growth can only be expected in the second half of the forecast period – provided that (as we assume in the forecast) after a possible democratic consolidation of the political situation in South Africa, relations with the South African economy help to dynamize the development of these countries.

All this provides only modest possibilities for the increase of international trade; nevertheless, a 3–4 percent, or even somewhat faster, expansion in the volume of world trade seems to be sustainable, even in the longer run.

Despite the moderate growth rates, we do not believe that the world economy will stagnate or change slowly and that the adjustment difficulties of the Hungarian economy will primarily be due to such features. On the contrary, in production and demand – or, from another approach: in the structures of supply of exports and demand for imports – we have to reckon with rapid, radical, and – in terms of physical composition – largely unforeseeable changes. These will create a substantially new situation and set new requirements for all participants of the world economy – including Hungary.

The least certainty in our forecast is connected with the expected economic development of the socialist countries. This is because, while the economy of several CMEA countries shows signs of stagnation, it is gradually being recognized that in order to halt the tendency of stagnation substantial changes in economic policy and radical reforms are needed. However, the implementation of radical reforms takes time (their outcome is by no means obvious), and the materialization of the positive effects of restructuring on growth could extend to a major part of the forecast period. Consequently, the economic growth of the CMEA countries will, at best, just reach the average growth rate of OECD countries. Yet this is possible only if, as a result of the consistent implementation of reforms, their growth speeds up during the 1990s. In the worst possible case their growth rate will be around that at present, which – as is also pointed out in the Soviet economic and statistical literature [2] means hardly any real growth. The publications mentioned also emphasize that – with special regard to the deep structural changes under way in the world economy – the key problem is not the rate, but the content, of growth.

Limitations and uncertainties of the forecast

Very much can be known – or at least justly assumed – about the expected tendencies and implications of structural change. We believe, for instance, that in the developed industrial countries – where the service sector has already become the biggest sector of the economy – this process will continue. It will be accompanied first of all by

further significant qualitative changes within the service sector: owing to the continuous development of information technologies, the scope and proportion of services embodying the most developed production-related technology will rapidly increase*. This has vast bearings on qualitative changes in the demand for labour, on education and vocational training, and, among other things, on world trade as well. This is one of the main reasons why, within the trade of merchandise, *the weight of manufactured goods is increasing to the detriment of raw materials* – and also the reason why, within international trade in a broad sense, *the trade in services tend to overwhelm that of merchandise.*

As for the other side of the process, further significant changes can be expected in the manufacturing sector of the developed countries: while productions will increase, employment – first of all in the category of blue-collar workers – will dramatically decline. This process, in fact, is one of the primary explanations for the structural – i.e. non-cyclical – unemployment prevailing in the developed countries – a very slow reduction of which is envisaged from the present 8 percent level.

Beyond the general tendencies of structural changes, however, the prediction has serious limitations. For instance, we can tell neither the leading or lagging sectors in world industry nor the most or less dynamically developing countries in the coming 20 years. The former would have direct implications for industrial policy, while the latter would influence trade policy – however, both should eventually affect the overall approach of economic policies.

In *industrial policy,* for instance, a study of the contemporary technological endeavours, sectoral priorities, and policy instruments of the leading developed countries – which, of course, would be highly informative – should not be coupled with an idea that those features, in their specific forms, can be examples to be followed by a future Hungarian development policy. This is because, quite apart from what we think about the contemporary technological endeavours of the governments of developed countries, it is fairly probable that a part of the sectors and activities considered as worth promoting *today* will belong to those lagging *by the time* we will have developed and acquired them – or at least that, by then, the markets will have become saturated and highly competitive, and thus no place will have been left for newcomers. The reason why we have to strongly emphasize this fact is that the belated imitation and top-priority given to technological development and restructuring endeavours – within the framework of one-sided, merely CMEA-oriented production and trade policies – have so far been the prime factors responsible for the weak export performance in the world market of the Hungarian manufacturing industry.** It is to be feared that now, with the slogan of modernization, such development conceptions will be formulated which will most probably not change the situation in the future, either.

*This process is thoroughly analyzed in [3].

**A detailed analysis of this problem is given in Béla *Greskovits*'s article [4] published in this issue.

Trade policy considerations of today should inevitably reckon with the implications of the fact that in the world economy, according to all indications, the forging ahead of the Asian-Pacific area, to the detriment of the Atlantic-Western European region, will continue. Though any fast and radical relocation of Hungary's selling and buying markets seems unrealistic, it is also important to bear in mind that the countries and regions which are leading now are not necessarily the ones that will be leading 20 years from now. On the contrary, the countries which today are developing at the fastest pace and are most able to improve their positions in the international division of labour will, in our view, also encounter critical situations in the course of their further development. The solution of these situations will depend on the then existing circumstances and their own policy choices.

A good example of such a critical situation is that of Japan today. It is still not clear whether the unprecedented deceleration of growth of the Japanese economy in 1986 was a non-recurrent slip or – with the constraints of the export-led growth pursued so far becoming apparent – whether it was in fact a modification of the trends of its long-term growth. This depends on a lot of factors which are in connection, on the one hand, with Japan's new role in the world economy as the world's greatest capital exporter – and the concomitant domestic implications of this role; on the other hand, it depends on factors, concerning the continuous modernization of Japanese society and, connected with this, whether the replacement or completion of the traditional system of values by that of the Western civilization will influence the performance of the economy. The development of the newly industrialized countries might be influenced by many kinds of changes in the world economy as well as by the way they react to these developments. How are they affected, for instance, by the change of Japan's world economic role? How are they affected by the presumably increasing competition of India and China? How can they cope with the effect stemming from the fact that, in the developed countries, continuing modernization and automatization reduce the share of labour costs within overall production costs – the presumable result being that the countries concerned will lose some of the competitive advantages arising from the availability of relatively cheap labour?

Economic development and institutional changes

The developed countries responded to the changed conditions of economic development since the mid-1970s by substantially transforming their institutional systems and economic mechanisms. Analyzing these processes from the point of view of Hungary, both the *fact* and the *direction* of these transformations are remarkable.

As regards the *fact* itself, the severe shocks of the 1970s – which may now seem mild only in the context of the present Hungarian economic situation – everywhere led to the recognition – at the political level – that in order to cope with the new situation at a time of sharp international competition, it would be necessary to revise deeply rooted institutions, socio-economic mechanisms, economic policy conceptions and other instruments developed in the post-war period.

As for the *direction* of changes, the revisions in question were aimed primarily at the extent, directions and expedient methods of state intervention. The significant points in this context comprise the revision of state industrial policy, the reduction of the limitations set by the welfare state (through the fiscal redistribution of a dynamically increasing part of national income*, on enterprise, the orientation towards efficiency, the increase of international competitiveness, the easing of rules controlling enterprise activities (so-called *deregulation*), the transfer of state companies into private ownership (*/re/privatization*), and the *liberalization,* involved by the reduction and elimination of constraints on foreign exchange transactions and on capital flows. In sum, the *direct* role of the state or the *relative* weight of the state and the budget in the process of economic development and the redistribution of incomes has been diminishing, while there has been a simultaneous increase of the role of monetary policy. All this does not mean that the state has withdrawn from the sphere of the economy, but rather that its role has shifted in the direction of establishing more favourable conditions for the market and competition, as well as of promoting orientation towards performance – in fact, in the direction where the presence of the state is really positive and indispensable.

It is not easy to answer the question concerning where the limits of this process lie. For the time being, there is no sign that this development which has gradually been getting stronger since the turn of the decade – will be interrupted. On the contrary, it seems that it is expanding into more and more areas. There are, of course, tendencies of the opposite direction as well, among which one of the most important and spectacular – the strengthening of protectionism – will be separately discussed in this paper.

It is obvious that this revision of economic policy and institutions also has serious constraints. The constraints lie, among other things, in interests effectively attached to direct state intervention, in the long-term impacts of the state intervention applied so far, and furthermore, in the fact that the elimination of welfare institutions will ultimately not promote but rather diminish orientation towards efficiency. These points suggest that the best way forward involves rather the rationalization of welfare institutions.

The degree this process of revision will reach in the coming years and decades is difficult to foretell. It cannot be excluded either that in the longer run it will slow down or even change direction. This possibility, however, by no means weakens the strength of our earlier conclusion that the revision of the economic role of the state as well as of the institutional system and economic mechanism currently under way in the developed countries is a relevant response to the past 10–15 years' world economic and domestic difficulties and tensions. This fact makes it likely that the institutional system of the developed economies will change continuously in the future as well.

*The share of state expenditure within the GDP of the OECD countries rose from 30 to 37 percent between 1960 and 1970, and to 47 percent in 1980. At the same time the share of social expenditure within total state expenditure increased from 50 to 59 percent.

(Source: OECD, Social expenditure 1960–1990. Problems of growth and control. Paris 1985 – Annex C.)

Integration versus isolation in the world economy: on the problem of protectionism

The question concerning the condition of the system of international trade (or in a broader sense: of international economic relations) at the very end of the millenium is one of the most captious questions facing forecast-makers: it often happens that their judgement of different variants of world economic development primarily depends on the estimated future extension of (currently spreading) protectionism.

It would be illusory to expect any breakthrough towards free trade; nevertheless, as the most likely variant, the spreading of protectionism will be less enough to prevent world trade from growing at a modest but palpable rate – probably somewhat exceeding the growth rate of production.

Given a world economy with a number of uncertainties, the motives for protectionist measures will continue to be present for governments. As long as the tremendous international financial imbalances exist or are reproduced, as long as in the OECD countries unemployment is not substantially reduced and important sectors or product groups are "sensitive" (i.e. seriously endangered by external competition in the foreseeable future), protection will remain on the agenda, and we shall often hear about newer and newer limitations, mutual retortions and "trade wars".

We believe, however, that the increasing integration and interdependence present in the world economy will also help to maintain and strengthen anti-protectionist tendencies, too. Not that international interdependence excludes interstate trade conflicts. On the contrary: the more "global" the world economy, the more conflicts of interest arise in international economic relations – and a *part* of them takes the form of interstate conflicts as well. The international financial system which functions today also has important elements of a protectionist and isolationist character. In our opinion, nevertheless, the fact of interdependence (in relations *between* the OECD countries) and the fact and recognition of dependence on global developments (in the *leading* OECD countries) have an anti-protectionist effect. The former may lead to the recognition by governments that, in response to their possible protectionist measures, their partners are *forced* (and also *able*) to take counter-measures. This suggests that, eventually, the positive results to be expected of protectionist measures will be negligible. The counter-measures, in turn, may promote the adoption of an external economic policy which sets out not only from the direct and short-term interests of the country concerned, but also from more indirect and longer-term interests. These could be attached to a smoother functioning of the world economy as well as to a more stable economic development of the partner countries.

Of course, it would be illusory only to set hopes on the sound discretion and enlightenment of governments and decision-makers. In the case of strong domestic pressures these kinds of considerations can hardly be enough to ward off protectionist reflexes. What is more important is that international interdependence also means that it is more and more difficult to reduce national economic interests to market-protecting interests. Such a reduction will become difficult because of the opposition on behalf of

increasingly significant groups, who are in some way interested in the external sector, i.e. exporters, importers, consumers of imports, foreign investors, banks with foreign interests. This can happen even if, for reasons which are analyzed in the relevant literature, the protectionist interests get more easily organized and enforced than those opposed to them.

Finally, some of the earlier mentioned developments of the world economy may also have an anti-protectionist effect. Neo-protectionism in the OECD countries was mainly called forth by the intention to provide defence against the market offensive of Japan and the newly industrialized countries, as well as by the fact that the existing mechanisms of adjustment could only make the necessary restructuring possible over a longer period of time. The hot Japanese-American debates hint at the survival, or remaining tension, of these problems. However, in some of the "sensitive" sectors (though by no means everywhere), such transformations have been carried out in the recent decade which may reduce the necessity of administrative protection in the areas concerned. True, it is also the experience of recent years that, simultaneously with the economic and technological progress of the partner countries, ever more sectors are becoming "sensitive" – and may become sensitive in the future as well. In our view, nevertheless, the palpable changes in economic structure – the increasing dominance of high-technology services, the decreasing role of labour costs as a factor influencing competitiveness in the manufacturing industry – may tend to reduva internal protectionist pressures in the OECD region.

The world economic forecast and crisis scenarios

As the most probable variant, for the coming longer period we envisaged an, in any case, moderate rate of growth in the world economy. It seems obvious that the development will not be even, but will be interrupted by lesser or greater setbacks. Of course, *it cannot be excluded either* that a serious crisis may shake the world economy which might cause similar or even greater shocks in the economy of some countries or country groups than the oil price explosions or the 1982 debt crisis, and which could possibly retard international economic development for a long time.

As for the scenario we considered *the most probable,* the presumable range of fluctuations in the rate of growth is also estimated to be relatively small. This is justified by experiences in the recent period, the tendencies of structural changes, and the analysis of long-term trends of demand and supply.

Nevertheless, our forecast, stemming from the nature of the problem, includes very diverse elements of uncertainty. In the world economy of the next 20 years there may also be serious shocks, including ones, which may considerably alter the system of conditions for the external economy, for the participants. It will be difficult for them to adjust to these processes, but they might be followed by new changes and developments, which will not only press for, but also offer an opportunity of adjustment. They could affect the economies of individual countries and country groups primarily through the

sphere of international finance. We believe, however, that these shocks – besides *strengthening* adjustment mechanisms (which, in spite of every difference, difficulty and inconsistency, are the most characteristic endeavour of economic policies virtually all over the world) – will not interrupt the trend of world economic development, growth and restructuring.

We have not made an attempt to predict the nature of, and reason for, the potential shocks. The difficulties of this kind of forecast are suggested not only by the fact that the world economic shocks of the past 15 years were hardly predictable. Even the processes themselves could be foreseen and were actually anticipated by the analysts, the consequences were considerably different from those that had been generally expected. Take, for example, the case of the fall in oil prices in December, 1985. Here, instead of the expected positive nature of the overall effects, the world economic situation became more complicated.

As a result of the drop in oil prices, one thing has become more obvious than before: that the economic situation and prosperity of the developed industrial countries are highly dependent on the effective demand of the developing world. If the latter stagnates or declines because of the absence of funds to finance the increase of imports, this becomes a serious obstacle to economic growth in the developed countries as well. This phenomenon is not entirely new: since 1973, none of the shocks of the world economy has emerged or been solved as an internal affair of the developed region. Rather, all of them have become settled in the framework of the relations between the developed and developing countries (or between certain groups of the developing world, e.g. oil exporters and debtors), reestablishing the relations (of power) among them and mutually compelling them to adjust to the new situation. It is fairly likely that in this respect the situation will not change – despite the fact that the shift of world economic power relations in favour of the developing countries during the 1970s went into reverse in the 1980s. Also, according to our forecast, the relative position of the OECD region will continue to gain strength in the future, too.

Two conclusions can be drawn from the discussion so far:

a) During the past decade the shocks of the world economy have affected the countries and country groups differently, depending on their specific conditions. Every realignment had both winners and losers. Nevertheless, the fact that a country or country group is always among the losers cannot be explained solely by its unfavourable natural, developmental, or structural conditions and endowments. Rather, it is explained by the fact that, due to the country's isolation from the mainstream of the world economy, the adjustment mechanisms of the economy are extremely weak.* This explains why the positions of Eastern Europe – including Hungary – deteriorated to a relatively greater extent than those of both the developed and developing countries.

*Or – as Gábor *Oblath* emphasized in the dispute over the forecast – the other way round: if, for inherent reasons (the given mechanism and institutional system of the economy, the position and scope of manoeuvring of enterprises, etc.) the economy is unable to adjust, then every change in the external environment will call forth reflexes of isolation. These, in turn, will further strengthen the inability to adjust. It will be more and more difficult to break this vicious circle.

b) In a fairly uncertain world economic environment, less and less security and higher and higher costs may be involved by preparations for such developments. Yet these comprise changes and shocks which, even if not to be excluded, cannot be considered likely either; they may emerge, but will not necessarily last long. The reason why we emphasize this consideration here is not because the really dramatic world economic shocks are usually not foreseeable. It is because in the world of today *we simply cannot see any other possibility of long-term growth,* and of preventing the technical-structural gap from increasing and living standards from falling, that is, of avoiding the expected or unexpected unfavourable developments of our environment and their serious or disastrous consequences, other than the establishment of the mentioned adjustment mechanisms. These include the strengthening the openness of the economy, the increasing role of the market and competition, and the adoption of an effective export-oriented economic policy.

The Soviet reform and economic outlook

After decades of rigidity and stagnation, such changes have occurred in the approach and endeavours of Soviet politics and economic policy, the significance of which is as yet inappreciable. Some of the features of these changes are, for instance, a more realistic appraisal of the country's own economic performance, the recognition that the current economic problems have their roots in the political practice and the underlying theory of half a century ago, and the adoption of the idea that the system of traditional directive planning (having existed for half a century and having been identified as the adequate economic system of socialism) is not simply to be "improved" but radically reformed.

Any long-lasting and significant improvement of Soviet economic performance, however, requires further reforms and changes of such portent that the measures already taken and decided upon, will later appear as no more than the very first steps. This is because, on the one hand, a radical economic reform – as is well known from the Hungarian experiences – is not completed with the elimination of directives, the replacement of the rationing of the means of production by trade relations, the transformation of the price system, and declarations concerning enterprise autonomy, self-financing and self-management. All these only constitute the beginning of the reform process. Morcover, our available information suggests that even the reform conception does not contain these principles in a consistent way. In most cases the compulsory (physical and value) targets of output are to be replaced by likewise compulsory state orders, even if non-directive elements (interfirm supply contracts) are also to be included in the system. On the other hand, it seems that the economic reform process could be advanced by further substantial reforms in such fields as ideology, foreign policy, or, rather, the entire conception of attitudes towards the external environment. The economic reform should also comprise a radical revision of the agricultural system. This would undoubtedly be a long and painful process.

Apart from all these considerations, there has been no sign either that the intended economic reform could be implemented within a short period of time, or that it could result in early economic success. On the contrary: the Soviet leadership is giving more and more signs that it finds the situation more difficult – and the prevailing problems more complicated – than it predicted when it decided upon the reform. As Mikhail Gorbachev pointed out at the Central Committee of the CPSU meeting in June, 1987, ". . . the changes carried out so far are not substantial or comprehensive. We still have not been successful in eliminating the mechanism of retardation and replacing it with the mechanism of acceleration."[5]

We must also add that in certain areas, which are of primary importance from the point of view of Soviet economic performance, no consistent steps have been experienced during the course of the reform endeavours. In our opinion, for instance, in the cooperation of the CMEA the interests of Soviet economic development would be best served by a market-type development or, more precisely, by the transformation of cooperation in this direction. So far, however, Soviet efforts – culminating in 1986 and 1987 – have represented other tendencies: the main direction in the development of cooperation has been a stronger coordination between economic policies through some kind of common planning – an idea which up until now has always ended in failure. Even though important steps were taken in the management and organizational system of the external sector in 1987 (which Gorbachev referred to in his above-cited speech as aiming at strengthening the participation of the Soviet Union in the international division of labour,[6])in the meantime the approach to trade relations with the non-socialist world has not been revised. Moreover, insofar as there was change, it tended to support an anti-import attitude.

The motives of this attitude, on the one hand, can easily be understood. Owing to the fall of oil prices in international markets, the convertible currency revenues of the Soviet Union have dropped by some one-third within two years. This makes the reduction of imports – probably not only in the short run – inevitable. This is so also because the Soviet indebtedness *vis-à-vis* the West – however unnoticed – is rapidly increasing,* although this increase still does not have excessively hard constraints in the short run. Too often, however, it is not this consideration which is referred to as an explanation; the cut of imports is deemed justified not because of the shortage of funds, but because of certain economic and political risks involved in the increase of imports. This approach, in turn, carries the danger that economic policy and economic practice will continue to follow the conceptions of a kind of self-sufficiency, independence from the world economy or "invulnerability". Furthermore, as has already happened in Soviet history, the necessary non-recurrent import restriction urged by the deterioration of the external balance can easily become a lasting policy. Following this development path in a world economic environment such as the one described above would make illusory the achievement of those far-reaching goals which the Soviet leadership has set itself.

*According to OECD estimates, from the end of 1984 to the end of 1986 gross debt rose from 22 to 36 billion US dollars, while net debt rose from 11 to 24 billion US dollars. (Source: Developments in East-West financial relations in 1986 and medium-term prospects. In: *OECD Financial Market Trends,* February 1987. p. 21.)

Economic relations within the CMEA

As long as there is no substantial change in the developments discussed above concerning the Soviet economy and economic policy, the minor CMEA economies will be exposed to effects which will continue to make their adjustment to the world economy difficult and complicated.

On the one hand, as long as Soviet economic and technological development – and economic policy in general – remain inward-looking, the most essential problem of these economies will remain unchanged. That is to say, they will have to conduct one-third to two-fifths of their foreign trade with a market in which the qualitative and structural features, the quality of demand, the mechanism of relations – consequently, the internal regulation of these relations, too – are absolutely different from those that characterize the world market. In that case, it would be unrealistic to expect changes in CMEA cooperation which could palpably alter this situation. As a result of the deepening contradiction between the ever tighter and ever ambitious economic goals and the weak economic performance, for the Soviet Union the importance of the CMEA cooperation tends to narrow down to the possibility of channelling additional resources into the development of the Soviet economy. The recent Soviet initiatives (joint enterprises, direct intra-firm relations, the Comprehensive Programme) unambiguously show this tendency.

On the other hand, in contrast with the increasing demand for imports, we do not see any possibility of a marked increase in Soviet export potential in the foreseeable future (at least as long as the economic reform does not bring positive results). This argument, which is valid both for traditional Soviet exports to the CMEA countries and for any other exports of a different structure which meet the import demands of the partner countries, must be strongly emphasized. Since the mid-1970s the economic managements of the CMEA countries, including that of Hungary, have systematically overestimated the possibilities of Soviet imports; they have deemed the imports contracted in the framework of trade agreements based on collated plans as stable even when there were indications of their unstability; and they have pretended to be surprised when the Soviet partner has curtailed the supply of highly important commodities. In our opinion, it is true even of contemporary Hungarian economic policy that it reckons with higher-than-realistic import targets for the current five-year-plan period.

Our argument, that in the near future there is no way to considerably increase imports from the Soviet Union in a structure consistent with the Hungarian demand, does not necessarily mean that there is no such group of commodities from which imports can be augmented. We believe that such commodities do exist, and it is an important task of the trade policy to find and make the most of them; otherwise it will be impossible to avoid a drop of imports. Nevertheless, to consider an increase of the volume of Soviet imports (or, in general, of rouble imports) as a basic economic policy objective is a serious mistake which can easily lead to maladjustment.

What makes these considerations particularly topical is the fact that, in contrast with the tendency of the past 15 years, the terms of trade of the minor CMEA countries, *vis-à-vis* the Soviet Union, are about to start improving. In the bilateral clearing trade

within the CMEA, a country can only take advantage of the improvement in terms of trade if it increases the volume of its exports more slowly than that of its imports. If the volume of imports is to stagnate, then only the reduction of the export volume makes it possible to exploit these advantages. The three areas of Hungarian–Soviet trade where we deem this kind of reduction possible and important are as follows:

– participation in investment projects in the Soviet Union:
– the least efficient exports;
– those fields where the Soviet partner suggests a decrease of Hungarian exports.

To our knowledge, this problem arises not only in Hungary, but, even more pronouncedly, also in other CMEA countries. The decisive argument of those who, even in these circumstances, urge a further increase of the export volume to the Soviet Union is that the productive capacities working for Soviet exports cannot be switched over to other markets. Indeed, they are considered as the most important, most up-to-date, and most expensive capacities of these economies. An additional argument is the risk of losing the Soviet markets. Finally, it can often be heard, too, that in the 1990s the tendency of oil price movements may change, and in the case of higher oil prices the compensation for Soviet oil supplies will require the increase of their export volume as well.

The latter two arguments can be refuted relatively easily. With the present level of Soviet convertible currency reserves, there is no opportunity whatsoever for the Soviet Union to replace the manufacturing supplies of the CMEA countries by imports from the West. As for the oil prices, they can increase of course, but – as has been pointed out – the price increase, in any case, has serious constraints. At the same time, it is not very likely that in the future such differences will evolve between the conditions of purchase within the CMEA and in the world market in favour of the former as was experienced in the late 1970s and early 1980s. Moreover, it is not certain that Soviet supplies of oil and other raw materials can be maintained at their present levels, quite apart from compensation. Among other things, this also suggests that it would be a blunder to base the development conception of trade with the Soviet Union on the assumption or requirement that the level of Soviet oil and raw material supplies need to be and can be maintained. In general, the survival of a situation in which the essential question of CMEA cooperation (and of cooperation with the Soviet Union) is the supply of raw materials and energy – to which the entire structure of industrial development and foreign trade is subordinated – might in itself paralyze the adjustment to the world economy and the closing up to international tendencies.

The first argument mentioned is obviously very strong. In fact, this constitutes one of the basic problems in the economic policy of the European CMEA countries. It is indisputable that the vast majority of productive capacities now working for Soviet export can – if at all – be switched over to convertible exports only with great efforts and considerable additional costs. (It is, of course, also true that the convertible import content of exports to the Soviet Union is increasing despite all contrary objectives and programmes – not only in Hungary, but in other CMEA countries as well.) Nevertheless, whatever short-term difficulties and losses emerge in consequence of a possible reduction of the volume of exports to the Soviet Union, the other option is that within a couple of

years the problem becomes even more serious, and such reduction will be even more indispensable from the point of view of national economic equilibrium – while it will be even more difficult, too.

We do not foster illusions concerning the possibilities of switching over to new export markets. On the contrary, we think that this switch-over is extremely difficult. This is why we believe that very little can be realized in the way of improving the convertible export performance of the Hungarian economy (one of the basic goals of Hungarian economic policy) if attempts are made to encourage, modernize, and restructure convertible exports in such a way that at the same time exports to the CMEA region remain untouched. In other words, convertible exports can only increase steadily if there are such changes in both the economic policy and economic mechanism which modify the conditions of exports to the convertible currency area and to the Soviet Union *at the same time.* Without taking steps to deal with trade with the Soviet Union, there is, and there will be no money, no pressure, no interest and no inclination for the implementation of this objective.

The minor CMEA countries and East-West economic relations

As for the minor CMEA countries, it is well known that they have common or very similar difficulties not only in trade relations with the Soviet Union, but also in those with the Western economies. Another common feature is their considerable indebtedness – even if there are differences in magnitude – and the related fact that their efforts to restore external equilibrium are still on the agenda – as they were at the turn of this decade.

The improvement of the international financial position of the CMEA countries, stemming partly from the success of export-encouraging and import-restricting policies, and partly from the appreciation of the US dollar, came to an end – moreover, reversed – in 1985 and 1986. Consequently, the medium-term prospects are not favourable.*

It seems that a further increase of indebtedness can only be halted at the expense of an increasing isolation from, and lag behind, world development. This would be in the framework of a harshly restrictive living standards policy – that is if the internal political situation permitted such an option. This is true even if the increase of indebtedness does not necessarily involve modernization in these countries which relies on foreign financial resources.

In the present situation the emergence of (repeated) serious liquidity problems cannot be excluded either. These would further diminish Hungary's chance to participate in international trends.

*In the course of discussing East-West financial relations I will rely heavily on the study of Veronika *Pásztori,* prepared in the framework of the forecasting project.

The new tendencies of international capital markets, however, offer a lot of *connecting possibilities* for the CMEA countries if they dare to seize the advantages. The expansion of liberalization and deregulation, as well as the appearance of new and aggressive capital exporters exempt from prejudices and excessive precaution – first of all, Japan – may open new perspectives for the CMEA countries as well. This would be so at least as long as the manifestation of a possible economic, social or political crisis does not cross business relations.

Despite their difficult external economic situation, the key problem in the case of the CMEA countries is *the realization of additional capital imports with the simultaneous management of outstanding debts.* This is a necessary precondition for economic development and for halting the tendency of falling behind. The *development of direct financial (credit and capital) relations with Western firms* might promote the increase of exports and contribute to the maintenance of the creditworthiness of CMEA countries which, at the moment is jeopardized. As for the direct investment of foreign capital, its acceleration is necessary not only because the possibilities of having access to foreign loan-capital seem to be much more limited than before, but also because the experiences of the past 15 years show that the borrowing policy was unable to play that positive role in the promotion of adjustment processes and in the development of export orientation which was expected of it.

It is obvious that direct foreign investment cannot, even in the most favourable circumstances, meet the total demand for capital import. But, according to experiences, wherever direct foreign investment gains national economic importance, this situation increases other possibilities of importing capital from abroad, too. In addition, the settlement of foreign firms could also be an important factor in improving domestic market conditions, strengthening competition among domestic producers and breaking the monopolistic positions of large domestic firms.

On the basis of what has been presented so far, we cannot have positive expectations towards the development of East-West trade – at least within the foreseeable future. Nothing justifies the assumption that just because of the aforementioned liquidity problems trade will not be further repressed in the remainder of this decade and in the early 1990s.

It is difficult to predict the farther perspectives. The perspectives of East-West trade will be entirely different if the reform process in the socialist countries speeds up or if it gets stuck, or if the response of the West to the reforms is positive or, on the contrary, uncooperative.

The debate about whether Western political considerations make it desirable to develop trade relations with the East, especially with regard to the promotion of the technological development of the socialist economies as well as the financing of trade from Western financial resources, has been going on ever since 1917. In the framework of this paper we do not have the opportunity to characterize the arguments of the advocates and opponents of such trade, and thus we cannot assess their strength. It is necessary to note, however, that no uniform Western standpoint has been formulated as a result of the debates of the recent past. On the contrary, the opinions of the American, Western

European and Japanese governments have been considerably at variance. On the other hand, an anti-trade attitude became dominant – primarily in the United States – after 1974–1975, and this was in close connection with a changed judgement of international political events or, more precisely, of Soviet behaviour. Inasmuch as the notion gained strength that Soviet internal and external political actions were deviating from the spirit of the US-Soviet and international agreements made in the early 1970s, efforts were made to strengthen and modernize embargo policies as well as to ban inter-governmental credit provision to the Soviet Union. However, as a third, parallel tendency, we must also note that, along with the strengthening of strong, well-represented interests attached to trade with the Soviet Union, the Soviet Union was itself able to succeed in some of its endeavours despite the unfavourable political climate. A good example of this is the American grain export to the Soviet Union. This had been subject to partial embargo at the turn of the decade; yet, one or two years later – in spite of the obvius increase of Soviet dependence on the importing of grain – the existing domestic situation urged the United States to become less strict and only to demand that the Soviets be ready to purchase as much American grain as possible.

The facts discussed above have several implications. One is that the political environment of East-West trade is likely to vary and it will also be far from ideal for trade relations in the future. Nevertheless, a Soviet foreign policy which is able to achieve progress in the way of arriving at agreements on essential international problems will probably call forth a positive response on the part of Western trade policy behaviour, too. One of the impacts of such a development would be that the American standpoint would have less influence on that of Western Europe and Japan – and Western Europe will certainly be more interested than the United States in the maintenance of Eastern trade in the coming decades. On the other hand, the opinions favouring trade relations could also gain strength in the United States. It is very important, however, that the main development of economic relations make the business circles of Western countries interested in involving larger and more important areas of activity in trade with the East. This is because the circles involved in such trade could become the primary advocates of the fight against trade restrictions. The preconditions of this, of course, are the steady and significant growth of trade as well as the development of new – already mentioned – forms of economic relations.

We must emphasize, however, that the *perspectives of East-West economic relations depend above all else on the CMEA countries.* A considerable part of the present difficulties stem from the fact that the CMEA countries – partly because of Western restrictions, partly owing to their own decisions related to political and ideological considerations, and partly as the logical consequence of the postwar political division of the world – have precluded themselves, and have been precluded, from those institutions and mechanisms which are of great importance today for the development of the international division of labour as well as the closing-up of certain countries and regions. European CMEA countries collectively rejected participation in international financial institutions (IMF, World Bank) for a long time (even now there are only three members – Hungary, Poland and Romania). Most CMEA countries joined the GATT relatively late

(even now not all of them are members*). Also the CMEA countries did not recognize the European Economic Community, even though this body could make agreements with virtually all important and less important countries and country groups of the world in the essential questions of trade relations. These factors led to apparent trade and financial disadvantages. The main problem was, however, that isolation from, and non-participation in, the system (as well as the show of "non-conformity") discouraged a considerable number of the CMEA's potential partners and limited the possibilities of developing relations with them.

Similarly, until recently the CMEA countries avoided the multinational division of labour. So far only some of them – and then only with strong restrictions – have permitted the import of equity capital as well as the establishment of joint ventures on their own territories. Meanwhile, it was exactly in the given period that many developing and industrializing countries were able to increase their chances of closing-up through attracting foreign investments. As a result, the CMEA countries were hardly affected by the wave of redeploment and relocation and they proved to be practically unable to cope with the export offensive of the newly industrialized countries.

Hungarian economic policy and the world economic forecast

When analyzing the long-term perspectives of Hungary's world economic environment, Hungary's current economic performance and its international appraisal must not be left out of consideration. For a long time Hungarian economic policy could take it for granted that in the West its appraisal was relatively favourable, while in the East it had to face a more or less open and unambiguous distrust.

The situation has changed. With the development of Soviet reform endeavours, it is no longer necessary to interpret the Hungarian reform movement (and the features of Hungarian economic policy which appear to deviate from those of other countries) as something that automatically pushes Hungary into a defensive position *vis-à-vis* its socialist partners. In a sense, the situation is just the opposite: the Soviet Union and other countries are expressively interested in the further development of the Hungarian reform process – even if the specific content of this reform process is not the same as that in the Soviet Union and elsewhere. On the other hand, however, the opinions about the economic performance of Hungary are more and more negative, and this fact in itself adversely influences the possibilities of improving the situation. The negative opinion is based on the actual deterioration of Hungarian economic performance, as well as on the view that so far the economic policy has not shown enough determination in pressing ahead in a direction which will facilitate further development.

As a recent study of the OECD points out, – "Unlike other East European countries, Hungary has made essentially no progress in reducing its debt burden in

*The Soviet Union has recently applied for observer status but this has been sharply opposed by the United States.

1981–1985. In 1986, the pattern of deterioration continued. By the end of 1986, debt and debt-related indicators were already near or at their tolerable limits."[7] Unlike in 1981, Hungary's debt position in 1987 is probably worse than that of any other minor CMEA country, except Poland.

What another study [8] considers as the biggest mistake of post-war Hungarian economic policy is that after 1973 it did not draw the necessary conclusions from radical changes in the world economic situation and it did not reduce the rate of growth. These factors are cited as the reasons for the rapid accumulation of debt. Despite the severity of this mistake, we must not ignore the fact that, in the course of the restrictive policy of the 1980s, the situation continued to worsen. The essential objectives of restriction were not achieved, and economic consolidation – after nearly 10 years – has still to be realised. In addition, the implementation of such consolidation has to be carried out in circumstances which are now more difficult than those that characterized the Hungarian economy at the turn of the decade. We believe that the analysis of the causes which led to this situation is an indispensable precondition for the foundations of evolvement, and long-term progress. The obvious reasons for this are manifold.

The economic policy – in spite of several important partial measures – did not undertake genuinely the task of strategic change even in the 1980s. Such action, due to radical changes in both internal and external conditions, should have been inevitable. Yet a contrary situation developed: the most important decisions and measures were born in the spirit of continuity. More and more decisions were made which received no support from either the political leadership or the government or the executive apparatus. In fact, nobody considered them as really appropriate but, at most, as better-than-the-worst. The adopted and enacted plans were not only not fulfilled (this in itself was not limited to the 1980s and Hungarian planning alone), but it must have been obvious for policy-makers and planners, from the moment of the adoption of the plans, that they could not be fulfilled. The plans were not on a realistic consideration of the economic situation and the available possibilities; they depended mainly on political, rather than economic, expectations, which the economic policy and the planning agencies could not, or did not want to, definitely reject.

Thus the central economic management made efforts to facilitate the achievement of macroeconomic goals primarily through an ever-changing and more and more confusing regulation of enterprise activity. This, however, proved to be largely unproductive and dysfuncitonal: it did not really hinder enterprise endeavours that jeopardized and upset the macroeconomic (first of all, the external) equilibrium but, at the same time, it set such requirements for the enterprise sector which prevented the structure of production from changing in line with the declared objective of export orientation. The fact that the gap between the actual and the officially declared functioning of the economy was wider and wider disoriented all economic agents.

Recently, one opinion which has gained strength suggests that, as a necessary precondition of further development, consumption and living standards have to be significantly curbed in the coming years – that is, compared with the slow and gradual deterioration which has been experienced for nearly a decade. Actually, this will probably

be inevitable. However, a further cut in consumption will, in itself, solve none of the problems which are responsible for the general decline of performance in the Hungarian economy. On the contrary, if declining real wages and falling living standards cause a withholding of performances, there will simply be a further obstacle to improving the situation. We are convinced that – in spite of its considerable tardiness – the economic policy still has reserves which can, and have to, be mobilized if it definitely aims at consolidation. These reserves do not lie primarily in a modification of the proportion between consumption and accumulation, but rather in a revision of economic policy. While in Hungary an export-oriented development policy has been publicly declared, what has actually been happening is just the opposite: a large part of the money which could really serve export orientation has been invested in projects which contradict the aims of export orientation. There are two blatant examples: On the one hand, the development of the economy continues to concentrate on raw material-related industries (investments in fuel, raw materials and basic material industries account for the majority of industrial investments). This is unjustified from the point of view of both the world economy and, particularly, the domestic conditions of these sectors. On the other hand, as a closely related problem, reference should be made to those primarily energy-industrial projects (implemented partly domestically, and partly in international cooperation), upon which Hungarian economic policy has made final decisions in the last 2–3 years. The directions of these investments make export-oriented development impossible, while they do not make any progress towards the achievement of their declared objective – that is, towards a more balanced situation in energy and raw material supply – either. We believe that a revision of this policy is the only possibility of avoiding a radical fall of living standards – otherwise, such a fall inevitably has to be undertaken by the Hungarian economic policy.

The policies discussed above comprise the suggested revision of economic policy (or development policy), yet by these we do not simply mean that instead of these traditional priorities other sectors or other kinds of goals should be given preference in the distribution of resources: and in no case could we agree with the idea that the new priorities should be enforced with the same policy instruments as were used with the old priorities. The revision of development policy also includes other types of institutions and mechanisms, another type of relationship between the state and the enterprises, a significant increase of the openness of the economy, as well as the development of market relations. Perhaps the most important conclusions of the analysis of world economic trends is that which suggests that a change in the economic conditions and economic policy goals requires the transformation of the institutional system which came about in earlier conditions and in the interest of former goals.

Although what concerns decisions for the near future, experience shows that the realization or postponement of these decisions could largely determine the development of the Hungarian economy for the next 15–20 years or even longer. Just as the economic policy of the 1950s determined in many respects the economic development and the structural and efficiency problems of the ensuing decades, and just as the absence of a post-1973 economic policy revision can be made responsible for the rapid increase in

indebtedness (from which a way out has still to be found), so Hungarian economic development at the turn of the millenium will depend on whether a relevant economic policy response is given to the contemporary problems.

References

1. Köves, A.: Gondolatok világgazdasági környezetünk következő 20 évben várható alakulásáról (Thoughts on the expected development of Hungary's external economic environment in the coming 20 years). *Külgazdaság*, 4. 1987. pp. 3–17.
2. Selyunin, V.–Khanin, G.: Lukavaia tsifra. *Noviy Mir*, 2. 1987.
3. Palócz, É.: Services in world trade. This issue of *Acta Oeconomica.*
4. Greskovits, B.: Western technological policies and the approach of Hungarian industrial policy. This issue of *Acta Oeconomica.*
5. *Pravda*, June 26, 1987.
6. *Pravda*, June 26, 1987.
7. Developments in East-West financial relations in 1986 and medium-term prospects. In: *Financial Market Trends*, 36. OECD, Paris 1987. p. 38.
8. Erdős, T.: A magyar gazdaság és a gazdaságpolitika fejlődése az 1968–1985 közötti időszakban (The development of the Hungarian economy and its economic policy in the period of 1968–1985: Conclusions for long-term planning). Manuscript.

ВНЕШНЕЭКОНОМИЧЕСКАЯ СРЕДА И ПРОГРАММА ПОВОРОТА

(Размышления после разработки прогноза)

А. КЁВЕШ

На основании результатов долгосрочного прогноза развития мировой экономики, подготовленного Институтом исследования коньюнктуры и рынка для Государственного управления в статье делаются некоторые выводы.

Хотя можно предположить лишь невысокие темпы роста мировой экономики даже на долгосрочный период, трудности приспособления венгерской экономики, вероятно, будут связаны в первую очередь не с этими, а с теми быстрыми и радикальными, а в отношении товарной структуры в большой степени непредсказуемыми изменениями, которые произойдут в структуре производства и потребления словами, иными в предложении экспорта и спросе на импорт. В такой мировой экономике, которая во многих отношениях неопределенна, нет другой возможности удержаться на мировом рынке, как создание механизмов приспособления благодаря повышению экономической открытости, усилению роли рынка и конкуренции и по-настоящему ориентированной на экспорт экономической политике. Это общее положении особенно справедливо для Венгрии и других стран Восточной Европы. Ведь сдача наших позиций на мировом рынке за последние пятнадцать лет, отставание от развитых и развивающихся регионов в первую очередь объясняется чрезвычайно слабой приспособляемостью, связанной с изолированностью и изоляцией от основых мироэкономических процессов.

В связи с ориентированным на экспорт развитием в статье рассматриваются выводы, которые можно сделать из предполагаемого экономического развития стран СЭВ. Развертывание процесса реформ, в первую очередь идущего в Советском Союзе, в перспективе может создать возможность для остановки отступления на мировом рынке. Однако до тех пор нереально рассчитывать на динамизацию сотрудничества СЭВ, и понимание этого должно найти отражение и в нашей экспортной политике. Что касается экономических связей Восток-Запад, то для стран-членов СЭВ ключевым вопросом является достижение добавочного импорта капитала при одновременном снижении имеющейся задолженности.

Acta Oeconomica, Vol. 39 (1–2), pp. 23–44 (1988)

WHY DOES NOT IT WORK?

A. NAGY

Three major factors cause that Hungary does not make any (or only insufficient) headway in improving efficiency, competitiveness and adjustment of the economy to world market changes: 1. the long-standing protectionist seclusion of the country, 2. the highly monopolized nature of the domestic market and 3. the fact that the interests of producers are protected by the state against those of consumers. All this can be traced back to the conflict of interest between producers and consumers, manifest in their attitude to competition. The solution could be: increased openness of the economy, the extension of competition and the creation of capital ownership organs interested in the efficient use of the social capital.

Why doesn't Hungary make any headway (or only much slower than we would like) in improving efficiency and competitiveness, in adjusting to the world market and in shaping the structure of the economy? This is the situation despite the fact that countless resolutions, quidelines, articles propagating these decisions and homolies have been published. A great number of financial regulators have also been introduced just for this reason moreover, these have been modified time and again. Who and what are to blame for this state of affairs?

Obviously our investigation should commence by putting the time-honoured question of the ancient Romans: *cui prodest,* or more precisely: *cui non prodest?* Whose interests run counter to moving out of the present situation and progressing in the direction of efficiency? If there is such a group, why can they assert their interests more effectively than those in whose interest it would be to establish a more up-to-date, more competitive economy capable of adjusting efficiently and quickly to changes in demand?

The causes of troubles have been pointed out by many observers and on many occasions: excessive centralization, the survival (albeit in a refashioned form) of the system of compulsory plan instructions, the insufficient independence and profit motivation of enterprises, lack and/or distortion of the market, considerable isolation from the world market, a serious decline in the work morale, wastefulness and squandering – the well-known and interminably repeated causes could be recited on and on. However, the question, should be put in the following way: if the causes for the increasing backwardness of the Hungarian economy are so manifest, why isn't something done in order to achieve a change? What are the obstacles in they way of, and whose interests are jeopardized by, the elimination of these welldefined "pathogens"? Why do we lament only together with the patient instead of curing the disease?

This inertia and the cessation of, or only very slow movement of, progress is regarded by many as a consequence of a rigid power pattern, and the striving of those in power to maintain their domination, and their clinging to material benefits, or of their outright incompetence. Others blame the laziness, the lack of will to learn and develop,

even the amorality of the man in the street. Some people try to deflect the responsibility of decision-makers and to derive internal troubles and difficulties from perceived external disasters.

One of the major obstacles in the way of an efficient economy is obviously the intention of the bureaucracy to have a central grip on, and to control and supervise everything. Since these centralizing efforts go hand in hand with a feeling of mistrust towards lower-level organs and the enterprises – moreover, against the citizens as a whole – they tend to restrain and even paralyze creativity, ingenious enterpreneurial skills and flexible adjustment. Nevertheless, it cannot be maintained that the central organs are not interested in an effective functioning of the economy, for even in the most highly centralized organization it is in the interest of the dictator to employ the resources most effectively for his own purposes.

It is often rumoured that "high above" are the adherents of the reform and more effective economic management. Their efforts, however, are doomed to failure because of the resistance of the middle functionaries and managers and the public administration. Some experiences undoubtedly point to the fact that a number of correct principles of the reform have got lost in the course of the elaboration and implementation of regulations and decrees aimed at the carrying into effect just these principles. However, it can hardly be believed that this stratum should be motivated in such a way as to impede a competitive, efficient economic management. In any case, where could it find the power to be able to frustrate consecutively the reform pursuits of the central bodies? I think the troubles can be explained on the basis of the interests and conflicts of the conomic and political organizations. In my opinion, resistance to change and progress is rooted much deeper in socio-economic life and cannot be explained satisfactorily and acceptably by superficial assumptions. There has to be a significant soical force whose interests run strongly ***against*** the realization of the objectives of an efficient, competitive economic management which can rapidly adjust itself to new conditions – what other reason could there be for failing to realize these objectives?

I don't think, this clash of interests can be detected in the single-dimension conditions of power relations, even if it is a well-known fact that both the power centre and the organizations in the middle and lower levels of the hiearchy are highly structured. Among them, too, there are all kinds of rivalries and bargaining. To explain this phenomenon it seems necessary to introduce a further dimension of the conflicting interests of producers and consumers.

Why do the interests of the producers and consumers clash? Consumers would like to get up-to-date, high-quality products which meet their needs, as far as possible, and are as cheap as possible. The producers, on the other hand, would like to sell their products at the highest possible price, and if there is a chance, they would like to shake off the nuisance of satisfying such requirements as diversification, assortment, quality and modernity. This conflict is reflected most clearly in their standpoint on competition: competition between productive and servicing companies is in the interest of the consumers for it enchances their possibilities of choice and renders it possible for them to get better, more suitable and cheaper goods. Moreover, producers are forced by competition

to continuously develop technology, to improve their products and regularly to take into account the changing requirements of the consumers. If they succeeded to get rid of competitors, all this would become superfluous – or at least less urgent. No producing or servicing enterprise favours competition, and all enterprises do their best to circumvent it. As early as in the 18th century the maxim had been coined in Britain: "All men would be monopolitsts if they could."

In my view it is this very clash of interests which leads to the fact that "it doesn't work." This is so despite all the good intentions, the setting of objectives and the repeated promises. It is here that a significant and powerful social force can be detected which is interested not in the development of competition but in seclusion and monopolization. I think, the explanation telling us "why it doesn't work" can be found in three closely interrelated factors, which strengthen each other: 1. the long-standing protectionist seclusion of the country, 2. the highly monopolized nature of the domestic market, and 3. the protection, by the state, of the interests of the producers against those of the consumers. As a result of the interrelated character of these three factors, economic policy and the development of the system of planning and management are dominated by the interests of "minorities". They have no interest whatsoever either in opening up, in competition or in adequately meeting consumers' needs. However, the "majority" – interested in rapid progress – is unable to defend itself.

Before examining the above three factors one by one, it should be emphasized that my assertions are by and large of a hypothetical nature; some of them can be perceived by intuition or observation or by means of logic. Though only a few can be attested by documentary evidence, I am sincerely convinced that they are valid. If I concentrate on these three factors it does not mean that I do not regard the previously disclosed errors of the economic policy and the system of planning and management as unimportant. In fact I believe that they call for amplification from the point of view of the issues to be discussed.

Hungary's protectionist seclusion

Official statements try to present Hungary as a highly open country integrated with the world economy. All economic difficulties, or at least the greater part of them, are attributed to the seclusion and protectionism of other countries and their discriminative policy against Hungary. In the course of the debate on openness [20, 17, 24] several of us have pointed out the well-known, though generally hushed-up fact, that the Hungarian economy is qualitatively or from the point of view of trade policy extremely closed especially if this is measured by the ease with which frontiers can be crossed by goods, capital, people and all kinds of skills and informations. I have summed up my views as follows: "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 conomy."*([20]p. 221.)

The protectionist seclusion of Hungary has historical traditions of long-standing, but this could be also stated in the reverse: integration with the world economy, and

liberal, free-trade ideas and practices have almost no tradition whatsoever in Hungary. Under the influence of German economic nationalism Hungarian industrial development was of an introverted, import-substituting character even before World War I. However, at that time this was directed towards an Austro–Hungarian Monarchy-size domestic market which rendered production in most fields efficient. The Hungarian economy, narrowed down by the Trianon treaty of 1919, lost a considerable part of its markets. Although it would have been of vital interest to develop economic integration with the neighbouring countries, i.e. to engage in a policy of "openness", this was prevented by the nationalist fanaticism of that time. Instead of this, the ambitions to reconquer the "territories annexed by the neighbouring countries" and at the same time, the dread of the possibility that the countries of the Little Entente would "encircle" Hungary, led the country towards an introverted, uneconomical, import-substituting form of industrialization. This was oriented towards a narrow domestic market, while at the same time the modernization of agriculture was impeded by the system of latifundia burdened by feudal constraints. Some results were undoubtedly achieved by adjusting to the new situation and there were some firms which switched over to an export oriented business policy and achieved outstanding successes both in technological development and in widening their markets even under conditions of keen international competition. Yet despite this, industrial development was very slow and the distribution of incomes exorbitantly disproportionate, thus resulting in great social tensions. Little wonder that under such circumstances, following the serious shocks of the Great Depression, significant leading groups of the Hungarian economy tried to find a way out by militarization of the economy, by joining nazi Germany and fascist Italy and by the so-called "Grossraum" economy of world conquest – as promised by those powers.

Following the collapse and devastation after defeat in World War II, at the time of reconstruction the idea concerning the "economic cooperation of the nations along the Danube" and the economic integration of South East Europe was put on the agenda once more and seemed to have been revived. It was hoped at the time that chauvinistic conflicts stirred up prior to and during the war could be done away with by the people's democratic transformation which was headed by the Left. It was hoped this would bring about a vast market which could become the foundation of a meaningful international division of labour and economic progress. The idea of South East European economic integration, in all probability, preceded that of the integration of Western Europe, but – in spite of this – unfortunately it could not be carried into effect since it ran counter to Stalin's plans. Following communist take-over and the sharpening of Cold War tension it became obligatory to imitate the economic policy of the Soviet Union. This meant seclusion from the capitalist world and a general policy of increasing the pace of an introverted, import-substituting industrialization. [6] Such a policy might have been justified (though probably not absolutely necessary) in the case of the Soviet Union, encircled as it was by hostile countries. It had been forced into a war, and thus into autarky and reliance on own resources. The development of all branches of its industry were based on ample raw material resources and a huge domestic market, and they were also affected by the loss of importance of foreign trade. The copying of all this, however,

proved to be a serious error in the post-war era in the small countries of Eastern Europe, whose economies had been devastated by the war. These countries have still not recovered from the grave consequences of that policy. The division of labour, and integration among the CMEA countries, were made extremely difficult by the highly centralized stateowned economic system within the national frameworks. At the same time, the consequences of the system compulsory plan instructions and the neglect of rentability made both enterprises and authorities uninterested in the exploitation of advantages resulting from trade. All this was not counter-balanced by the establishment of the CMEA, because by this system all member countries became closley attached to the Soviet Union.* Also, by means of its arbitrary specialization, it induced relatively intensive trade among the member countries which, however, was not based on world-market competitiveness, technological achievments and up-to-date standards.[16]

It is worthwhile recalling the events of the recent (or not so recent) past because it can thus be understood that the tutors of the present-day decision-makers of economic policy (moreover, of economists in general) and even the professors of their tutors had lived in a world dominated by a protectionist way of thinking and practice. Although they had learned about and taught on, the theories of comparative costs and the advantages to be derived from foreign trade, for the majority of them these ideas had meant some kind of abstract, artifical theses devoid of reality. Thy felt – and still feel, with good reason – that these theories had and have nothing, or little to do with our world and practice.

Much has changed since the fifties: as early as 1954 critical remarks were published on the neglect of advantages resulting from foreign trade, and there also appeared the idea of the efficiency related to foreign trade. This was followed by a wave of comprehensive criticism on the Stalinist system of plan instructions, which resulted in the realization that the whole system of planning and economic management was in dire need of fundamental reform. The seclusion of the Hungarian economy from the world market was significantly eased by the new system of control and management introduced in 1968. Thus an end was brought to the total separation of production and foreign trade. As a result, the information of producers regarding developments in world markets was enhanced considerably. Nevertheless, twenty years have not been sufficient to carry into effect the principles of the liberalization of trade which had been set as the original objective. A great number of resolutions have been passed, measures taken and articles published on the enhancement of the efficiency of foreign trade. Nevertheless, capitalist imports have been regarded as an unavoidable evil and the objective of exports has remained the covering of import needs. The concept that foreign trade benefits if uneconomical production is substituted by imports and only economically produced goods should be exported is still regarded as a ridiculously heretic or even naive view by many decision-makers. This has been the fault not only of the trend of "reversal to the old" following a few successful years after 1968, but also of the stabilization programme

*This is termed "one-core East European region" by Ferenc *Kozma.* ([13] p. 144).

launched in the early eighties in order to put a halt to the indebtedness which started in the wake of the above trend.

Halting and withdrawing the reform process and reducing openness got a strong impetus when, following the price explosion in the world market, the Hungarian economic policy-makers unfortunately regarded seclusion and CMEA orientation as the manifestation of the superiority of socialism, i.e. they imagined that such a policy would be able to "defend" the Hungarian economy against the relative price changes. Even worse, they were able to pursue such a policy for quite a long time and therefore neither producers nor consumers adapted themselves to the new price and demand relations in the world market. This resulted in immense and long-lasting losses in the terms of trade, as well as in the failure to implement structural changes in production and consumption.* If the original principles of the reform (i.e. that foreign trade prices have a direct effect) had been introduced this would not have occurred and – similarly to other countries flexibly adapting themselves to market changes – the terms of trade losses would have been much smaller and would have lasted for a shorter time. If, in the second half of the seventies, world market price changes had asserted themselves on the domestic market and enterprises had operated on the basis of profit-orientation, there would not have been such an important increase in consumption and investments. These increases resulted in a high rate of Hungarian indebtedness. The majority of enterprises would have not been in a position either to increase wages or to raise investment credits and many of them would have faced a serious financial crises (as happened in many other countries). This, however, would have necessitated a structural change and a technological and market regeneration which pointed towards a real solution. The changing of the structure of production would have caused many difficulties and demanded the acceptance of considerable social sacrifices in the second half of the seventies. However, these would have been less than those of today, moreover they would have been more tolerable, owing to the political stability of that time.

Instead of this, Hungarian economic policy-makers chose the course of maintaining an unchanged economic structure and simultaneously stepping up an enforced increase of consumption and investments. These quite naturally, could be financed only by foreign loans and these increased by leaps and bounds.** True, they were supported in this policy by the unreasonable, abundant money offers of Western bankers who, irrespective of what these loans were assigned to, regarded them as good investment. The unchanged structure of production and industrial development oriented to CMEA markets naturally did not enable the rapidly increasing imports from capitalist countries to be covered by exports. When, at the end of this path, Hungarian debts became increasingly oppressive during the late seventies, the bringing to a halt of the process of indebtedness and the

*The CMEA orientation could be realized "only" in the investment policy determining the structure of production and exports. It failed, however, to materialize in imports since the possibilities of the CMEA countries were greatly overestimated in that respect.

**This is termed by Zsuzsa *Bekker* [5] "the path of passive drawing in of resources", i.e. when foreign loans are used not for structural regeneration but in order to postpone such restructuring. (p. 186)

restoration of the equilibrium of the balance of payments was declared to be the chief objective. Of course, halting indebtedness is absolutely necessary, but setting it as the major objective is a grave error since *only the improvement of efficiency can be the genuine target.* This alone can provide a firm basis for balancing and developing the economy. If, instead of this, external equilibrium becomes the objective, the economy will unavoidably be pushed in the direction of deteriorating efficiency and seclusion, i.e. it will be plunged into a downwardly spiralling whirlpool.

Yet there has not been any major structural change, opening-up, adjustment to the world market, and enhancement of the independence and of the profit-motivation of the enterprieses. Instead exports have been radically stepped up, imports have been restricted, investments throttled and the forint, the national currency, has been revalued.* The protectionist seclusion of Hungary was increased by this policy in two ways: enforced exports tend to result in backing up unprofitable, uneconomical exports – thus further deteriorating the structure of production instead of improving it by adjustment to changes in the world market. Administrative, and therefore necessarily arbitrary, restriction of imports not only causes difficulties in production and exports (thereby increasing shortages) but stimulates any kind of import-substituting production, however uneconomical it should be, i.e. it further deteriorates the structure of production.** The insistence on the expansion of exports and the granting of various preferences and subsidies hides the policy of import substitution but makes it look as if export orientation was being pursued. However, it suffices to cast a single glance at the development of industrial investments to show what stupendous sums are spent on objectives such as the Jamburg gas pipeline, the Bős-Nagymaros hydroelectric system and primary production. It also shows how little remains for updating the manufacturing industries and thus rendering them competitive in the world market.*** If – as mentioned above – the enforced substituting of imports with domestic production is also taken into account, it becomes obvious that Hungarian economic policy has not become open and export-

*It was Béla *Balassa* ([2] pp. 29–31) who first pointed out that subsequent to 1978 – contrary to the official statements – the forint had been revalued and not devalued. This was shown by adjusting the currency-basket, used for measuring, according to the market composition of Hungarian trade.

**The rapid growth of material and semi-finished goods imports from Western countries seemingly contradicts the development policy based on import substitution. Actually, however, the restriction of imports and import substitution at any price usually happens paralell with the squandering of imports on a grand scale. By the allocation of imports and the lack of price and profit sensibility enterprises are stimulated to attain as high an import allocation as possible and to defend their "rights" thus secured. Consequently a situation aries in which there often occurs both superfluous imports and unprofitable, import-substituting production.

***In the words of András *Köves*: "Hungary – like all other CMEA countries – is characterized by the fact that imports for development from the capitalist countries generally do not serve the aim of export-oriented development sufficiently, but are still part of import-substituting on a CMEA (sometimes on a national) scale." Imports from capitalist countries aim first of all at the development of engineering and the chemical industry. "However, the development of these branches of industry has been realized mainly as part of the plan to improve qualitatively and quantitatively the supply of the CMEA region. Thus, in Hungary for example the central development programmes for engineering (public vehicle programme, computer programme) have not defined the stepping up of exports to the West as a requirement and are aimed exclusively at the increase of domestic supply and exports to the CMEA region." ([16] p. 124.)

oriented, but has remained of an introverted CMEA-oriented nature, isolated from the world economy. "Opening" does not mean that a country exports anthing which can be sold but that all profitable export possibilities are grasped. On the other hand, imports are substituted by domestic production only if it is profitable, while domestic production is gradually terminated if it cannot be made cheaper than imports. Naturally this demands an export-oriented development policy, the concentration of investment funds with the aim of developing profitable exports, and the withdrawal of capital from deficit export ventures or import substituting activities.

The protraction of an introverted protectionist policy and the missing of the chance for opening was a serious error, not only because a distorted production and trade structure became ossified, but because growth was also slowed down and subsequently brought to a stop. This made it impossible for Hungarian export capacity to avoid lagging behind the increase of import demand and eventually prevented the preservation of living standards. It was an error also because, meanwhile, the world changed a lot: the world market for industrial products – and particularly of the most up-to-date ones – has increased rapidly. Of the small nations, the only successful ones were those which were able to integrate into this process by specializing their production and marketing their goods all over the world. The global character of raw material sources, the production and the distribution of technological knowledge on a global scale, the internationalization of the division of labour in more and more areas and in increasing depth of the production process, the expansion of the world market, the international flow of capital, information, scientific and technological knowledge and experts – all these are processes expanding irresistibly despite fluctuations in the world of business and the protectionist set-backs of certain periods. It may even be added that in spite of the rapid progress of globalization and internationalization, these processes are in many respect only at the start of their course and such tendencies will, in all probability, gain further ground. Therefore the lag of a small country like Hungary – falling behind the developed industrial centres because of its protectionist isolation as regards the most dynamical sectors of industry – is much more significant than fifty years ago. If this policy is continued it is to be feared that the situation will be much worse twenty years from today.

However, if this policy of protectionist isolation seems to be obviously unreasonable and disadvantageous and is doing so much harm, then who is profiting by it, in whose interest is it and how is it able to survive?

The monopolization of the Hungarian economy

Naturally, seclusion has many causes and these start with ideological-political schools of thought which want to defend Hungarian economic and cultural life against capitalist influences. They scent subversive intentions and hostile activities behind any Western relations. Then there are defeatist views which regard becoming competititve on the world market as hopeless and wish to mitigate the increasing exposure of Hungary by

introversion and the restriction of foreign relations.* Opening towards the world has been impeded considerably by the fact that in the selection those working in the foreign trade organizations and missions of Hungary and also those sent abroad on official or business trips (and this is much the same today) attention has been given to the viewpoints, of political reliability and vigilance of the personnel. Foreign trade know-how, command of languages and technical competence have been considered secondary factors.**

In my opinion the ideological, political and "vigilance" aspects are by no means negligible factors in the development of isolationist attitudes. Nevertheless economic interests, often almost indiscernible and overshadowed by them, are probably at least as important as those – although they are mentioned less frequently. Thus it would be a mistake to assume that isolation from Western markets in enforced solely from above against the will of the enterprises; the situation is often just the reverse: Hungarian enterprises, too, fight for and achieve or maintain protection in their own interest against import competition. I think I am not mistaken in attaching great importance to the interests of producers who want to eliminate the judgement of the world market and regard such interests as the core of an introverted isolationist policy. It is no wonder: efforts to restrict, and if possible to eliminate, competition have as long a history as the market and competition themselves. It is the natural attitude of the productive and servicing enterprises – and this should not be held against them and cannot be changed – to strive to get rid of their rivals. If they are unable to achieve this, they try to come to an agreement instead of competing with them. Producers can be but forced to compete, but nowadays this is proving to be a difficult and not very successful task anywhere in the world. A necessary, but by no means adequate, condition of this is the legal prohibition of any restrictions of competition whatsoever – i.e. the guaranteeing of free "entry" and "exit" in various economic activities, the interdiction of collusions, market allocations, price agreements and distribution of production lines etc. among corporations. It is a well-known fact that such laws do not wholly guarantee the free functioning of markets. In this respect, too, everything depends on the enforcement of the laws. Of course, if the establishment of monopolies and the elimination of competition have not been prohibited but, on the contrary, organized, pressed for and guaranteed by menas of decrees by the state itself, it involves much graver consequences.

The reasons are known but, to may mind, it is still not adequately clear why the monopolization of production and sales has reached unprecedented dimensions in the socialist countries [31, 27, 18, 19]. It is argued by many experts that this form of economic organization suits exactly the purposes of the system of a hiearchically organized power structure with compulsory plan instructions. This is because central

*According to Ferenc *Kozma* Hungary's balance of the "rent on capital and brain" in her trade with the capitalist world shows a deficit ([14] p. 47.) and "while socialism has a minority position in the world economic pattern this will result in an outsider's position for us. As long as our technological development, organizational standards and discipline lag behind those by whom we are regarded as small enterpreneurs, our status as outsiders gives them an opportunity to exert pressure on us." ([15] p. 45.)

**The specific character of Hungarian foreign trade companies by which security aspects and the absolute conformity with central directives have been put into the fore (while the aspect of efficiency has been played down even to a greater extent than at civil productive enterpriese) was termed "the superiority" of these enterprises by István *Salgó* [25].

management finds it easier if its instructions have fewer "adressees", and it can also be justifield by the rationality of the economy of scale. There was so much talk about the "superiority of socialist big enterprises" that apparently the disadvantages of the monopolies had been quite forgotten, as if such drawbacks existed only under capitalism. However, these "big enterprises" (which are often organizationally merged enterprise conglomerates) have, as a rule, not proved their superiority in the course of competition, have not produced better, more and cheaper goods (thus superseding smaller producing and servicing enterprises by means of evolution); they were called into life by Party directives and state measures and merger campaigns organized from above. In the course of this process of monopolization, political and public administrative bodies have become closely intertwined with the newly established managements of big enterprises (quite frequently somebody who is a deputy minister today becomes a general manager tomorrow or vice versa). Therefore, it is difficult to estimate the extent to which this phenomenon has been due to the interests of the centralized power structure, to the "megalomania" and "imperialism" of the unbounded ambitions of the managements of the big companies or to the strong desire to get rid of competition. It can be stated with certainty that there has been no serious resistance, on the part of big enterprises, to mergers: in the same way the disintegration of big enterprises has not been supported strongly either. Thus, there is no significant, organized, social force which is interested in decentralization and in calling into life and/or developing competition.

Striving to shun the judgement of the market is the natural attitude of the technical staff of enterprises all over the world including those who want to introduce the most up-to-date technological procedures. It is much easier to be modern if one doesn't have to think about the price of modernity or to contemplate whether this would be recovered in the price of the product. Of course, along with this, it is much easier to conserve obsolete technologies and not to develop either production or products if there is no competitor in sight. Therefore, it is to be feared that the "increased appreciation" of the technical intelligentsia, so often declared nowadays (and actually needed very much, indeed), would in itself not render Hungarian products competitive.

Socialist monopolistic ambitions were not motivated by earning monopoly rent since profit-related interest hardly functioned at all. Even if it functioned in a small way, the possibilities for price and profit increases were highly restricted. The interest in eliminating competition tends to be very strong even if there is no profit-related interest. The conditions and the characteristics of the economy of shortage were in great detail and from many angles described by János *Kornai* [10]. Obviously, under the conditions of an economy of shortage and in a sellers' market, where the producers are in a position of superiority, this interest manifests itself to an even greater extent, and thus the position of the producers is further strengthened. Having eliminated competition, the consumers' needs and changes in demand can be disregarded more than ever, technological development can be left out of consideration, the pressure of the market decreases, the intensity of work and discipline can be loosened, and quality can deteriorate. However, the productive enterprise is often compelled to put up with these conditions because competition has not been eliminated solely by it, but by its suppliers as well. As a

buyer, the enterprise also becomes exposed and is obliged to tolerate the inferior quality of materials and semi-finished goods as well as their uneven delivery. This is because it cannot approach anybody else on the monopolized market. The elimination of competition and shortage spreads to the labour market as well: management cannot take a resolute stand in dealing with the workers, it has to put up with a drop in productivity, intensity and discipline, and it also has to accept the production of sub-standard goods – if its does not want to risk losing its workers.

The attitude of the worker, however, is also understandable since he reasons economically. If he feels his job to be cumbersome and does not derive any pleasure from it, but at the same time he has not to fear being sacked because of the prevailing shortage of labour, then he can have only three aims: to get the highest possible wages, to work the shortest hours possible and to exert as little effort, and physical and mental energy as possible. If his working hours are fixed and cannot be shortened, if his wages do not or only to a very small degree depend on performance, then he has no other choice but to minimize his input and reduce the work-intensity; consequently, the quality of his work deteriorates. This can be restricted by traditional decency, honour of the trade and exacting demands towards himself. However, practice unfortunate clearly indicates the effect and the duration of the above factors. Naturally the worker's attitude changes immediately as soon as his employment and/or wages become dependent on working hours and performance as can be observed in the second economy.

Striving for a monopolistic position is often justified by being seen as a defence against the suppliers as a result of shortage. The position of the enterprise as a buyer is also strengthened by the elimination of competition: as a major or single buyer it can face its suppliers more effectively than if its strength was spent in competition. This argument seems watertight as regards the secluded domestic market of a highly monopolized economy of shortage, but it does not hold up when productive or foreign trade companies brandish the same argument in defence of their monopolistic positions in the export trade, in order to maintain the prohibition of export competition. As a matter of fact, Hungary has virtually no export product which has reached a monopolistic position on the world market and, therefore, Hungarian export goods inevitably have to compete with similar or substitute products. Thus the prohibition of export competition does not strengthen Hungarian positions abroad, it simply ensures that the domestic conditions for producers and sellers are rendered more comfortable.

Naturally producers are also buyers, and as such they would like to buy raw materials, equipment, and component parts on a market based on competition, from those who offer the most adequate goods at the lowest price. While every monopolist defends his own market against competition, he regards as desirable to eliminate monopolies, to introduce free competition and to liberalize imports in all other areas. (Why it is the producers' interests, rather than those of the buyers, which assert themselves in practice – this will be discussed in the following chapter.)

With the majority of products, the elimination of competition – a reasonable and instinctive endeavour of all producers – becomes possible only on closed domestic markets. For this very reason the policy of protectionist seclusion and the "defence" of

the domestic market are deeply rooted in the interests of productive and trading enterprises, irrespective of whether they operate under the conditions of a system of compulsory plan instruction or a market economy, or within the bounds of a transitional system between the two. The system of compulsory plan instructions (destined to eliminate commodity-relations, money and market) was of course *par excellence* suited for the elimination of competition and the rendering of almost complete monopolization. However, it would not have been able to bring it to "perfection" if it had not coincided with the well-founded interests of the productive enterprises. Naturally it is not only the productive enterprises but also the trading and servicing firms which try to eliminate competition and to achieve a monopoly position: it should not come to light that others can buy or sell under more favourable conditions or can offer better services at a lower price. Yet while the exporting enterprise does its very best to hinder others in exporting the same product, it would like to be able to choose among the rivalling producers. The importing enterprise, too, would be in favour of triggering off competition on the domestic market but would not like to share import rights with others.

Every enterprise tries to present the maintainance of its own monopolistic position as "national interest", and to this end companies more often than not get the support of the sectoral ministries and other authorities. Unfortunately, while emphatically asserting "the interests of the national economy" the basic truth often gets lost: it is *only the interests of the consumers* i.e. the freedom of competition, opening towards the world which *could represent the true interests of the nation.* It is this alone that would guarantee the acquisition of high-quality products in abundant quantity and at a relatively low price, and also ensure that resources flow to enterprises where competitive production can be extended.

The efforts of the enterprises – in the course of the reform process – to gain greater independence, to get rid of the direction of "higher" organs and their practice of interference in major and minor matters alike, and the apparent discontent of the enterprises at being veritably hamstrung, have deceived many people and made them believer that they were adherents of a free market economy and competition. Nothing could be more off the target: actually the enterprises would like to get rid of the "bullying" by the authorities in order to strengthen their monopolistic positions. It has never entered their minds to voluntarily resign their right of being protected by the state against competition particularly against import competition.

Everybody deplores and condemns the tendency of chronic indebtedness, the insufficiencies of export performance and the necessary restrictions of imports. Consequently, the extremely strong interests of all producers in setting themselves against the influx and competition of imported goods have become blurred. Instead of complaining they ought to be grateful that, owing to the monopolization and to the low efficiency of the Hungarian economy, the consumers have generally no possibility to choose between domestic and imported goods. If they did have a choice it might compel Hungarian enterprises to work in a more disciplined and efficient way, and to turn out higher-quality products based on a more developed technology.

Who should be protected by the state?

The elimination of competition and the establishment of monopolistic positions is obviously in the interest of the producers, and it is similarly evident – only less well-known or stressed – that market competition is at least as much in the interest of the consumers. The abolition of the economy of shortage is considered desirable, and it is a coveted aim to bring about an abundance of goods, and a buyers' market instead of a sellers' market – yet this is feasible only by means of competition and opening up towards the world market. In economies isolated from import competition it is often attempted, quite in vain, to break up big enterprises; this alone cannot bring about market relations since it is soon realized by enterprises producing or marketing similar products that collusion is more advantageous for them. Thus they prefer to agree on prices and the partition of the market, rather than compete in the field of prices, quality and delivery and risk being alarmed at the prospect of losing buyers to a competitor.

It is a natural concomitant of the division of labour that there are always less producers of one article or another than consumers: everybody wears shoes but relatively few produce them. How is it possible that in spite of this, the minority can assert its will and interests such that in the sphere of the economy, too, *the majority is dominated by the minority?* Where the market is cut off from foreign competition and monopolies can rule, the interests of the productive minority dominate, and the more spheres in which these prevail the more valid this statement proves to be. In Hungary this is the case is many fields today, even if the reform has brought quite a few improvements in this field, too.

The theory of Mancur *Olson** long ago supplied the answer to the question which asked why smaller organizations can assert their interests more successfully than bigger ones: "The larger the number of individuals or firms that would benefit from a collective good, the smaller the share of the gains from action in the group interest that will accrue to the individual or firm that undertakes the action. Thus, in the absence of selective incentives, the incentive for group action diminishes as group size increases, so that large groups are less able to act in their common interest than small ones." (See: [23] p. 31) If such a disproportion prevails between smaller and bigger groups and organizations, as regards the interest and even more the successfulness of their fight to assert their interests, then it cannot be expected that some kind of optimum solution should be produced as a result of the free bargaining among the organizations representing various interests in the distribution of either resources or incomes. "Some groups such as consumers, taxpayers, the unemployed and the poor do not have either the selective incentivies or the small numbers needed to organize, so they would be left out of bargaining", writes Olson. "It would include choosing policies that, though inefficient for the society as a whole, were advantageous for the organized groups because the costs of the policies would fall disproportionately on the unorganized." ([23] p. 37)

*See: [22] and [23]. Olson's theory could be reviewed here only in a very abbreviated and incomplete form.

It follows that it is worthwhile for the interest groups to cut out a larger "slice" of the "pie" of the gross national product even if by doing so they reduce or even diminish the growth rate of the GNP. When monopolistic organizations succeed in achieving greater profits by eliminating competition, by means of higher prices, by tax allowances or by maintaining activities which could not survive in case of competition, both the distribution of resources and the pattern of consumption is distorted to such an extent that the gross national product is either reduced or its growth rate slowed down. ([23] p. 42) This is made possible for them because the consumers of the other parts of the "pie" are not organized sufficiently to be able to defend the interests of the majority and of the national economy.

On examining protectionist seclusion and the high degree of monopolization, it turns out that in Hungary a strong influence is exerted on the public industrial and trade policy by the various interest-protecting organizations, big firms, and trusts – the situation is similar in agriculture, too, as regards the state farms and the big cooperative farms. As a result, certain big enterprises and cooperatives are in a position to attain special subsidies, credits, protective tariffs, import-stops, wage and tax allowances from branch ministries, the Planning Board or the Ministry of Finance. This often implies that what is put at the disposal of firms of poor efficiency is taken away from those operating profitably* and thus, the efficiency of the economy as a whole diminishes: *some are allotted more than they were entitled to receive and meanwhile everybody gets less than would otherwise be possible.* However, more is involved than this much criticized though invariably functioning harmful practice: as a rule the more or less well-organized interests of the producers are dominant in public economic policy, whereas the practically unorganized interests of the consumers, taxpayers and citizens are pushed into the background. Sometimes even ideologies are fabricated to substantiate such policies by contrasting the socialist "society of the producers" with the capitalist "consumers' society" as if meeting the consumers' needs on the highest possible level, a "basic law" of socialism which has been repeated over and over again, had not in fact been taught for ages.

The obvious counter-argument is that the consumers' interests, too, are protected by the state. Thus under the conditions of the economy of shortage the restriction of price increases is in the interest of the consumers, so are a great number of the means of quality control and so is the "supply obligation" of some big firms, i.e. it is their responsibility to ensure that no major shortage of basic goods should ensue. Authorities have to take a great number of such measures because if the dominant monopolistic

*The redistributive influence of budgetary curtailment and allowances affecting enterprise profits are analysed in detail by *Kornai* and *Matits* [12]. They stress as one of the most characteristic features of this system the compensation of losses and the drawing away of big profits (p. 180.). The new turnover tax system holds out the hope that such redistribution will lessen. In the wake of the enhanced interest taken by citizens in the activity of the Parliament, the question arises that this cannot be regarded simply as fiscal-profit levelling. The question is put as follows: what will the voters think of the practice of subsidizing enterprises in the red out of their (the tax payers') money? Wouldn't it be possible to pay less taxes or to put the money towards the financing of worthier objectives?

organizations were able to enforce their interests without restraints within the framework of a secluded shortage economy, this could result in economic anarchy: the consequences would be rapid inflation, difficulties in the supply of basic goods and a seriously unbalanced budget.

Yet, despite the fact that authorities are compelled to take many such measures, it is the highly monopolized interests of the producers, namely the big companies, which basically prevail in the economic policy of the state.* This is substantiated by the fact that the state did not forbid or impede but, on the contrary, itself organized and sometimes enforced mergers of firms and cooperatives, the establishment of monopolistic organizations, and the elimination of competition even if such measures were not justified by efficiency considerations. When the irrationality of this practice became obvious in more and more fields, the administration started reluctantly and half-heartedly to break up some big enterprises. However, collusions were not prohibited and thus there was no need to engage in competition.** This is also borne out by the high level of protectionism in trade policy, i.e. on the market of industrial finished products there is very little, and in case of most products, no considerable import competition. Moreover, this is also reflected by the fact that – as mentioned above – even if it were in the interest of the big enterprises to be able to purchase high-quality raw materials, semi-finished products, and investment goods cheaply on a market based on competition, in their quality as buyers they belong to the "weak" majority and thus the interests of the "strong" minority assert themselves.

However, appearances are deceptive and therefore managers of big enterprises and high officials of ministries, too, would certainly protest about an allegetion stating that monopolies are protected by the state. It is not protection but exposure to the authorities which is felt by the enterprises, whereas the state authorities might feel that they "resist the pressure exerted by the enterprises" and are rigorous and exacting, since only a minor part of the requirements of the enterprises are acceded to. This, however, does not invalidate the basic fact that the elimination of competition represents an extremely high degree of protection. A green-house means protection even if flowers wither away in it. No wonder that amidst the raging storms of the world market those ones which are withering (despite, or rather because of their protected situation) cannot hold their ground. It is not to be wondered at either, that the less competitive and adaptable they feel themselves to be, the louder they protest against the competition of imports.

*An aspect of this problem has been analyzed by Kornai [10], who describes the relationship of the "paternalistic" state and its enterprises (pp. 561–568). A spectacular feature of this is – as termed by the author – the "soft budget constraint" (pp. 306–309) and/ or "pumping" from the higher authorities (p. 569).

**Even small ventures (moreover, the second economy) become beneficiaries of the monopolistic position and are able to sell somewhat better quality good than those turned out by big state enterprises, or products more eagerly sought for and having a high profit margin. Nevertheless they are obviously unable to oust the big companies by competition or to compel them to raise their efficiency. In such cases even the increase in the number of enterprises cannot bring about real competition thus the increase of social efficiency, and the position of the consumers, too, tends to improve but modestly.

Consumers are wronged seriously in two ways by the lack of competition, and within that, by the lack of import-competition. First, as mentioned, with competition the assortment of goods is increased and consumers are helped in their efforts to find the most suitable products at the most reasonable prices. It is also advantageous for the consumers if producers are compelled by competition to develop production technologies and products, to improve quality, and to ensure that marketing organizations need to search for and broaden consumers' requirements. The lack of such direct advantages are highly damaging to the interests of the consumers. Yet consumers suffer even more disadvantages by the fact that, owing to the lack of competition, enterprises are not forced to produce more efficiently, to turn out better quality products, and prevent waste. Enterprises are not selected by competition according to their efficiency, and neither bankruptcy, nor upswings, nor a new start are made possible under this system. Thus the general increase of social productivity is retarded. A broadly-based system of competition could lead to a twofold result: first, it could help consumers to spend their incomes on better-quality, more up-to-date, lower priced goods; second, since competition increases the efficiency of the economy as a whole, incomes would rise at a faster rate than they would (if at all) in a situation in which the monopolistic position of producers and seclusion remained. *These are exactly the two major complaints of the consumers: often, even at a high price, they do not get what they need, and incidentally, they have much less income than feasible.* Both of these troubles could be put right only by competition and opennes.

It is often stated these days by the authorities that wages cannot be raised and consumption cannot be increased – moreover, it is said it ought to be considerably reduced – because production is insufficient, and prior to increases in wages and in consumption, productivity must be enhanced. However, this argument is deficient: social productivity is low because, with the active assistance of the authorities and in the interest of the producers, there has been established a highly monopolized domestic market secluded from world market competition. It is precisely the elimination of the factors required for enhancing performance that has kept the gross production of society at a low level. The question arises whether it should not be pointed out to a greater extent that these are the reasons why there have developed immense differences in productivity and incomes between countries formerly at a similar level of development, e.g. the two parts of Germany, or Czechoslovakia and France, or Austria and Hungary? (Naturally this phenomenon also has a number of other causes, criticized from many aspects in the literature of economics and politology.)

The extent to which economic policy is influenced by big enterprises and sectoral lobbies has been highlighted and described by several authors [3, 7, 28, 1]. Moreover, there are quite a few authors who regard the centralization of a socialist economy as insufficient, meaning that the central authorities (Planning Board, Council of Ministers) are often powerless in the face of the lobbies enforcing the interests of branches of industries or monopolistic companies. The task of the central authorities has frequently been restricted to seeking for compromises and the coordination of the demands of all-powerful organizations representing particular interests. In my opinion the solution

cannot be found, of course, by strengthening the central organs or by helping some economic dictator to assume power but by radically changing the roles of the state authorities.

If it is true that the producers' and trading organizations have been from the outset superior in strength to the majority – the consumers and users – then it seems obvious that the authorities controlled by the political organs ought to take sides with the weaker majority in the course of the process of democratization, and in helping the population realise its interests. The public authorities should protect the interests of the consumers, i.e. of competition and openness towards the world economy, whereas the producers should take care of and defend themselves. This, of course, should not be interpreted as an imperative "either – or", but as a demand that the conscious and deliberate protection of the consumers should get much more weight in public decision-making. It should also be seen as the realization of the fact that it is the consumers who, as a rule, are afflicted by the multifarious favours granted to the enterprises.

Such a change of roles by the authorities and an increased influence of consumers' interests can be realized only if separate organizations are called into being with the task of preserving, increasing and safeguarding the effective functioning of social capital.* The capital owner's functions ought not to be separated from the state authorities but such organs should be established which would be able to exercise such funtions.** The low efficiency of production and the various forms of wastage can be explained mainly by the fact that capital has had no real owner. It is for this very reason that, despite rigorously strict measures, "the protection of social property" is rather a shaky affair in Hungary, and also, that almost nobody is interested in the most efficient operation of capital.

Although the state organs have not behaved like real owners, due to their almost unlimited right of disposition over capital they have become intertwined with the interests of the producers.*** Why should he, who exerts the owner's functions of the mans of production, protect the consumer against the producer? Thus, if this function is not separated organizationally from the organs of state power it cannot be expected that the interests of the consumers will be consistently protected by the latter. This, however, is an unavoidable condition of democratization. Moreover, without such a separation of tasks neither an efficient operation of capital nor the development of competition can be realized. For this reason it is regarded by many of us as the key issue of progress in Hungary.

The state should not organize and protect the monopoly organizations but should prohibit their existence, and fight against all kinds of restriction on competition and against market distortions, since this is in the interest of the consumers, i.e. the citizens.

*The question concerning the most adeguate form of ownership rights is a subject of debate among Hungarian economists. See e.g. [4, 29, 30, 8, 26]. According to the preliminary results of this debate it can be ascertained that it seems expendient to establish not one but more forms of exercising ownership rights, yet it would demand longer experiences and testing before they could function in a statisfactory way.

**It was *János Kiss* who drew my attention to this distinction.

***According too Ferenc *Donáth* "the reasons for the soft budget constraint of the enterprises are rooted in the ownership function of the state" ([9] p. 189).

Producing enterprises should be defended against foreign competition by protectionist measures only under the most exceptional conditions and then only temporarily. Such protection is due exclusively only to promising beginers and only as long as they have not become competitive following a period of technological and market "running in". When weak, non-competitive producers are protected by the state – sometimes indefinitely, the consumers are unable to defend themselves and are damaged by the retention of production of low quality, obsolete technology and high costs.* Such protection, if as extensive as in Hungary, lays an insupportable burden upon the budget and enforces the repeated raising of foreign credits which, in turn, results in the reduction of civil consumption, an increase in the pressure of taxation and a drastic cut in investments. This, however, cannot be a permanent set of solutions, for it is only a postponement of the treatment, and as such it aggravates the disease.

Those who do not want or think it impossible to reduce the intervention of state organs into the management of enterprises often accuse the consistent adherents of the reform that they demand "the withdrawal of the state from the economy". Under the present circumstances, in a modern economy where the state has to shoulder many tasks of common concern, the voicing of such a demand would be not only illogical but unfeasible as well, and therefore nothing of the like has been suggested by anybody.** The debate is focused on the necessity of changing the economic role of the state. On the one side there are those who do not wish any essential changes in that field, i.e. the adherents of the theory "let us do the same but better"; on the other side are those who demand substantial changes – suggesting, for instance, the creation of social capital owner organizations, separated from the state authorities. Thus it is claimed that instead of a detailed regulation of production, investment, material supply, wages, and instead of informal interventions, the main economic task of the state organs should be the protection of the consumers. This – wherever it is reasonable and efficient – is served best by developing and sustaining competition. It should be driven home that the support of the particular interests of unprofitable ventures is always to the detriment of other activities and society as a whole. People should be made aware of the fact that the veritable jungle of various prerogatives, special stimulations, protection against imports, subsidies, tax exemptions, easy credit terms, and the impeding of the flow of capital and labour impair the efficiency of social labour as a whole. While small collectives may profit by these practices, all of us live much worse than we could live if all these privileges did not exist.

Is all that has been said not an attempt to "square the circle", to demand of the state organs to protect the consumers instead of the producers, or more exactly: to

*The majority of society can decide, of course, to make sacrifices in order to maintain the activities of certain non-competitive enterprises since this is considered justified for one reason or another. Such a case could be for example the maintainance of a certain degree of agrarian protectionism for the sake of self-sufficiency in food production or the protection of the farmers. However, to make correct and voluntary decisions, it should be seen clearly in such cases how many sacrificies are accepted (and by which strata of society) by means of buying at higher prices or by paying higher taxes.

**See more details ([121] p. 8) and ([10] p. 565).

significantly diminish in their decisions and measures the influence of the interests of the producers and to increase those of the consumers? Do I not contradict quilelessly with this demand Olson's theory cited above, according to which small interest groups can fight more successfully for advantages than big ones, particularly if the latter ones are not even in the position to associate? How could the state be persuaded to behave and function in a different way if it followed from the natural logic of things that the anti-competitive attitude of producers' interests coincided with the principles and practice of centralized hierarchical power? These are "good questions" because it is hard to answer them, moreover we cannot be sure that our answers have been correct.

Howeover, it has become a generally accepted fact that the Hungarian economy has got into an extremely grave and critical situation, and there is no possiblity whatsoever to get out of, and recover from, this rock-bottom predicament by following the old trends. Thus a change in policy and in the institutional framework is regarded today by many people – "at the bottom", "high above" and even inbetween – as necessary and unavoidable. This is a rare occasion, holding out some hope of changes which will not only break-up some previous power and economic interest associations, ossified habits, and friendly or corrupt personal relationships demanding and granting prerogatives, but also bring changes in the public policy of protecting producers to the detriment of consumers. However, I cannot predict whether this hope of mine is well-founded or not, whether there will be comprehansion enough "high above" and social pressure from "below" which could achieve such a turn round of attitudes.

It is an undeniable fact that the changes suggested: the development of competition, the reduction of protectionism, and the cutting of uneconomical production would imply – particularly in the present situation of Hungary – considerable social commotions. The vitality and viability of any system, however, depends on its capability to effect changes of the necessary level and in time, to adjust itself to new conditions and to tackle unavoidable conflicts inherent with such changes.

I have drafted my statements in rather sharp terms but this does not mean that I am not aware of the fact that progress can be made only step by step in all these fields, i.e. in eliminating the monopolies, developing competition, in the process of openness, import liberalization, changes in the roles of the state, protection of consumers' interests and the establishment of organs functioning as owners of capital. Yet I am greatly worried because Hungary does not make any headway (or does so only to a very limited extent) in these directions. Moreover, as a rule, even the objectives are not defined unambigiously and thùs it is difficult to see what we are driving at. It is first of all the clear definition of strategic objectives which is needed in order that experts should be able to elaborate, in full view of the public, the detailed policies required to achieve the tasks successfully.

Much is talked about the reforms but little is done, and this has resulted in the fact that a considerable part of the population has identified worsening living conditions, inflation, increasing tax burdens, and the restrictions of cultural and public health service with the reforms. They do not realize that all these problems originate from the omission of long-suggested and overdue reforms. If society were to support the reform, it ought to

see that it serves its own interests, and demands not only sacrifices from the people but holds out the promise of a significant improvement of its living standards as well. Thus the state would protect society not less but in a better and different way than before. If society cannot be persuaded on this point, the anti-reformist forces will continue to gain allies from the public, for their efforts to frustrate the changes suggested.

Progress is also impeded by very strong economic interests, and the reason why "it doesn't work" is neither simply the conservatism of bureaucrats jealously guarding their power, nor their incompetence. Creating the conditions of a market, true competition and opening-up have encountered extremely strong counter-interest and silent resistance. Thus, it is no wonder that "it doesn't work". However, the question arises: how long is this state of affairs tolerable?

References

1. Antal, L.: *Gazdaságirányítási és pénzügyi rendszerünk a reform útján* (The reform of our economic management and financial systems). Közgazdasági és Jogi Könyvkiadó, Budapest 1985.
2. Balassa, B.: Az „új növekedési pálya" Magyarországon ("The new growth path" in Hungary). *Gazdaság,* 2. 1986. pp. 24–46.
3. Bauer, T.: A vállalatok ellentmondásos helyzete a mai gazdasági mechanizmusban (The contradictory situation of enterprises within the present-day system of economic management and control). *Közgazdasági Szemle,* 1975. pp. 725–735.
4. Bauer, T.: A második gazdasági reform és a tulajdonviszonyok (The second economic reform and ownership relations). *Mozgó Világ,* 1982. pp. 17–42.
5. Bekker, Zs.: Adjustment processes in Hungary, 1973–1983. *Acta Oeconomica,* Vol. 37, Nos 3–4 (1986) pp. 169–188.
6. Berend, T. I.: *Gazdasági útkeresés 1956–1965* (Seeking ways and means for the economy, 1956–1965). Magvető Könyvkiadó, Budapest 1983.
7. Csanádi, M.: A vállalatnagyság, a jövedelmezőség és a preferenciák néhány összefüggése (Some interrelationships of the size of enterprises, profitability and preferences). *Pénzügyi Szemle,* 2. 1979. pp. 105–120.
8. Csillag, I.: Az új vállalati szervezet alapvonásai (Basic features of the new system of enterprises). *Valóság,* 7. 1985. pp. 45–49.
9. Donáth, F.: Tulajdon és hatékonyság (Ownership and efficiency). *Medvetánc,* 1. 1983. pp. 161–190.
10. Kornai, J.: *Economics of shortage,*. North-Holland, Amsterdam 1980.
11. Kornai, J.: The Hungarian reform process: vision, hopes, and reality. *Journal of Economic Literature,* 1986. pp. 1687–1733.
12. Kornai, J.–Matits, Á.: *A vállalatok nyereségének bürokratikus újraelosztása* (The bureaucratic redistribution of the profits of enterprises). Közgazdasági és Jogi Könyvkiadó, Budapest 1987.
13. Kozma, F.: *Gazdasági integráció és gazdasági stratégia* (Economic Integration and Economic Strategy). Közgazdasági és Jogi Könyvkiadó, Budapest 1976.
14. Kozma, F.: A népgazdaság optimális nyitottsága (Optimal openness of the national economy). *Külgazdaság,* 11. 1980. pp. 38–47.
15. Kozma, F.: Az optimális nyitottságról – még egyszer (Once more on optimal openness). *Külgazdaság,* 9. 1981. pp. 44–54.
16. Köves, A.: *A világgazdasági nyitás: kihívás és kényszer* (World economic opening: challenge and constraint). Közgazdasági és Jogi Könyvkiadó, Budapest 1979.
17. Köves, A.: Is opening still topical? *Acta Oeconomica,* Vol. 37, Nos 3–4 (1986) pp. 205–218.

18. Laki, M.: Liquidation and merger in the Hungarian industry. *Acta Oeconomica,* Vol. 28. Nos 1–2. (1982) pp. 87–107.
19. Laky, T.: A recentralizálás rejtett mechanizmusai (The concealed mechanisms of recentralization). *Valóság,* 1980. pp. 31–40.
20. Nagy, A.: Open we must! *Acta Oeconomica,* Vol. 37, Nos 3–4 (1986) pp. 219–239.
21. Nyers, R.: "A reformhoz kötöttem a sorsomat" – interjú ("I have thrown in my lot with reform" – An interview). *Mozgó Világ,* 1984. pp. 5–17.
22. Olson, M.: *The logic of collective actions.* Harvard University Press, Cambridge Mass. 1965.
23. Olson, M.: *The rise and decline of nations.* Yale University Press, New Haven 1982.
24. Pásztor, S.: Nyitott-e a magyar gazdaság? (Is the Hungarian Economy Open?) *Közgazdasági Szemle,* 1987. pp. 326–335.
25. Salgó, I.: Gazdasági mechanizmus, külkereskedelmi szerep és külkereskedelmi vállalati magatartás (The system of economic management and control, foreign trade roles and the attitudes of foreign trade companies). Dissertation, manuscript. Budapest 1986.
26. Sárközy, T.: Problems of social ownership and of the proprietory organization. *Acta Oeconomica,* Vol. 29, Nos 3–4 (1982) pp. 225–257.
27. Schweitzer, I.: *A vállalatnagyság* (The size of enterprises). Közgazdasági és Jogi Könyvkiadó, Budapest 1982.
28. Szalai, E.: The new stage of the reform process in Hungary and the large enterprises. *Acta Oeconomica,* Vol. 29. Nos 1–2 (1982) pp. 25–46.
29. Tardos, M.: Development program for economic control and organization in Hungary. *Acta Oeconomica,* Vol. 28. Nos 3–4 (1982) pp. 295–315.
30. Tardos, M.: Gazdaságunk szervezete és a reformok (The structure of our Hungarian economy and the reforms). *Magyar Tudomány,* 1987. pp. 271–282.
31. Voszka, É.: *Érdek és kölcsönös függőség* (Interest and interdependence). Közgazdasági és Jogi Könyvkiadó, Budapest 1984.

ПОЧЕМУ НЕ ПОЛУЧАЕТСЯ?

А. НАДЬ

Почему мы не движемся вперед по пути улучшения эффективности, приспособления к мировому рынку, изменения структуры несмотря на то, что была принята масса решений об этом и многие хозяйственные регуляторы были введены с этой целью и множество раз изменены? Какова причина того, что это, именно то, что мы с полным основанием считаем самым важным, не получается?

Уже многие и правильно указали на причины неудач, однако сказанное до сих пор нужно дополнить противоположностью интересов производителя и потребителя. Потребитель хочет получить как можно лучше соответствующую, качественную, современную продукцию по как можно более дешевой цене. А производитель как раз наоборот хотел бы продать свою продукцию как можно дороже и — если можно — стремится избежать удовлетворения требований к ассортименту, качеству и современности. Это противоречие наиболее четко проявляется в их отношении к конкуренции: конкуренция предприятий сферы производства и услуг в интересах потребителя, в то же время ни один производитель или обслуживающее предприятие не любит конкуренции в делает и делает все, чтобы ее избежать.

То, «почему не получается», имеет три, тесно связанные между собой, усиливающие друг друга, причины: 1. давно продолжающаяся протекционистская изоляция страны; 2. чрезвычайно

сильная монополизация внутреннего рынка и 3. то, что государство защищает интересы производителей по отношению к потребителям. Переплетение этих трех факторов ведет к тому, что решающее значение в формировании экономической политики и системы управления и заинтересованности, имеют интересы таких «меньшинств», которые не заинтересованы ни в открытости, ни в конкуренции, ни в хорошем удовлетворении потребностей потребителей. Анализ этих трех факторов показывает, что нашему движению мешают весьма серьезные экономические интересы, и причиной того, что «не получается», являются не просто консерватизм, желание сохранить свою власть и некомпетентность бюрократов. Созданию условий для рынка, для подлинной конкуренции и открытости мешают весьма сильная контрзаинтересованность и молчаливое сопротивление.

Решение могло бы дать то, чтобы по мере развития демократии власти в первую очередь все больше защищали бы потребителей с помощью развития конкуренции и поворота к мировому рынку, а это может произойти лишь в том случае, если задачу эффективного использования общественного капитала будет поручено отделенной от власти, заинтересованной организации.

Acta Oeconomica, Vol. 39 (1–2), pp. 45–60 (1988)

INTERNATIONAL COMPETITIVENESS AND IMPORTS

A. INOTAI

The study reveals a definite correlation between the international competitiveness and the import structure of certain countries in a wide international context. In the last years the import-restrictive behaviour has been replaced by a more liberal import-licensing system and a sytem of means aiming at an overall improvement of import efficiency. A decrease in their share in the world economy and especially on the world market of industrial goods and their unsuccessful efforts to expand exports greatly depends on the import policy of the European CMEA countries. The latter is obviously deeply rooted in the outwarn economic mechanism and the autarkic and restrictive policies, increasing under unfavourable influences of world economy.

Of the recent changes in global economic power relationships and in the international division of labour, most attention has been given to – and deserved by – the strengthening of the industrial division of labour and the enhanced activity of many earlier less- or medium-developed countries. Numerous studies deal with the sudden advance of developing countries and the increasing sophistication of their exports. That is, they not only export more industrial products but also the exports themselves comprise more and more complicated, highly processed engineering products. Both the undeniable success of some countries in this field and the weak performance of others (and last but not least the spectacular losing ground of the European CMEA countries) have prompted many economists in Hungary and abroad alike to attempt to explore the causes behind such varied performances. On the basis of their findings they have suggested tentative solutions for economies which lag behind. Analyses have revealed many causes of the competitiveness of manufactured exports; these include: economic strategic approaches (export orientation), and surveys starting from the sales market side (expansion of the international market-place, trade policy of the receiving countries). However, there have also been analyses tracing back successes and failures to a few factors (e.g. technological development, separation of the export sector from the economy as a whole, and the exaggeration of the otherwise positive role of certain export promotion measures). Again there are views (mainly in the latest literature on the subject) that explain competitiveness not only by economic but also social and political factors, and by a different scale of values.

While admitting that competitiveness is a multi-factor characteristic of any economy [1], in this paper the author will concentrate on one of its specific relationships. It will be examined if there is a relationship between manufactured exports and the dynamics of imports of a given economy and if there is one, how close it is. This question has not been raised for some time, either in the Hungarian or the international literature on the subject. It has came to the forefront only in recent years, since many countries

Acta Oeconomica 39. 1988
Akadémiai Kiadó, Budapest

have frequently been forced to significantly reduce their imports. Thus a practical economic policy put the basic question: how, if at all, can exports be increased while imports are cut back? The question is all the more topical in Hungary, for there have been complaints, from the very start of import restrictions, which stress that under such circumstances it is impossible to boost exports (particularly against dollars); import restrictions necessarily weaken the economy's export potential and undermine its market position.

This paper wants to throw light on two themes: firstly, the connection between the competitiveness of exports of manufactures and imports will be highlighted through international statistics and secondly, the major features of national import policies which influence the competitiveness of industry will be outlined.

Exports of manufactures and imports

Beside European CMEA countries, we drew into the statistical analysis the NIC (Newly Industrialized Countries) group that has 10 member nations, and a further eight economies – the manufactured exports of whom, to OECD member countries, exceeded US$ 650 million in 1985 (in fact, it was more than one billion for all but three countries). We considered the SITC 5–8 categories as manufactured goods, except for SITC 68 (non-metallic minerals). We took into consideration trade with the OECD only. We did so because (a) this offered a proper basis for comparison, (b) most manufactured exports (and all the competitive ones) go to those markets, and (c) the positive impact of imports affecting the competitiveness (in the forms of machines, equipment, technology) can be best felt in the imports from the OECD countries.

Table 1 compares total manufactured and engineering exports and the respective import items. All NIC countries increased their total exports, some of them to a very large extent. The picture of developing countries in the second line is not particularly uniform and as for most CMEA countries, they registered less dollar export revenues in 1985 than in 1980. There was only one developing country unable to increase its manufactured exports, but most CMEA countries fell into this category. The situation is even more telling in the engineering industry: here each and every CMEA country lagged considerably behind its own performance back in 1980 – althought this was the field which developed most dynamically in the first half of the decade and it was also here that the growth of exports by developing countries was the strongest.

Yugoslavia performed much like the CMEA, as did Argentina, India and Morocco – the latter being unable to get rid of import substitution. Elsewhere, in the Far East, Brasil, Mexico, Israel and Tunisia engineering export outpaced the dynamics of their total export of manufactures, and more than once even doubled between 1980 and 1985. Highly varied growth paths are best shown by the figures of the first two lines: in five years, developing countries increased their exports of manufactures by 57 percent, but engineering exports by 106 percent, while the CMEA countries reached 81 and 64 percent, respectively, of their exports in 1980.

Table 1
Changes in exports and imports between 1980 and 1985[a]

	Total	Manu-factured	Engi-neering	Total	Manu-factured	Engi-neering
	exports			imports		
	changes between 1980 and 1985 (1980 = 100 percent)					
South Korea	174	175	286	137	149	162
Taiwan	193	199	241	113	105	109
Hong-Kong	127	129	171	120	121	144
Singapore	136	166	183	107	115	112
Brasil	146	106	214	64	60	69
Mexico	158	222	273	82	83	89
India	124	112	96	132	140	151
Israel	126	139	241	126	126	141
Yugoslavia	120	134	106	75	74	65
Argentina	109	105	102	11	30	28
Malaysia	103	160	168	100	95	124
The Philippines	89	134	154	62	58	60
Thailand	114	171	340	98	101	112
Indonesia	82	304	61	73	72	67
Saudi Arabia		227	79	81	79	74
Morocco	90	162	119	87	113	75
Tunisia	67	95	129	73	75	73
Pakistan	137	149		121	114	119
Hungary	93	80	76	86	86	93
Romania	101	102	65	37	38	30
Soviet Union	78	74	63	97	95	96
GDR[b]	111	100	87	60	67	62
Poland	71	60	46	48	54	48
Czechoslovakia	82	83	72	73	81	77
Bulgaria	72	81	38	114	114	154
European CMEA countries	88	81	64	80	82	81
Developing countries	83	157	206	90	89	91

[a] based on data of trade with the OECD
[b] trade with the FRG excluded
Source: OECD Trade by Commodities Series C.

The other key message of the table is that there was no synchronized movement between manufactured exports and the total, and manufactured imports, respectively. In other words: there were still possibilities for expanding the export of manufactures while total imports were reduced or grew much slower than manufactured exports did. Of 18 developing countries, only seven raised their imports, one kept them at a stable level and the others cut back by one or two thirds, or by 20 to 25 percent in most cases. Where

there was a growth of imports, this was either accompanied by substantial exports resulting in imports while improving the balance of trade – or else debt problems were not that serious. In other words, the balance of payments did not call for import restrictions. Although developing countries with the biggest debt burdens were forced to cut back their imports, this did not set back their manufactured exports at all. Brazil's imports, for instance, fell by one third between 1980–1985 while its manufactured exports more than doubled; Mexico's imports declined 18 percent but its manufactured exports grew 2.2 times and even Argentina, which over five years reduced its imports by an unprecedented two thirds, managed to expand its manufactured exports by 5 percent between 1980 and 1985.

Now what do we see in the CMEA? Their imports, with the exception of Bulgaria, considerably fell and so did exports. What's more, manufactured exports in the Soviet Union and Hungary dropped more than total import did. In trade betwen Bulgaria and the OECD, a 14 percent growth of imports was coupled with a 19 percent slump of manufactured exports. The picture gets even clearer if we seek indexes like the import dynamics of socialist countries compared with the developing ones: they are easy to find for imports by the latter also dropped in most cases. Hungary's imports from the OECD declined just as much as Morocco's but less than Mexico which compensated for the dwindling of imports by raising its industrial exports 2.2 times; Morocco managed the same by a margin of 62 percent. However, in Hungary, manufactured exports dropped by 20 percent. Bulgaria's import growth of 20 percent equals that of Taiwan, but its manufactured exports did not feel the benefits – they fell by 19 percent while Taiwan's doubled. The conclusion is obvious: even countries on a far lower level of industrial development than the CMEA have been easily capable of boosting their exports of manufactures while cutting back their imports. The gist of the problem is to find out what the structure of imports was like and what pattern of production it supported. It is evident that maintaining an outdated, non-competitive structure kept alive traditional and similarly non-competitive import demands. However, their full or even nearly full satisfaction cannot result in growing exports because such a situation supports a production system which turns out uncompetitive products. Thus the solution lies in restructuring, and the import policy must also be put at the service of this and not towards the upkeep of loss-making production lines.

The obsolescence, depreciation and non-competitiveness of the import structure as against the export structure can be best proved by the dynamics of engineering imports, shown in the last line of the table. It is well-known that engineering imports are usually the driving force behind the technical/structural development of an economy and it is these imports that carry the promise of strengthening export potential and improving competitiveness. Hence they enjoy a distinguished place among imports, particularly when the balance of payments difficulties call for import restrictions. The question is: what items should be sacrificed? The dynamics of the total imports of developing countries fell, in most cases, far behind the dynamics of engineering imports. Of the NIC countries, Yugoslavia and Argentina are the only exceptions, a fact that explains in part the growing problems of both countries' attempts to remain competitive. As for the Far

East, the increase of engineering imports outpaced that of the total imports by 5 to 25 percent (here Taiwan is the only exception). Mexico and Brazil, countries applying the strictest restrictions, could not avoid the decline of their engineering imports between 1980 and 1985, but the percentage proved to be 5 to 7 points less than that of the total imports. In this respect CMEA countries are closer to the overall trend: their engineering imports fell sizeably (except for Bulgaria), but not as much as their total imports did (the exceptions are the Soviet Union and Bulgaria). The Hungarian data are, relatively speaking, satisfactory (though many believe they are not): beside a 14 percent reduction of the total imports, engineering imports only fell by 7 percent. Total figures also indicate more or less uniform international tendencies: regarding the entity of socialist or developing countries, there is virtually no difference between the dynamics of total imports and engineering imports; as for NIC countries, it can be seen that the door opens slightly in favour of engineering imports. This is a major element contributing to greater competitiveness. However, another element can be found not so much in the dynamics of imports but instead in the efficient application and use of imported goods, namely, engineering exports facilitated by such imports. This is where the big difference is: a 19 percent reduction of engineering imports in the socialist countries was followed by a 36 percent drop in engineering exports, while in the developing countries 9 percent less engineering imports were coupled by engineering exports soaring to a 106 percent increase and in the NIC countries, the relevant percentages were 1 percent and 120 percent. Thus it is not the magnitude of input that is decisive but the transferring potential of the economy using the input, the economic policy and the structures serving this potential. (For the indexes see *Table 2.*)

Another basic problem, closely related to the economic policy applied, lies in the widely varied share of engineering imports in the different totals. *Table 3* shows the share of engineering imports for selected countries between 1980 and 1985, as part of their total imports from OECD countries. It seeks answers to two questions: first, what is the usual share of engineering imports necessary for the success of a development policy and secondly, how did import restrictions affect the share of engineering imports?

From the figures it is obvious that the machinery imports of developing countries from the OECD are far greater than these of socialist countries. The Soviet Union's engineering imports equal those of Taiwan and lag far behind those of South Korea, Singapore, and lag behind, by an even greater extent, those of Mexico or Saudi Arabia. Of course, it is needless to stress the difference in development level and economic potential between the Soviet Union and the latter countries. Engineering imports by small European CMEA countries between 1980 and 1985 may be compared, at best, to the lowest figures of Morocco or Tunisia; they account for about a half or two thirds of fairly curtailed Argentina imports, less than half of those of Portugal, one third of those of Greece and in some instances less than one-tenth of comparable imports by rapidly developing Far Eastern and Latin American countries.*

*Engineering imports by these developing and European industrialized countries come mostly from the OECD, while those of the CMEA countries come from within. However, the comparison stands since machine trade *within* the CMEA, with a few exceptions, has not improved international competitiveness (sometimes it works the other way round, i.e. it *prevents production* satisfying world market requirements).

Table 2
Specific (per unit) imports of industrial and engineering exports, 1980–1985[a]
(1980 = 100 percent)

	Engineering exports[b]	Engineering imports[c]	Industrial exports[d]	Engineering exports[e]
	total industrial exports	total imports	total imports	engineering imports
South Korea	1.63	1.18	1.28	1.77
Taiwan	1.21	0.96	1.76	2.21
Hong-Kong	1.33	1.20	1.08	1.19
Singapore	1.10	1.05	1.55	1.63
Brasil	1.04	1.08	3.22	3.10
Mexico	1.23	1.09	2.71	3.07
India	0.86	1.14	0.85	0.64
Israel	1.73	1.12	1.10	1.71
Yugoslavia	0.79	0.87	1.79	1.63
Argentina	0.97	0.90	3.39	3.64
Malaysia	1.05	1.24	1.60	1.35
The Philippines	1.15	0.97	2.16	2.57
Thailand	1.99	1.14	1.74	3.04
Indonesia	0.20	0.92	4.16	0.91
Saudi Arabia	0.35	0.91	2.80	1.07
Morocco	0.73	0.86	1.86	1.59
Tunisia	1.36	1.00	1.30	1.77
Pakistan		0.98	1.23	
Hungary	0.95	1.08	0.93	0.82
Romania	0.64	0.81	2.76	2.17
Soviet Union	0.85	0.99	0.76	0.66
GDR[e]	0.87	1.03	1.67	1.40
Poland	0.77	1.00	1.25	0.96
Czechoslovakia	0.47	1.35	0.71	0.25
Bulgaria	0.47	1.35	0.71	0.25
European CMEA countries	0.79	1.01	1.01	0.79
Developing countries	1.31	1.01	1.74	2.26

[a] based on data of trade with the OECD
[b] figures higher than 1 show a growth of engineering exports higher than that of the total exports.
[c] figures bigger than 1 show a growth of engineering imports higher than that of total imports.
[d] increment of industrial and engineering exports projected to one unit of imports and engineering imports
[e] trade with the FRG excluded
Source: own calculations based on data from OECD Trade by Commodities, Series C.

Table 3
Engineering imports from OECD countries

	Million USD			In percent of OECD imports			
	1975	1980	1985	1975	1980	1983	1985
South Korea	1760	4143	6719	36.6	33.9	38.0	40.0
Taiwan	1584	4718	5127	39.8	43.1	37.9	41.6
Hong-Kong	975	3776	5428	27.5	33.0	34.6	39.4
Singapore	2025	5479	6116	53.1	52.4	52.5	54.9
Brasil	3737	4557	3162	48.2	43.2	46.0	47.1
Mexico	3638	9653	8604	50.9	47.5	45.7	51.5
India	925	2109	3187	25.6	32.2	38.7	36.8
Israel	1151	1590	2239	38.4	34.6	46.7	38.8
Yugoslavia	2194	3524	2293	45.5	43.2	35.3	37.7
Argentina	810	4200	1181	34.7	55.5	39.0	49.7
Malaysia	1010	2710	3363	51.1	48.2	59.5	59.6
The Philippines	1228	2338	1404	48.7	47.4	53.0	46.0
Thailand	884	1879	2106	46.6	41.5	46.0	47.4
Indonesia	1901	3644	2438	47.8	49.5	50.8	45.4
Saudi-Arabia	2647	10884	8001	54.2	48.2	49.6	43.7
Morocco	693	980	736	40.2	33.2	35.2	28.5
Tunisia	452	894	651	41.2	32.0	38.8	31.9
Pakistan	564	1342	1591	40.1	49.1	46.8	48.1
Greece	1887	2833	2222	46.1	34.9	35.1	30.5
Ireland	897	2988	2915	28.2	30.9	30.7	32.7
Portugal	961	2539	1670	37.1	39.0	39.4	33.3
Spain	3304	6069	6729	36.2	36.9	38.9	40.2
Turkey	1796	1597	3295	53.6	42.9	48.7	51.0
Hungary	461	898	838	25.2	27.5	27.3	29.9
Romania	676	901	272	33.9	23.2	15.7	19.1
Soviet Union	4478	5388	5156	35.7	25.0	30.6	24.5
GDR [a]	332	538	333	29.3	21.6	30.9	22.4
Poland	2052	1806	873	37.3	27.9	20.8	27.9
Czechoslovakia	669	985	755	35.6	33.2	32.9	34.9
Bulgaria	491	437	671	44.7	27.2	38.9	36.6
European CMEA countries	9159	10953	8898	35.2	25.9	29.5	26.3
Developing countries		140500	127412		43.4		44.0
Latin-America	17344	34481	26810	46.8	45.9	43.5	47.2
Far East		37527	50695		39.7		45.1

[a]trade with the FRG excluded.
Source: author's own calculations based on OECD Trade by Commodities, Series C, Exports.

Such differences cannot be attributed solely to the problems of imports against convertible currency of socialist countries (because this problem first emerged in 1975, when there were no balance of payments problems), neither can they be justified by arguing that these countries purchase the overwhelming part of their machinery from within the CMEA. The basic difference is rooted in the economic policy applied, notably the tendency of the existing structure to devour more and more imports to be paid in convertible currency. This is why engineering imports as a part of total imports from the OECD move around 25 percent, while elsewhere they range from 35 to 50 percent. Given the fact the CMEA countries have been (were) able to satisfy most of their import demands from within the socialist integration, they could have been expected to put imports against dollars at the service of development policy and technical renewal. However, what has actually happened is just the contrary.

Import restrictions since 1980 have practically failed to significantly affect the share of engineering imports as a part of the total. Although some countries were unable to avoid a slight but temporary setback in their volume of engineering imports (Mexico, Brasil, Pakistan), by 1985 the above-mentioned index of engineering imports rose again and soon rose to a level above that of 1975/80. One of the factors contributing to competitiveness lay in the fact that they managed to increase the share (as part of total imports) of development-geared imports even under hard circumstances. Between 1980 and 1985 this indicator rose in the Far Eastern countries less afflicted by financial problems by 2.5 to 6 percentage points, but as much as 11.4 percentage points in Malaysia and by some 4 percentage points in Latin American countries having the gravest debt problems. CMEA countries show a mixed picture: it was precisely engineering imports that fell victim to Romania's harsh import restrictions (its 20 percent share of engineering imports is unprecedented and jumps to the eyes from the table); the GDR considerably curtailed its imports in this field; while Poland and the Soviet Union held their place. Over the period, Bulgaria significantly increased the proportion of its engineering imports, as did Czechoslovakia. Hungary also registered an increase, by 1.5 to 2.5 percentage points.*

The most blatant differences are found in the comparison of figures for engineering imports by CMEA countries and by the debtridden Latin American countries:

– there is a "historic" difference in the share of engineering imports from within the total Latin America's lead was over 10 percentage points as early as in 1975: while machinery from OECD countries accounted for a third of all CMEA imports, its share was nearly one half in Latin America;

– the share of engineering imports in the socialist countries dropped in the second half of the 1970s by some 10 percentage points from what was already a low level, while it maintained its share in Latin America. In the CMEA countries it is hard not to see the consumption policy of the second half of the seventies when mainly consumer goods

*For details see: [2]. May I note at this point that Brasil's machine imports rose 42 percent in the first three quarters of 1986 as against the same period in 1985. The share of high-tech products imported by the Far East countries from the US was 36.5 percent, which is 10 percent of all US high-tech exports. See: [3].

were imported, the delayed restructuring, the excessive stress on an extensive growth and the large agrarian imports distorting the relative share of machinery imports;

– between 1980 and 1985 the, by then, urgent restrictions did not bite further into the CMEA's engineering imports, yet its very low proportion resulted in sizeable shortfalls in development. The much higher barriers in Latin America did not lead to the crumbling of their historically large engineering imports. Moreover, between 1983 and 1985, when their share fell 3.2 percentage points in the CMEA, in Latin America it grew 3.7 percentage points and by 1985 had outgrown the level of 1975.

These differences were clearly the outcome of the economic and development policy pursued in the early 1980s. They go far beyond their statistical meaning and have considerably affected the scope of manoeuvring of the long-term economic policy and the competitiveness of the Hungarian economy.* The Hungarian economy indeed suffers from import limitations, but it would be even more painful to liberate imports in a manner that would help prolong the old production pattern. The structure of imports must be revamped but this can only be accomplished with a simultaneous restructuring of the domestic production, so that the import demand of the Hungarian economy emerges not in the losing branches but in those worth developing.

Some characteristic features of the import policy

Behind the afore-mentioned changes in competitiveness and the correlations of industrial exports and development imports there are, of course, countries with widely varying levels of development, historic heritages and economic systems. Yet even though those differences are wide, there are two universal prerequisities for strengthening competitiveness and using (for the latter these are indispensable) imports in a reasonable and cost-efficient way: an exchange rate policy and the liberalization of imports.

It is easy to see that there can hardly be any export promotion with an overvalued national currency. On the contrary: such rates will encourage imports even at times when the preservation of the balance of payments already calls for export promotion and import restriction – the latter by market instruments, such as exchange rates, i.e. making imports dearer, and not by administrative measures. In fact, it is realistic for exchange rates to be able to call lots of successful import substitution programmes into being which cannot be instituted with an overvalued national currency (or can only be instituted with

*The cut-back of investments and machinery purchases after 1982 had a particularly adverse impact on the Hungarian economy. At the same time, a significant volume of machinery was bought from the West, but the ensuing capacities were good for nothing because they were not up to international requirements. "The main difficulty . . . lies in our own activity: . . .we are "afraid" of deciding against the, naturally wellmeaning, representatives of the "losers" of the selective development policy (. . .), we do not dare to face unavoidable conflicts and difficulties entailed by their solution." [4].

a large amount of uncertainty as to the returns).* The comparison of Far Eastern and Latin American countries clearly shows that the difference in the two region's global competitiveness can, at least up until the early 1980s, be attributed to no small extent to their different exchange rate policies. While the former were more or less able to set realistic rates for their currencies, the national currencies of the latter remained, in most cases, chronically overvalued – in spite of intermittent and substantial devaluations. It is characteristic that in the Far Eastern countries the black market only paid 6.9 percent more for one dollar than the official rate, while the same percentage was over 40 in Latin American countries.**

Divergences between different efficient economic policies are not simply in the affirmation or negation of a realistic exchange rate but in the measures chosen to achieve and/or maintain it (i.e. intermittent devaluations in systems with fixed rates, planned and continuous devaluations, free-floating rates).***

A frequent concern related to the implementation of realistic exchange rates is that it does not facilitate the enforcement of a stabilization policy because repeated devaluations perpetuate the pressure of (imported) inflation. This is true but the effects should not be overestimated. Notably, only those imports that are competitive under the new rates are made dearer by the devaluations (otherwise such imports could easily be substituted for with domestic products). This is when it turns out that under the new rate, some imports are not needed at all. On the other hand, previous import restrictions are not likely to disappear at once, i.e. simultaneously with a change of the exchange rate but they are more likely to be eased step-by-step. In other words, the slow clearance of import channels may, in spite of more costly imports, ensure a certain gradualness. However, there is one thing which must be avoided. The exchange rate policy is an instrument of export orientation and of making the economy more flexible – it is not to serve an anti-inflation policy. It may cause considerable problems if, as happened several times in the past, we try to attain certain economic goals by using inappropriate means. In such a way we would not only be unable to reach the goal but also we would inject a great many additional contradictions, tensions and rigidities into the economic processes. The total social and economic costs of such contradictions would eventually be more

*It is not by chance that the extroverted Far Eastern countries, prompted by realistic foreign exchange rates, substituted far more of their imports than did Latin America, a long-time vanguard of import substitution. See [5].

**See [6]. The repeated successes of the Far East in 1986–87 cannot be separated from their realistic exchange rate policy either: as the US dollar dropped, their national currencies, too, were devalued against West European currencies, and also against the yen. Thus the region again gained a competitive edge while managing to maintain its positions in the US market (and even expanding them as against Japan). Between June 1985 and June 1987 South Korea devalued its currency against the yen by 37, Thailand by 38, Singapore by 39, Malaysia by 43, Hong-Kong by 43 and the Philippines by 47 percent. See [7].

***The question has been amply dealt with by the international trade literature. In particular, studies by the World Bank and the World Economic Institute of Kiel have elaborated the relevant experiences in various countries. It should be noted that methods have been worked out for the simultaneous implementation of realistic exchange rates and stabilization and several countries have tried to use them, with varying degrees of success. See [8].

expensive than the costs of solutions that the economic management refused at the very beginning (because they seemed too costly) or did not dare introduce at all.

The use of exchange rates for the performance of functions alien to them can be observed mainly in the practice of the European CMEA countries. Between 1981 and 1986 most countries under survey experienced significant devaluations, sometimes dramatic, of their national currencies as against the US dollar. Yet Czechoslovakia, the GDR and the Soviet Union countered these effects by revaluing the dollar rate of their currencies. Romania left the dollar rate of its currency untouched. There is no denial of the fact that sizeable differences in export performances may partly be due to differences in exchange rate policies; but it is more than just this: the point is that the enforcement of basically different economic policies also varied widely in the application (or non-application) of the instrument treated here.

All in all it can be stated that:

– there is an obvious correlation between incorrect (ambigious) exchange rate policies and a weak export potential; devaluation in itself did not prove to be a decisive factor in relation to competitiveness, and this again indicates that an efficient economic policy calls for the application of a wide array of other instruments as well;

– in some cases, even a dramatic fall of the value of money did not lead to a level of economic disorganization such that it might have endangered the export potential; moreover, it was sometimes exactly those countries carrying out the biggest devaluations and experiencing the highest rates of inflation that excelled in increasing their industrial exports.

Loosening the control of imports and gradual (or sometimes not so gradual) liberalization of imports are other important means for stimulating an export-orientated policy. Only at the first sight does it appear paradoxical that such trade policies should be pursued by countries that are facing serious balance of trade problems. Here import restrictions may seem to be the best remedy. However, in this case short-lived successes are followed by the paralysation of potential export sectors; new, value-creating processes have no access to imports while the long-established, inefficient commodity pattern of imports is preserved. The practice of forced exports in socialist countries clearly shows the pitfalls in that street (which is in fact a dead-end street).

Thus we have a case for the radical transformation of the former system of import policy. Import limitation may of course, from time to time, be necessary and the volume and magnitude of imports may be regulated even for longer periods. However, it cannot be centrally ordained where to reduce or where and how much to increase. It is exactly the reduced import resources that imperatively call for the best possible husbandry; and this can be done if imports are gradually (or quickly) liberalized and an import competition, only limited by the amount spendable, is created.

The liberalization of imports (more precisely, an import policy put at the service of the economy's technical revival and the strengthening of the value-creating process) is, as in the case of changing economic strategies, not a matter of economic decisions but of the outcome of political struggle.

If this problem has been surmounted, then "technical" but actually essential questions related to the liberalization of imports must be clarified, e.g. exchange rate policy implications, the main tools of liberalization and the time-schedule of implementation.

Given a fixed rate of exchange, the liberalization of imports may reduce the economy's inclination to substitute imports because entering imports must compete with less marketable domestic products. Also, such imports may help to lower prices because they are cheaper than domestic products. However this only occurs if budgetary, social and other considerations do not raise the domestic consumer price of cheaper imports to the level of domestic products; this would have just the opposite effect. At the same time, it fails to encourage exports, it has no impact on the capital and labour market nor does it regroup the production factors towards exports. In other words, it may cause severe ruptures in the balance of trade and payments of countries with non-convertible currencies. Its impact on interest groups appears to be even more important: while the liberalization of imports swells the number of those opposing that step (including those whose interests are hurt by cheaper imports), no "other camp", a *potential* supporter of the import liberalization, can be formed simply because of the failure to strengthen the export interests.

Therefore, for many reasons, the kind of import liberalization that is connected to changes in exchange rates (to devaluation) appears more efficient. On the one hand, it boosts the interest in exports and on the other, it alleviates the fear of imports (imports get costlier). In addition, it may result in continuous and controllable imports along with a significant liberalization of imports (and gradually do devaluations let imports loose on a previously protected home market).

A gradual strengthening of import competition may be accomplished by controlling imports through quotas or customs tariffs. The literature deems the latter more effective since the former comprise normative regulators while customs tariffs maintain (or "smuggle" back) individual treatment, upkeep the significant differences in the measure of protection of the various branches and conceal comparative advantages important for competitiveness.*

The time horizon of liberalization is another key element in changing the import system. One advantage of sudden and grand-scale liberalization may be that it shortens the time span, precludes rearrangement (shock therapy) and leaves no one in doubt about the policy determination of the economic management. In most cases, however, no such quick opening is possible because neither the population nor many manufacturers on the losing side can endure the shock therapy: the government's determination would be weakened by various views; and finally, a sudden liberalization can be successful only if it includes the liberalization of the capital, money and labour markets as well. Therefore this "package" can, in all likelihood, be introduced only step-by-step.

However, all these warn of two things: firstly, that import liberalization cannot be an end in itself and cannot go its "own lonely way". From the very beginning it must be

*The majority of countries apply tariffs and quotas.

linked with changes introduced in other fields of the economy (exchange rate, capital market, money market and labour market policies). Secondly, it is an indispensable means of the export orientation which, in recent years, has even been used by those countries (and not simply under pressure from the IMF or the World Bank) that found themselves in a grave financial situation and had for decades pursued a highly protectionist trade policy.

Efforts by developing countries to liberalize their imports have been intensified in recent years. During 1986 they introduced twice as many relief measures as restrictions, while the proportion was fifty-fifty in industrialized Western countries.[9] Customs tariff reductions became general, less import licences were required and in some cases the system of import deposits was lifted. Most countries promote exports not only with customs-free imports but also with expedite procedures, and in many cases with free imports (registration but no licensing). Such a change of economic policy gets support from two sides. Some countries have accumulated a sizeable surplus over the years and they are trying to reduce this since the growth of their exports increasingly depends on the supplies of the buying country(ies) as well. The prevention of protectionism, not infrequently warding off political pressure, also calls for the use of such means (see the Far East–US relationship). Again in other countries it was the strengthening of the export potential that put this question on the agenda: as a result of a lid on imports, a pretty large part of their capacities remained under-used; the technological gap increased and the balance of payments was not improved in the medium run because the loss in exports amounted to at least as much as imports "saved". Centrally distributed import allocations almost never reached the right place, while the long queues discouraged foreign capital, and the commodity credits offered to numeruous countries could not be drawn on.

The liberalization of imports cannot take place without the liberalization of the foreign exchange markets. Channels to finance efficient and competitive exports have been established even in countries where the trade in foreign (freely-convertible) currencies is closely controlled by the central banks. There are legally approved second markets (sometimes with quite large surcharges) or the central bank gives foreign currencies for imports to anyone paying a certain (15 to 25 percent) surchargege; from time to time certain amounts of foreign currencies are set free and are open to tender. Exporters are often allowed to keep a part of the foreign currency they have "produced": they might spend it on further purchases, i.e. they can remit it to their own account; they may reduce their export-related expenses (such as advertising, services etc.) by convertible imports necessary for such exports; or else they are given a special "certificate" that later can be cashed in foreign currencies. A 100 percent delivery of foreign currencies earned by exporters is nowadays a rare exception. The highly controversial attempt by Poland to set up free a "foreign exchange market" can be considered as the first such experiment by a socialist country.

Whatever solution the individual countries may choose, it is now obvious that, at a given stage of economic development and with the priority of joining the international division of labour, not only do central (monopolistic) foreign exchange control methods not fit the array of instruments necessary to reach the desired goals, but they even work

against them. This has been particularly conspicuous in recent Hungarian practice where import restrictions and a strong central foreign exchange control have hampered proper specialization. This is partly because imports increasingly went to companies handling the biggest volumes of forced exports; the economic policy viewed such imports as "vital". The result was that exports earned less and less foreign currency and needed more and more subsidies, while their import-intensity was rising. Exports produced with one unit of imports meant an ever-growing burden for the economy. What is more, in some instances it did not even cover the import expenses. On the other hand, one should not forget that international specialization is a two-way road. All and every sector can join the international division of labour *only* if growing exports are followed by growing imports. As it is, some products can be turned out in much bigger quantities than demanded by the domestic market, for in their case the country has comparative advantages. This applies especially to the basic material and labour intensive branches, which are becoming structurally outdated.

Experiences in the Far East indicate that over and above the simultaneous application of the afore-mentioned instruments, many more prerequisites must be there to accomplish a proper adjustment. These are: the existence of the money and capital markets, the possibility of competitive basic material imports, a domestic tax system, and the support of exports by small companies and the like. [10]

Some conclusions

1. The correlation between the competitiveness of manufactured exports and imports lies basically in their structure and not in their magnitude. An import policy that enabled a substantial restructuring of imports could render considerable support for exports – so that exports could be increased with even less imports than before.

2. The economic-philosophical ordering principles of the "classic" import policy have largely changed or are just about to change. Prohibitive- and restrictive attitudes obeying short-term and short-sighted balance considerations have been widely replaced by liberal import-licensing in all countries where imports serve as the basis for exports which contain a sizeable amount of value added. This export potential cannot be separated from the fact that the exporting company and/or branch needs to purchase raw and basic materials, components, services, technologies and machinery from the most appropriate sources in the global competition. The turnabout in economic philosophy can be summarized by saying that, previously, competitiveness was thought to be created or improved by establishing a domestic supply industry – nowadays it is the imports that play that role. Such imports must not be prohibited or hampered – in fact, it is the other way round: competing with imports, domestic suppliers for export branches may flourish. Reverse thinking and action systems have, as experience shows, been unable to create either competitiveness or an efficiently operating supply industry.

3. As for the increase of industrial competitiveness, the previously unambiguous production and export promotion measures should be replaced by an extensive loosening

of import restrictions, these restrictions being obstacles to competitiveness. However, realistic exchange rates, the liberalization of imports and the abolishment of foreign exchange monopolies (or their indirect practice), all promise results if they are employed in a coordinated and parallel way and not separated from each other (in the latter case further severe distortions may appear and discredit the otherwise correct measures).

4. No central interference in itself can improve the efficiency of imports. It goes without saying that the scarce production factors should be used in the most efficient manner and that precludes their central (re)distribution. Only market conditions can ensure that the scarce resources reach firms producing the biggest value added. On the other hand, it is illusory to expect higher efficiency from the imports than from the economy as a whole. It is not difficult to see that economies which generally use their production factors in an inefficient way and are known to waste investment, labour, energy and skills alike would not handle imports any differently. The amount of waste and poor efficiency inherent in the functioning of the economy should be eliminated not by central measures, no matter how well-intentioned they are, but by changing the functioning of the system itself.

5. International experience indicates that there is a well-defined and in recent years an increasingly close relationship between the import policies and export achievements (competitiveness) of economies. Consequently, they can keep abreast of global competition if their import policy, being an important factor of competitiveness, is also adjusted to the requirements of the period. Lacking this, even good initiatives will bring, at best, only partial success, accompanied by growing distortions and serious tensions and contradictions.

References

1. Inotai, A.: Gondolatok a nemzetközi versenyképességről (On international competitiveness). *Statisztikai Szemle*, 10. 1987.
2. Monkiewicz, J.'s article from *World and Development*, 6. 1986 is cited in *Világgazdaság*, October 21, 1986.
3. G. S. P.: A csúcstechnológia az USA-ban és a kelet-ázsiai újonnan iparosodó országokban (High technology in the USA and in the newly industrialized East-Asian countries). *Világgazdaság*, 13 November, 1985.
4. Balassa, Á.: Response to a poll by the periodical Külgazdaság. *Külgazdaság*, 2. 1986. p. 8.
5. Balassa, B.: Adjustment policies in socialist and private market economies. Berkeley, June 1985. pp. 18–19. Lecture at the 9th US-Hungarian Roundtable Meeting.
6. A tale of Asian winners and Latin losers. *The Economist*, February 22, 1986. p. 65.
7. *Business Asia*, June 29, 1987.
8. Preusse, H. G.: The indirect approach to trade liberalization. Ibero-Amerika Institut für Wirtschaftsforschung, Göttingen, October 1986.
9. Exchange and trade liberalization predominated in developing countries in '86. *IMF Survey*, July 27, 1987, pp. 225 and 230.
10. Yung Whee Rhee: Instruments for export policy and administration lessons from the East Asian experience. *World Bank Staff Working Papers*, No. 725. Washington D. C., 1985.

МЕЖДУНАРОДНАЯ КОНКУРЕНТОСПОСОБНОСТЬ И ИМПОРТ

А. ИНОТАИ

В рамках широкого международного сопоставления в статье показывается, что между международной конкурентоспособностью отдельных экономик и структурой их импорта имеет место определенная взаимосвязь. В последнее время ограничение импорта во многих случаях сменилось более либеральной системой разрешения импорта и системой рычагов, направленных на глобальное улучшение эффективности импорта в качестве непосредственного фактора производства. Усиливающаюся сдачу позиций в мировой экономике европейских стран СЭВ, а также неудача их попыток повысить свой экспорт в значительной степени зависит от проводимой политики в области импорта. А последняя, очевидно, имеет глубокие корни в устаревшем хозяйственном механизме и в усилении в результате неблагоприятных мироэкономических воздействий автаркического и рестрикционного мышления.

Acta Oeconomica, Vol. 39 (1–2), pp. 61–79 (1988)

CAN HUNGARY'S MONETARY POLICY SUCCED?

M. TARDOS

Discussing the possibilities and limitations of monetary policy in regard to market management, the paper examines the particular features of Hungarian financial policy between 1968–1986. Reviewing the introduction of the two-tier banking system, the author seeks answer to the question why and how long a substantial breakthrough cannot be expected in spite of the changes.

The historic, and still traceable, basic principle of the socialist planned economy was that within a reasonable time it would render the market and money superfluous. These would be replaced by conscious and systematic *guidance* which would eventually lead on to the age of man's control over things.

Yet the world, and the views formed, have since been radically changed. It became obvious that the priod following nationalizations, in which money had to stimulate the plan fulfilment was not only marked by naïvety but caused damage as well. Boosting production had often become an end in itself and as such, it had not helped to satisfy human needs; demand, including effective purchasing power, frequently remained unsatisfied and there was nothing to effectively stop the waste of resources and the rapid increase of costs. The imbalance of demand and supply also resulted in the decline of creative spirits.

The ensuing situation soon made decision-makers realize that the role of money could not be lessened. In its reform efforts, launched in 1954 and continued through 1956/57, the Hungarian economy set itself the political goal of strengthening commodity and money conditions. Later on, in 1966/68, the concept of a regulated market economy guided by a plan was declared. One proof of how substantially our way of thinking has since changed is that the 1966 decison of the CC of the HSWP – a basic document of the reform – dealt with the coordination of a planned central management with the active role of the market and did not even mention the role of money as regulator of the economy. This concept was also missing from the then delivered address by Rezső *Nyers* (then economic secretary of the CC HSWP), as well as from guidelines interpreting the decision. [1, 2]

The 1966 decision first and foremost stressed the organic unity of national economic planning and the market. In this sense, it mentioned the growing importance of economic competition, controlled by the state, between profit-orientated companies. It added that "the socialist state would then ensure the implementation of national economic plans – or in a wider sense, the central regulation of economic processes – not simply by breaking down global plan figures but instead by exploiting possibilities provided by commodity conditions (i.e. mainly by economic means)".

Acta Oeconomica, 39. 1988
Akadémiai Kiadó, Budapest

The decision then lists such economic means:
– rules of taxation:
– budget expenses;
– government control of wages and prices;
– setting foreign exchange rates (multipliers);
– the rules of foreign exchange management and export/import policy.

The decision also referred to an active credit policy with regard to the use of both investment means and circulating assets. It is known that even the word "market" was not frequently used during the implementation of the decision. The word was fully avoided from statements formulating the goals of the economic policy after the repression of the "Prague Spring". From 1972 onwards, affected by domestic and external confrontations, the practice of Hungary's economic management moved even further away from the acceptance or application of markets and the power of money-circulation. In fact, the economic management wanted to employ money and prices, though under new conditions, almost as did before 1968. Instead of using money for the Soviet-type mandatory planning which enabled the existence of economic accounting of companies ("khozraschot") it was used for indirect control. This meant there were to be three factors underlying the use of money and prices. First, the functions of money: measure of value, medium of circulation and accumulation were expected to make economic processes easier to survey and reasonably calculable. Secondly, it considered money circulation and the pricing system as vehicles serving the implementation of goals set by the plan, helping the stabilization of the economy and allowing for the continuous growth of companies. Finally, it was hoped that money circulation and the pricing system would, provided the above-mentioned requirements (assumed to be in harmony) were actually met, make the executives and employees of companies interested in the fulfilment of the plan in an effective way and avoid the appearance of particular conflicts.

The economic management of the 1970s allowed the fiscal and monetary system to work smothly in a rather controversial manner. The regulation, as it was applied, resulted in a fiscal and monetary practice different for various companies and groups of users. No comprehensive market automatism came into being; companies were not integrated by money circulation [26]. Thus the new economic mechanism in Hungary failed to give birth to a market. Instead it turned into another version of the traditional Soviet system, combining the utilization of money and the economic accounting of companies with indirect central planning [3]. In the 1970s by curbing decentralized decision rights as well as market requirements the contradiction between the somehow market-oriented economic mechanism of 1968 and the prevailing centralized and hierarchically organized power structure was diminished.*

*One sign of the Hungarian economy's domestication was that in the Brezhnev era most of the Soviet Union's economic literature did not even consider Hungary's move to abolish mandatory planning as a substantial modification of the system [15].

Nevertheless, the changes in economic management still had positive results. They managed to eliminate some weak points of the traditional central planning. These weaknesses were rooted in the inherent inconsistency of obligatory instructions and the central distribution function of the material and commodity balances. [25] However, the indirect planning system was unable to achieve a breakthrough in the adjustment to the varying demands of users and in the economy of resources. Consequently, not only did the expected improvement of efficiency not come about but, on top of it, the country was not even able to meet the challenge of the deterioration of external market conditions. The consequent difficulties reflected the fact that the reform thoughts of 1966/68 had improved efficiency only slightly. There was also a weakening of the resistance to the temptation of attractive credit offers from the West, and this was about the only firm expression of having broken away from the strict of central planning.

The period of economic restrictions

The tensions caused by adverse trends in the debt stock and the country's balance of payments, respectively, had at least two results by late 1978: on the one hand, the existing practice of economic management had to be reviewed and new methods devised. The government hoped that these would bring a turn for the better and also assure the benevolence of the population and the creditors. On the other hand, the danger of insolvency justified restrictive measures for cutting back incomes. However, the country's institutions were simply not prepared for the implementation of such measures. It was because of this that the idea of a regulated market as opposed to indirect management was raised once again.

Market economies based on the demand-oriented attitude of companies may avoid insolvency by increasing exports, substituting imports, and reducing import demands by cutting back the money supply. For a restrictive policy to properly improve the economy's adaptability and efficiency, many prerequisites must be met. The most important of these are perhaps the following:

– it must be capable of regulating the aggregate demand by coordinating budget and credit policy;

– it must create an effective exchange rate;

– it must make the companies sensitive to any movement of the money market;

– it must provide the possibility for prices to reflect the new requirements for the restructuring of production; cost-effective or readily adapted new activities have to be provided by money to cover their additional wage, material and import costs even when money is scarce; free capital and credits must be available so that immediately after the shut-down or bankruptcy of unsolvent companies their assets and manpower can be effectively integrated into new companies;

– for persons dismissed because of restricted demand the protection of trade unions and unemployment benefits must be given; also, those affected must be provided with new options (change of workplace, setting up their own business etc.).

The above points make it clear that neither in 1979, when the restrictive policy was launched, nor in 1982 when, owing to the immediate danger of the country's insolvency, the demand for restrictions grew, was the country prepared to implement such a monetary restriction. It was not simply that the wage and price system and the credit mechanism were accustomed to bargaining, or that the cost-sensitivity of companies was low. It was rather due to the facts that the legal status of firms, the rules for the association and establishment of new companies, and the lack of a bankruptcy law did not make an effective monetary restriction possible either. The protection of employees and the scope of their freedom of movement was not regulated in accordance. Thus it was no wonder that in order to win the confidence of foreign banks, the government did only some rhetoric praising toward markets a little attempt to dismantle a few big companies (which represented a form of administrative monopoly) and to encourage private enterprises. The latter included market promotion and steps that were taken to drive small enterprises, which had avoided taxation, within a legal framework.

Major tools of the eventually successful "staying afloat" were: import restriction, individually applied administrative pressure (in order to boost performance), and export promotion (which did not set efficiency requirements). The benefits of applying such methods, along with the use of economic diplomacy (application for the IMF, World Bank membership, etc.), were eventually attained. Let us add that it would have been even better if, by the time we exploited the temporary results scored by using up stocks and hastily mobilizing hidden reserves (i.e. by 1984), we had been able to enter a new development path as promised. [5, 18, 21]

Failure of the new growth path

However, the package of new and market-oriented economic methods – as demanded by the circumstances and also promised by the government – was delayed. The fear of radical change was well demonstrated by the formal debate on whether the reform's reform or the implementation of principles already adopted in 1966 were necessary. [8] Unfortunately, behind tactical issues of wording there were genuine problems. The refusal to consider a radical turn towards the market was also shown by the fact that the relevant complex proposal was adopted no earlier than April 1984. Even then this was not as a CC decision but as a mere statement. The finally adopted package of programmes, containing quite a few inconsistencies, was further weakened in 1985 during its introduction. It was widely declared that the seven lean years were over and a new upswing had started.*

*To tell the truth, one cannot disregard the important factor (not that it provides an excuse for the domestic political leaders) that the breakdown coincided with the post-Brezhnev period (Andropov falling ill, Chernenko elected as secretary-general) in the Soviet Union and no doubt the conservative tendencies made themselves felt in Hungary as well.

For the purposes of this study, the weakness of the package is best indicated by its soft points in the field of the changes in the property rights, i.e. the introduction of new company forms and the development of the money market – in the latter case especially by putting off the reform of the banking system until 1987.

Political leaders could clearly see that the institutional foundation of the autonomy of companies had to be a key element of any change in the economic management. Numerous experts sought and found answers to that question.

They wanted to give an "open" signal to a wide range of autonomous companies, i.e. ones freed from the hierarchy of the administration [22]. All suggestions were based on the common recognition that the owner, the genuine business subject, was missing from a socialist economy. Workers and other employees did not develop owners' mind – not because they had petty bourgeois consciousness – but since their objective situation was a far cry from the assumed owner's position. After all, they did not possess the means of production and could not help but sign up with state companies or cooperatives in such a manner that, in exchange for their work performance, they could get an income sufficient to live on.

Company managements aligned themselves with the state hierarchy and thus did not represent owners either; they could see their company either from above (from the ramifying viewpoints of government administration) or in a selfish managerial way. None of the above-mentioned interest is suitable for business purposes.

Suggestions by the experts were geared to help create a great number of independent economic units. In order to accomplish this, they proposed, besides spreading self-management and private entrepreneurship forms, to set up state-owned property centres and to organize corporative forms representing the interests of the state and the employee alike. Through a maze of esoteric paths, and much to everybody's surprise, there arose a decision – suggested by no one – and this was that companies were to be directed by company councils and general assembly. The logic of that decision may be best approached by assuming that here, too, the method often applied by committees prevailed. That is, to comply with requests advising more caution, passages of the text of the proposal had been omitted so that it raised no more significant objections to the changes from the side of the decision-makers. Yet the final form makes no one happy and this applies not only to experts but presumably to company managers and employees as well [27]. There are not enough experiences yet but I daresay that the new company forms have only strenghtened the time-honoured attitude of Hungarian companies – in other words instead of considering the increase of wages and incomes as a tool of cost-efficient management, they use it to iron out conflicts within the company. Hence the changes implemented failed to spur the responsibility and commitment of either management or employees. Thus they did not set themselves goals which would preserve company assets, add to those assets, and improve the company's future profit-making potential.

As for financial changes, there has been something of a tug-of-war around the banking system. Most experts agree that cutting back fiscal intervention and strengthening credit ties can be successful only if accompanied by the control or aggregate demand

and deregulating prices, wages and investments. To push back discriminative individual processes, or to generalize what in Hungary is called "normativity", is possible only if solvent national economic demand is strictly limited – namely, if it is coordinated with the economy's performance and the special administrative restrictions are substantially eased.

This would call for a banking system where a central bank, publicly controlled by the Parliament, regulates the quantity of money and finances the budget, while commercial banks, operating fully separated from the central one, are there to grant loans. Yet this programme, too, has only been implemented partially and with much controversy. The reform of the banking system was missing from the 1985 package.*

Rather than keeping the economy's income-producing capacity within reasonable limits by demand management, it hurt efficient companies by cutting or calling in credits, along with a subsequent raising of interest rates. The result was that efficient companies turned their backs on the banks and availed themselves of the latters' services only if strictly necessary [21].

At the same time, the budget attempted to introduce new taxes and to centralize company profits better than ever before. Unlike previously, it helped companies in trouble mainly by reducing their taxes and to lesser extent by giving them subsidies [18]. Going on with exemptions was all the more necessary since the bankruptcy law was still in the making.

At this point it is worth looking into the relationship of money emission and inflation. The practice of money emission is not considered by the government to be a tool determining management conditions. It is used – beside securing the survival of firms – for restricting income. These two functions have to be harmonized with the combined purchasing power of the state budget, the firms and citizens. They are determined by the issue of money. (See *Table 1.*) The restrictive period of money emission was characterized by the fact that the growth rate of the quantity of money did not attain the nominal growth rate of the GNP. The acceleration of money circulation between 1980–1984 was counterbalanced by the mutual indebtedness of firms (the so-called "queueing"). In the period when economic activity was centrally stimulated, between 1985–1986, the growth rate of the quantity of money exceeded the nominal growth of gross output. In the same period the inter-firm credits diminished. The quantitative regulation of money is moderated not only by the spontaneous flow of credit among enterprises, but also by the fact that the purpose of credit-granting is to secure the survival of all firms, by making incomes flow from the good firms to the loss-making ones. Thus, the regulation of the quantity of money has a minimal role in stimulating economic activities.

The situation becomes even more confused because excess demand is not determinative even for the rate of inflation. This is a consequence of the fact that only a small

*Bankers originally claimed (this is now cited only with regard to maintaining the monopoly of foreign exchange management) that such changes would involve the risk that creditors would not like the market-oriented measures; thus, quoting changes in the legal status of their debtors, they would demand their money back at once [28].

Table 1

	GNP		Money supply		Export surplus	Price increases in percent		
	thousand million Ft	increment in percent	thousand million Ft	increment in percent	thousand million Ft	based on GDP	at state companies and cooperatives	consumption
1979	1648.9	6.5	342.6	8.3	–23.4	5.6	·	8.9
1980	1879.7	14.0	352.29	10.7	–15.6	5.1	·	9.1
1981	2032.1	9.2	380.20	7.9	– 8.2	5.1	6.5	4.6
1982	2214.6	7.9	405.57	6.7	+6.8	5.8	4.7	6.9
1983	2367.3	6.9	421.20	3.9	+17.1	5.0	5.3	7.3
1984	2559.7	8.3	443.09	5.2	+30.9	6.3	4.1	8.3
1985	2695.0	5.1	487.77	10.1	+21.4	6.0	4.4	7.0
1986	2845.4	5.6	541.70	11.1	–15.4	3.6	2.0	5.3

Source: Central Statistical Office (CSO) and National Bank of Hungary statistical reports.

part of the measured price changes is a result of market processes (2–4 percent p.a.), and the rest is the impact of central price measures. Thus, interestingly, the curbing of money emission could be accompanied by accelerating inflation. At the same time, the running away of credits, and within this of short-term credits, sometimes did not cause higher inflation than planned. In fact, in 1986 the price rises were even moderated in conformity with the political decisions. The faster growth of money supply than that of performances caused instead of fast inflation an increasing shortage, a lagging export performance and growing imports. Thus it contributed to the increase of indebtedness. This is shown by a growing import surplus (if the rate of emission of money does not attain the growth rate of GNP) and by a reduction of export (1986).

The "competitive" pricing system introduced in 1981 but contradicting market requirements was abolished, yet bureaucratic "harmonization" of supply and demand by so-called "free" prices remained in effect. It was only in the wage system where significant liberalization took place. Restrictions were also eased by the fact that separately administered and regulated company funds (reserve fund, investment fund, profit-sharing fund etc.) were merged. All these methods have, however, failed. Companies frequently used their growing freedom to implement unjustified wage increases. That led to a step-by-step drive-back of central income control.

The result was an economy that is neither planned nor market [8]. Instructions have though been replaced by expectations and discriminative financial incentives dropped, yet the gap has not been filled by the compelling force of money and market. This explains that in 1985/86 the economy's productive performance diminished in every respect and, combined with the deterioration of the terms of trade, this pushed the economy to the brink of a crisis again, a drop in the agrarian prices, a narrowing purchasing market of raw materials, shrinking export possibilities mainly in the oil derivates and steel market, rising requirements towards manufactured export products, etc. contributed to the slump too.

What can monetary control do?

In the foregoing it was said that before the introduction of a two-tier bank system, the appropriate prerequisites of monetary control did not exist in Hungary. In such situations, one must choose between individual discriminative methods, and/or a regulation that does not raise hard requirements towards firms.

But is it reasonable to expect better results from monetary restrictions? Many doubt it because some countries, mainly developing ones, with monetary instruments more sophisticated than Hungary's, cannot stop their indebtedness. Moreover, it is not infrequently combined with a galloping inflation. Also, in most industrialized countries successful monetary policies have had serious employment consequences and many blame the monetary policy for just that.

I do not think such doubts can be fully set at rest. What is clear is that the contested questions of monetary regulation in industrialized and developing countries are

not identical with the ones now unsolved in Hungary. Both experts and scholars of market economies virtually agree that it is money emission that must make solvent demand not exceed the economy's productive capacity. Also, it is obvious that the money circulation must not be disrupted by discriminative interference, especially not in such a way that incomes are siphoned off from efficient companies in order to keep inefficient, loss-making ones afloat. Last but not least, everyone agrees that the movement of money incomes among owners, companies and economic activities must be influenced by prices, exchange and interest rates. The level and movement of these will help to achieve a nationwide balance of demand and supply, and this includes individual markets.

At present, those who demand a monetary regulation in Hungary [6] are not asking for any more than it has already been agreed on by economists dealing with market economies. Economists in Hungary, as well as in the West, are also aware that a money-regulated economy not only cannot be controlled so precisely that the restructuring avoids some frictional unemployment, but also, during slumps or set-backs, unemployment ensues against any wish. It also has to be admitted that economics has not said the last word yet on the best methods of monetary policy, on the most reasonable combination of monetary and fiscal instruments, on the use of monetary instruments and on the possibilities of an anti-cyclical policy [11]. All these, however, should not prevent us from experimenting with the only efficient restriction we know – until we find a better one. In relation to this we must learn from those countries, as well as from monetarist and neo- and post-Keynesian economists and practical experts, who have studied experiences collected in market economies over the past decades. We ourselves must also try to find the solution best suitable for us.

Another group of Hungarian critics of the monetary policy has raised two questions: first, neither the "fine-tuning" (the "in" thing in the US of the 1960s) nor a longer-term monetary control can be successful in the market economies [24]. Such critics base their arguments on the theses of *Kalecki* [17] and Péter *Erdős* [12], respectively. Secondly, they spice their doubts with a conclusion drawn from a survey of the attitude of socialist companies, namely, the principle of forced growth. The first statement consists of two elements. Firstly, that in a monopolistic situation, big companies generate their own incomes, thus the monetary policy cannot stop the outflow of money. Secondly, that the supply of money cannot be properly controlled by the central bodies. The second question of the critics relates to the companies' hunger for investment. This, in their opinion, can only be stilled by capitalist entrepreneours [23].

These are important questions. It is true that the monetary and fiscal policy of recent decades did not fulfil the hopes of the leading capitalist countries; as I have mentioned before, it proved unsuitable for a "stop-go" type of "fine-tuning" of economic development. Also, it is true that no one has so far succeeded in controling the thirst of socialist companies for investment.

Yet it is not quite clear what positive conclusions can be drawn from this. As it is, recognizing the limits of human knowledge and social insensibility to market signals, respectively, should not lead to full passivity. And if I accept the statement of the authors

that they do not recommend a return to mandatory planning or even to a modified form of it, I think that we should arrive at the only conclusion, i.e. an efficient market must be created. This, considering our current knowledge, cannot be anything but to accept that we cannot eliminate economic fluctuations, the economic regulation must focus on the long-run trend accepting smaller fluctuations, just as is being done in the leading industrialized countries by their pragmatic harmonization of monetary and fiscal policies. On the other hand, efforts must be made to influence the socialist economy's power and institutional structure, that is, property rights so as to produce reasonable conditions for efficient development.

For Hungary, the first means, just like in a capitalist economy, that the monetary policy must be strengthened in order to be capable of enforcing the balance of money supply and demand under any circumstances. It must also counteract excessive money creation in the long run and accept that the handling of short-term problems, full elimination of disturbances is beyond its capacity. In a socialist economy heading towards markets the centralized structure of property rights should be replaced by a pluralized one in which large number of market actors are fulfilling the role of owners. There is a need to provide conditions for the appearance of a business actor, who is interested in maintaining and adding to its personal or corporate assets. The difficult task of restructuring socialist property goes beyond the subject-matter of this paper. However, as I have said elsewhere, I think the problem is solvable and that even a partial solution is better than nothing [27].

Hungary's monetary policy after the elimination of the monolithic banking system

After a lengthy tug-of-war, on January 1, 1987 a banking system, characteristic of market economies, was established in Hungary. Market economies, requiring under their laws the joint presence of competition and enterprise, expect their central banks to control the money circulation and to finance the budget. At the same time, the traditional tasks of a commercial bank (collection of deposits, granting credits, and running accounts) should be performed by competing banks separated from the central bank. In this sense, in 1987 five big banks were granted licences to render a wide range of financial services [7, 13]. The only two differences – as against a situation justified under market conditions – are relating to foreign exchange operations and banking transactions on behalf of the population. The former activity remained a monopoly of the central bank NBH (National Bank of Hungary), while the latter is dealt with by two organizations: OTP (National Savings Bank) and the cooperative savings banks.

Since June 1987 there has been a free choice of banks, and parallel bank relationships may also exist. Competition has been enabled because no banking institution may refuse any company wishing to open an account and, except in a few special instances, banks are not bound to grant credits and/or to take in deposits. Credit flow among banks has been unlocked.

The newly established banks are joint stock companies. Four percent of the principal item of their respective balance sheets was allotted as stock capital by the budget (see *Annex*). In addition, the banks increased their capital by issuing more shares. Beside the budget, many big companies in Hungary nowadays hold a fair amount of bank shares. According to the World Bank, the capital supply of banks is still low.

The Hungarian Credit Bank and the National Commercial and Credit Bank were formed from the previous commercial and credit departments of the NBH respectively. The Budapest Development and Credit Bank was established by merging a part of the State Development Bank, the Budapest and the Pest Country Directorate of the NBH. Over and above them, after some modification of their scope of activity, the Hungarian Foreign Trade Bank Ltd. and the General Assets Trade Bank Ltd., too, are now operating as fully licensed commercial banks. Both their clients and their organizational framework come from the division of the NBH, the Budapest Credit Bank and the State Development Bank, respectively.

Seven of the NBH's former county directorates belong to the Hungarian Credit Bank and ten to the National Commercial Credit Bank, respectively. Both banks have branches in Debrecen. In the future, the NBH will have small offices in every county seat. The Budapest Development and Credit Bank was formed from the Budapest Credit Bank, six NBH branches and from the Budapest department and county branches of the State Development Bank (the State Development Institute excluded).

The state as a shareholder is represented by the Ministry of Finance (holding the majority of shares). As is usual with joint stock companies, the founders (i.e. shareholders) lay down the bye-laws of the Bank. The bank's highest executive body is the General Assembly, and this elects the Board of Directors that directs the day-to-day activities of the bank, and the Board of Supervision that exercises general control over the bank's activity and consists of financial, accounting and legal experts.

From anotner part of the State Development Bank, the State Development Institute was formed in order to perform certain tasks of financing and to "pass on" the expectations of the central structural policy to commercial banks. In so doing, the institute will finance central investments, signing up commercial banks to arrange the relevant financial transactions. Also, it may suggest the terms of granting subsidies and it manages the budgetary financial funds of state guarantees. In addition to the five big banks, the two organizations engaged in dealing with banking transactions for the population and the State Development Institute, there are twelve more specialized banking institutions, two of which are subsidiary banks. These banking institutions were established as limited partnerships and are bound, while simultaneously modifying their bye-laws, to be reorganized into limited liability companies by December 31, 1987. In compliance with the intention of their founders, these are engaged in innovation activities, but would like to expand into all commercial banking activities. Also, there are two joint venture banks: Citybank Budapest Co. Ltd. and UNIC-BANK Co. Ltd. They enjoy the rights of extra-territoriality and as such, operate as off-shore banks.

The principially unlimited money-creating capacity of the five commercial banks empowered to keep accounts is controlled by the central bank. The array of control instruments includes permanent and flexible means of interference. In principle, permanent control instruments include the reserves of the central bank, stipulation of the so-called monetary basis and the refinancing limitation of credits. The first concerns the percentage of deposits placed at commercial banks which must be kept in cash, and also the percentage of account money, placed at the central bank. The second refers to the maximum amount of credits as controlled by the central bank through refinancing.

The operative, or flexible, instruments include interest-rate policy, refinancing over and above the normative refinancing limit, the power to refuse to refinance, and securities transactions. Such a wide range of instruments are essential in an advanced banking system. However, the Hungarian is not like that yet.

In my view, it is too early now, in the second half of 1987, to evaluate and judge the banking reform introduced earlier this year. The reform necessarily contained pragmatic compromises as well. Evaluation is now all the more impossible, for the new system has only allowed a free choice of bank since the middle of the year. Nevertheless, numerous and often contradictory reports in the press and literature – as well as discussions held with experts – prompt us to meditate on a few features of the new system which seem to contradict some earlier ideas:

– Originally we assumed that while the abolished monolithic banking system was unable to harmoniously regulate solvent demand and supply, the central bank, together with the network of commercial banks, would achieve this aim.

– We assumed that a profit-oriented system of commercial banks would be capable of ceasing the ear-marked features of various monies and would set out to rearrange its credit stock in such a way as to give an impetus to efficient economic actions and results. Pressure would be put on inefficient activities that, ultimately, would lead to cut-backs and bankruptcies.

In effect, the first year of introduction did not cause such waves [9]. The money supply of companies and their liquidity have improved in spite of the economy's weak overall and even weaker export performance. The volume of free money available to firms and banks continues to exceed the value justified by the performance of the economy. Experts agree that the support of poorly managed companies has not been stopped, and there are no signs of an acceleration in the financing of innovative activites started earlier by small banking isntitutions. The financing of fixed and circulating assets continues through separate channels even after the change [30]. The instruments of enterprise income regulation earmark the money to be spent on personal incomes even more strictly than earlier [31].

Criticism condemning the lack of positive changes could be rejected as impatience if we could see the results of the optimistic promises by leading experts managing the system, or by the statistics. However, the fact is that along with cautious, and often apologetic, statements from the side of government organs and the National Bank of Hungary, respectively, the leaders of new banks report on the limitation of their own scope of

action and the statistical data are not promising either. Let us try to approach these controversial facts, and even more ambigious statements, in a logical way in order to come to some explanation.

Let us look first into the question of demand management. Smooth money regulation is considerably hampered because the budget's money-creating activity has not been integrated into the banking system. As a result, the regulation of money handled by banks must, unilaterally, be adjusted to the budget. With regard to the regulation of the budget's money-creating activity, debates in the Parliament have only brought slight and insufficient changes. So, under the necessity of financing the likely deficit of the state, the NBH is forced to restrict the credit granting facilities of commercial banks. Thus efficient companies, too, have reason to fear that banks will be unable to continously secure their temporary money requirements, or incomes will be drawn away from them in some discriminative manner.

Another weak point of the monetary policy is the existing practice of refinancing. Everybody agrees that the reorganization was preceded by a large and unwarranted wave of money-creation in late 1986. The NBH did not prevent its soon leaving officers from hastily granting new credits to companies that they knew would become their clients in their next job at a commercial bank. This change, although adverse for the national economy, did not clash with at least two interests. Officers in their new positions at commercial banks demonstrated their goodwill towards their partners without having to accept the odium of their deeds. On the other hand, by early 1987 the central bank got into a situation in which it felt justified to counter the excessive liquidity of firms and the commercial banks; it could prove that it was still "master of the house". In this spirit, the central bank began the year with a radical restriction of the money supply. By means of refinancing quotas it reduced the credit stock available for circulating assets, in two phases, by a total of Ft 28 thousand million [9]. Under the new, and theoretically market-oriented practice, the administrative measures of the central bank, which were intended to reduce funds, in fact immediately triggered off the discontent of commercial banks – both against the practice of refinancing and the guidelines attempting to enforce them. Hence the effect of the banking reform, which was expected to build up the confidence of the business opportunities failed to materialize. Commercial banks complained about the administrative restrictions of credit granting. Company managers, on the other hand, continued to believe that the safety of their companies lay invariably in keeping stocks of material and parts instead of holding liquid money deposits. Therefore the majority of companies continue to minimize their ties with banks.

The system of business relationships maintained by commercial banks is not reassuring either. In this respect, one must consider not only what I have mentioned before (that is, that practically all long-term credits are decided upon by the state through refinancing), but also that the profitability of banks is controlled by the general assembly of shareholders, the Board of Directors and the Board of Supervision (the latter two being elected by the shareholders). The owners of the bulk of the shares (the Ministry of Finance have virtually not renounced their rights as founders (shareholders). However, the par-

ticipation of their representatives in the institutions managing the banks is not business-like, but of administrative nature. They only force a firm into bankruptcy if this is rational from every social point of view. Thus, the market viewpoints should be represented by the other members of the Board, observing the requirement of the safe return of moneys placed. The board of directors consists more or less of delegates of big companies that have rounded out the banks' capital stock, which had been provided by the Ministry of Finance. It is worth knowing that quite a few companies, having subscribed to bank shares, were indebted to the NHB just as they are now to its legal successor. The NBH used to regularly revolve the whole or part of this debt, (i.e. on the day of maturity it granted a new loan). Thus the main interest of shareholders lies not in a safe and profitable placing of bank credits but in upkeeping the practice of revolving credits. In such a situation it is hard to imagine a board of directors that vigorously wants the management to recall hopeless loans or, if necessary, to initiate bankruptcy proceedings. The profit motive of commercial banks makes the situation even more complicated. In the course of bankruptcy proceedings, by losing a part of the actually frozen debts due to them, banks may be forced into the red. This is bad because, beside many other things, in such cases the rules do not allow them to raise the nominal income of their employees. This makes it easy to understand why bank managers, if asked about why they initiate bankruptcy proceedings in exceptional cases only, perfunctorily say that this is something they cannot afford since two to three bankruptcy proceedings may easily ruin them [7].

Having listed the factors restraining the market behaviour of banks it is perhaps superfluous to add that, in spite of all logical arguments, there are still two different refinancing practices – one for fixed and another for circulating assets; also the refinancing of centrally preferred investment credits by the central bank (i.e. in some cases the increase of frozen amounts) is automatic because of government decisions. In addition, it should be mentioned that the calling in of credits and the initiation of bankruptcy proceedings, even if in principle the economic management expects commercial banks to do so, run into the savage and relentless opposition of the political bodies (the ministries concerned, the county/town councils and the party committees). The confusion caused by the only bankruptcy instituted since the reform of the banking system (the bankruptcy of a big company, the Veszprém State Building Co. (VÁÉV), initiated by the biggest commercial bank) is an example [29] of the inherent problems of the processes involved.

Lessons and possibilities

A great number of lessons may be learnt from the above. For some, the uncertain outcome of the bank reform confirmed their previous belief that to increase the efficiency of socialism by market-oriented reforms is hopeless. Others claim that half-hearted changes lead nowhere because money processes controlled in every detail from above neutralize those changes. As I see it, both standpoints reflect important observations. It seems that a substantial change in the management system, and the success of the

bank reform in particular, can be hoped for only if and when the political system accepts the fact that the circulation of money is the key regulator of efficient economic operations; and if and when it acknowledges that man is unable to master the circulation of money without breaching the requirements of efficiency. This does not mean that the regulation of money and the market, or the deliberate economic control by society are unnecessary, nor does it mean that the government may let loose the reins. However, aside from a direct regulation of public services, coordinating the volume of money with the economy's productive capacity and slightly correcting the monetary processes according to state preferences is all that is necessary and possible. At the moment this is all that the social power is capable of doing without causing considerable losses to the efficiency of the market.

It seems that changes in 1968, 1979 and 1985 – and even the bank reform of 1987 – have not increased the role of money to the extent justified by efficiency considerations, and have failed to radically transform the status of the centre.

Hence, experiences indicate that doubts with regard to the creation of an efficient socialist market are not unfounded. This runs, however, counter to a requirement arising from the recent economic situation. As things are, this position has not improved properly because the changes introduced have not been strong enough. The society has had to pay dearly for the failure to transform the power structure and for the constant undoing of reforms geared to creating a genuine market; if it goes on like this, the inherent problems, a relative economic backlog and the deterioration of living standards will only worsen.

Economic success calls for multiple changes. The prerequisites of an efficient national economy involve a solution of the difficult task of central demand management, coordination of the money supply with the utilization of resources and the adjustment of the budget to the latter. This, however, can be accomplished only if the policy does not hamper and enervate conflicts incident to the circulation of a controlled amount of money; it must enable commercial banks and owners of companies to husband the assets entrusted to them and in respect of which they are expected to draw the ensuing management, and personal, conclusions; it must create a situation in which economic units may acknowledge possible losses instead of being forced to drag along paper assets like the new, efficiency-orientated commercial banks do in the case of frozen credits. Another important prerequisite is that they should enjoy a much freer hand than they do now in setting prices and wages in respect of the competition for solvent demand.

It is up to the government, controlled by the Parliament, to provide the preconditions required for the success of a market-orientated reform. The solution has, however, been stunted by further contradictions: firstly, by the fact that changes essential for efficient money and market management, and implying a self-imposed limitation of power by the government, have to be implemented in a one-party system which does not provide really advantageous conditions for this; secondly, by the fact that the demand in Hungary for further reforms has been raised at a time when the restructuring of the system of economic management has already been on the agenda for 20 years or more – and there have been no spectacular achievements. Also, it ought to be realized that

Annex

The Banking system in Hungary from January 1, 1987

	Form of property right	Initial share capital	Additionally subscribed share capital	Liabilities	Number of clients
		(mn Forints)			
– Central Bank					
National Bank of Hungary	joint stock comp.	10 000			
– Commercial banks					
Hungarian General Credit Bank	joint stock comp.	8 900	3000	168 000	3 200
National Commercial and Credit Bank	joint stock comp.	7 600	2000	146 000	2 600
Budapest Development and Credit Bank	joint stock comp.	3 500	1500	57 000	17 000
Foreign Trade Bank of Hungary	joint stock comp.	3 000			
General Banking and Trust Company	joint stock comp.	1 000			
– Banks for the population					
National Savings Bank (OTP)	state owned	1 300			
Savings Cooperatives	cooperative				
– Development bank					
State Development Institute	state owned				

– Small financial institutions			
INTERINVEST Foreign Trade Development Association	deposit comp. (limited partnership)	2 170	4 000
Innovation Bank of Construction Industry	joint stock comp.	744	
TECHNOVA Industrial Innovation Fund	deposit company (limited partnership	424	888
AGRIT Agricultural Innovation Bank	deposit company (limited partnership)	610	2 000
Industrial Cooperative Development Bank	deposit company (limited partnership)	300	
INVEST-BANK Financial Development Bank	deposit company (limited partnership)	690	
General Venture Bank Inc.	joint stock comp.	2 200	6 245
INNOFINANCE General Innovation Financial Institution	joint stock comp.	500	650
Small Venture Bank	subsidiary of OTP	673	
Konsuminvest Cooperative Development Bank	cooperative	405	1 500
– Hungarian-Foreign joint banks			
Central-European International Bank Inc., Budapest	joint stock comp.	20 mn $	340 mn. $
Citybank, Budapest Inc.	joint stock comp.	20 mn. $	
Unic Bank Inc.	joint stock comp.	20 mn. $	

equilibrium between aggregate demand and supply, the precondition for changes, can no longer be achieved by reducing investment and through foreign credits, and that expenses have to be covered, fully or partially, by curbing consumption. So the intention to create an efficient market – tantamount to social stability and progress – has been confronted not only with the conservatism of the central bureaucracy, but also with the primary and short-term interests of citizens and certain social groups which are already restricted in their ability to safeguard their *political* interests.

Anyhow, neither a justified scepticism nor doubts can deter us from stressing again, in possession of our experiences so far gained, the need for a socialist economy which is ruled by money and the market – and that includes an efficient banking system.

References

1. *A Magyar Szocialista Munkáspárt határozatai és dokumentumai 1963–66* (Resolutions of HSWP 1963–66). Kossuth Könyvkiadó, Budapest 1968.
2. *A Magyar Szocialista Munkáspárt KB 1966. május 25–27-i ülésének anyaga* (Materials of the session of the CC of the HSWP, 25–27 May, 1966). MSZMP KB, Budapest 1966.
3. Antal, L.: *Gazdaságirányítási rendszerünk a reform után* (The system of economic management after the reform). Közgazdasági és Jogi Kiadó, Budapest 1985.
4. Antal, L.–Bokros, L.–Surányi, Gy.: Fordulatot a pénzügypolitikában (Turnover needed in fiscal policy). *Figyelő*, 36, Sept. 4, 1986.
5. Antal, L.–Várhegyi, É.: *Tőkeáramlás Magyarországon* (Capital flows in Hungary). Közgazdasági és Jogi Kiadó, Budapest 1987.
6. Antal, L.–Bokros, L.–Csillag, L.–Lengyel, L.–Matolcsi, Gy.: Change and reform. *Acta Oeconomica*, Vol. 38, Nos 3–4 (1987) pp. 187–213.
7. Babus, E.: A csődtörvény egy éve (One year after the bankruptcy law). *Heti Világgazdaság*, Sept. 12. 1987. No. 37.
8. Bauer, T.: Második gazdasági reform és a tulajdonviszonyok (The second economic reform and property rights). *Mozgó Világ*, 10. 1982. pp. 600–607.
9. Bódy, L.: A bankreform félévi mérlege (Half a year after the bank reform) *Figyelő*, 31, July 30, 1987.
10. Bokros, L.: Az üzleti viselkedés kibontakozásának feltételei a kétszintű bankrendszerben (Conditions for business behaviour in the two-tier banking system). *Külgazdaság*, XXXI. 1. pp. 21–32.
11. Byant, R.: Controlling money. The Brookings Institution, Washington DC. 1983.
12. Erdős, P.: *Contributions to the theory of capitalist money business fluctuations and prices.* Akadémiai Kiadó, Budapest 1971.
13. Fábri, E.: Változó váltó helyzet (The bill of exchange). *Figyelő*, April 9. 1987.
14. Falubíró, V.: Fizetőképes gazdaságtalanság (Solvent inefficiency). *Figyelő*, 40. October 1. 1987.
15. Golubeva, V. I.: *Sistema planirovanija* . . . (The system of planning. . .) Nauka, Moscow 1978.
16. Jánossy, D.: Huncut tallérok (Funny money). *Figyelő*, 3. January 15. 1987.
17. Kalecki, M.: *Selected essays on the dynamics of the capitalist economy, 1933–1970.* Cambridge University Press, Cambridge 1971.
18. Kornai, J.–Matits, Á.: *A vállalatok nyereségének bürokratikus újraelosztása* (Bureaucratic reallocation of enterprise profits). Közgazdasági és Jogi Kiadó, Budapest 1987.
19. Ligeti, S.: *A bankrendszer átszervezése* (Reorganization of the banking system). Közgazdasági és Jogi Kiadó, Budapest 1987. pp. 13–20.
20. Radnótzi, J.–Rózsa, G. R.: Az állami bankfelügyeletről (State control of banking). *Bankszemle*, 4. 1987. pp. 7–12.

21. Sándor, L.: Hitelezés üzleti vagy hivatali alapon (Business or bureaucratic credit launching). *Figyelő*, January 22. 1987.
22. Sárközy, T.: *Egy gazdasági szervezeti reform sodrában* (In the current of economic organizational reforms). Magvető Kiadó, Budapest 1986.
23. Szegő, A.: Vita a reform alternatíváiról (Discussion about reform options). *Kritika*, 1984.
24. Szegő, A.–Wiener, Gy.: A nyereségképződés makrogazdasági törvényszerűségei (Profit rules in the economy). *Pénzügyi Szemle*, 1. 1987. pp. 39–53.
25. Tardos, M.: The conditions of developing a regulated market *Acta Oeconomica*, Vol. 36, Nos 1–2 (1986). pp. 67–89.
26. Tardos, M.: Az infláció sajátosságai és a pénzgazdálkodás fejlesztése Magyarországon (Inflation and monetary policy in Hungary). *Gazdaság*, 1985.
27. Tardos, M.: Vállalati tulajdon, vagyonérdekeltség, tőkepiac (Property rights, interest and the capital market). *Külgazdaság*, 3. 1987. pp. 3–11.
28. Devizagazdálkodás és külgazdasági banktevékenység a kétszintű bankrendszerben (Foreign exchange in the new banking system). *Bankszemle*, 2. 1987. pp. 1–2.
29. A VÁÉV helyzete (The case of VÁÉV). *Figyelő*, 13. March 7. 1987.

МОЖЕТ ЛИ БЫТЬ В ВЕНГРИИ УСПЕШНАЯ МОНЕТАРНАЯ ПОЛИТИКА?

М. ТАРДОШ

Роль денег в реальном социализме — вопреки нашим прежним представлениям — весьма существенна. Реформа 1968 г. еще больше повысила роль денег. В ходе реформы ожидали, что благодаря роли денег как меры стоимости, их функции как средства платежа и накопления экономические процессы станут более обозримыми и целесообразно планируемыми. С другой стороны, на денежных оборот и систему цен смотрела как на инструменты, служащие достижению намеченных планом экономических целей, которые способствуют стабильногти хозяйственной деятельности, постоянному росту предприятий. И наконец, надеялись, что при этих, считавшихся согласуемыми, целях денежных оборот и система цен без особых конфликтов способны сделать руководителей и работников предприятий заинтересованными в выполнении плана и требований эффективности.

Статья обращает внимание на то, что этого решения недостаточно и что введение двухуровневой банковской системы также не является гарантией для обеспечения деньгам действительно определяющей роли. Условием обеспечения эффективной хозяйственной деятельности является шаг вперед в трудной задаче централизованного регулирования заработной платы, приведение эмиссии денег в соответствие с использованием ресурсов и благодаря этому гармонизация и состояния бюджета. Однако все это может дать результаты лишь в том случае, если политика не будет мешать, не будет нейтрализовывать конфликты, вытекающие из оборота регулируемого количества денег, если сможет добиться, чтобы коммерческие банки и собственники предприятий ответственно подходили бы к решениям в связи с порученными им средствами и делали бы из этого соответствующие хозяйственные и личные выводы, если гарантировано то, что хозяйственники принимают к сведению возможные потери и не попадают в такую ловушку, когда вынуждены к номинальному сохранению потерянного имещства, как это делают сегодня даже новые, ориентированные на эффективность коммерческие банки в случае замороженных кредитов. Нельзя также недооценивать и то условие, что в конкуренции за платежеспособный спрос предприятия должны иметь гораздо большую чем сейчас свободу в определении цен и заработков.

Acta Oeconomica, Vol. 39 (1–2), pp. 81–93 (1988)

EXCHANGE RATE POLICY IN THE REFORM PACKAGE

G. OBLATH

Neither experiences with Hungary's exchange rate policy nor theoretical models applicable for liberalized economies having hard currencies give real clues to the problem: what sort of exchange rate policy should accompany a comprehensive reform package designed to change the possibilities and typical behaviour of actors in the economy. In the trade policy sense, Hungarian economy is a closed one and the reform is conditional upon the lifting of this closedness and the liberalization of trade policies. In order to liberalize, the national currency must be devalued; in order to discover more about the purpose, extent and terms of such a process the experiences of developing countries which are trying to open up their economies are highly useful.

The question as raised here slightly differs from the usual ones related to exchange rate policies.* The usual question concerns other possible measures which could be combined with exchange rate policy to make it successful, that is, with what further elements should the programme package – which already includes a change in the exchange rate – be supplemented.

The question I want to look into here is different; it goes as follows: what kind of exchange rate policy, if at all, should be included in a reform package intended to change the whole functioning of the economy and the opportunities and behaviour of its main actors?

It is of course no accident that the question is being raised exactly in this form. Lately, a group of economists published a proposal for a comprehensive reform of the economy[1] and this included, among other things, the devaluation of the national currency. This part of the proposal was sharply criticized[2].

Although I personally do not agree with this criticism, and basically I do agree with the concept set forth in the study "Change and reform", I still think that an exchange rate policy consistent with the reform package raises many problems that deserve further investigation. In this paper, I also want to touch upon some methodological problems related to the question and to indicate that the treatment of this question has been hindered by stereotyped schemes of reasoning connected with exchange rate policy. I believe that we should get rid not only of clichés like "devaluation does not work here" but also discard some rather mechanical application of analogies, models and concepts borrowed from economies having convertible currencies which are much more liberalized and open than ours.

*This paper deals with Hungarian exchange rate policy related only to hard currencies.

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

Experiences and patterns of reasoning

On the one hand, experiences related to past domestic exchange rate policies and to effets of exchange rate changes (experiences which are, anyhow, difficult to interpret) can in themselves not be relevant from the point of view of the question: what kind of exchange rate policy should be pursued within the framework of a comprehensive reform package. This is so because the package is meant to further genuine changes in the functioning of the domestic economy, in the typical reactions of its actors and, through all these, in micro- and macro-level performances. The significance and purpose of the reform package is to change the economic environment influencing the behaviour of the actors of the economy in such a way that their particular and mass reactions (triggered by changes in exchange rates, beside many other things) be different from those of the past. Therefore, our past experiences in general, and pretentious summary statements on the ineffectiveness of devaluation in particular, carry no substantial message for an exchange rate policy meant to be part of the reform package.

On the other hand, experiences related to open economies with convertible currencies, along with the concepts and models elaborated for dealing with their relevant problems and issues, are not suitable for handling the issues of an exchange rate policy which is to be part of the domestic reform package.

We may put it even more bluntly: examples, models and analytical tools taken from the experiences and problems of liberalized, open economies may, in some instances, prevent an insight into the nature of dilemmas emerging in our system. They may even divert attention from real problems to ones that are not necessarily important, but display some characteristics similar to those found in liberal, open economies, and thus can be approached by these analytical tools.

I have questions in mind like the one which considers whether after a devaluation, the price ratio between competitive and non-competitive sectors change to the extent thought necessary for the improvement of the trade balance;* or what price elasticities are indicated by the relationship between relative changes in foreign trade prices (measured in Forint) and domestic prices on the one hand, and the development of exports and imports on the other. These questions are current in the formal (technical) sense and can be answered in a straightforward manner. However, they often address issues not really relevant and therefore the "correct" answers given to them tend to be misleading.

But why? I think that in order to work out an exchange rate policy, which can be included in the reform package, and to process our previous experience it will be much more reasonable if we try to think of this question and not of the ones cited above.

The main reason why the aforementioned examples are misleading has its origin in the same place as most of our economic troubles, those which force us to think of reform packages. This common cause is the closed nature of the Hungarian economy in the trade policy (or institutional) sense.**

*Wolf is one of the authors who formulate this question clearly[3].
**See more about this in[4, 5, 6, 7, 8].

In a closed economy, the role of the exchange rate is fundamentally different from that in an open economy; so are the effects of changes in and the level of the exchange rate.

This statement, which will be proved and elaborated in the following, is very significant when examining our past exchange rate policy. It is also important when considering our previous experiences and when learning what sort of exchange rate policy would fit best a reform package designed to change the operation of our economy. If our economic troubles have been caused by the closed nature of the economy and if openness could help to ease them, and further if the choice between maintaining closedness* and introducing openness involves choices concerning the direction of the exchange rate policy, then such a policy should be fit for a reform package that would contribute to diminishing closedness and to gradually opening up our economy.

However, these statements are too general and abstract. To decide how to proceed, our previous experiences, too, must obviously be processed. However, our experiences are not *a priori* granted. Figures, facts and phenomena become what is usually termed "experience" only after having been placed into some framework of analysis or reasoning. Since it was not our country which invented the rate of exchange and exchange rate policies, it is only natural that we first try to gather information. We are seeking to use existing patterns of reasoning and problem-solving for clarifying our own position, possibilities and tasks. Yet it matters a lot with what methods of analysis and concepts we approach our past and our opportunities. It follows from the above that analytical tools applied to closed economies – as well as analogies and reasoning patterns suitable for the handling of efforts to open and liberalize the external economy – may help us order our experiences, understand our problems and clarify our possibilities.

Closedness, openness and the rate of exchange

Neither fully open nor fully closed economies do exist. The "ideal" state of openness would be embodied by an economy in which foreign transactions are governed purely by the level of and changes in rates of exchange. Yet there are various degrees of openness and they can, among other things, be characterized by the role the exchange rate plays in the economy: it is decisive in very open economies but much less significant in the very closed ones.

Closedness may be maintained by a wide range of instruments, mechanisms and/or institutions; its manifestations, too, can be manifold.** Closedness always involves barriers raised between domestic and foreign transactions but these barriers are not always

*Closedness is used here and henceforth in the sense of "the state of being closed".

**I use the terms "closedness" and "inward looking trade and economic policies" as equivalents. My comments on closed economies heavily rely on the thorough and concise analysis of the 1987 report of the World Bank on alternative foreign trade strategies and the various instruments of economic policy implied by them [9].

explicit or even intentional. It is certain that closed economies restrict their imports, yet it seems that although exports in such countries are much more widely subsidized from central resources than in open economies, the position of their exporters is in most cases still worse.

As it is, companies in closed economies which want to produce for and sell in foreign markets suffer from two kinds of disadvantage. First, in comparison with domestic companies producing mainly for the protected home market; second, compared to all foreign competitors who may operate under much freer trade and institutional conditions, may choose their trade partners at their discretion, have access to cheaper and/or better inputs and so on.

The authorities in closed economies seek to offset such disadvantages by granting subsidies and supports to exporters. As a rule, however, these allowances and subsidies are neither uniform nor stable. From time to time, as the trade balance requires, they become more important and are expanded – only to be pushed back again later because of fiscal considerations. Both the efficiency and rationality of such supports from central resources is queried by the circumstance that, not infrequently, they are used to preserve highly inefficient and loss-making activities.

Thus the manifestations of closedness are not confined to import restrictions; subsidizing of exports might well be consistent with it. The explicit support of exports and its implicit, or even unintentional, dispreference agree very well with each other. In fact, under such circumstances, dispreference also originates from the method of fixing the rate of exchange: the national currency may be kept on a permanently overvalued level; this necessitates the maintenance of export subsidies but since mainly exporters with a rather low efficiency have access to subsidies, companies capable of exporting with relatively good costefficiency also suffer disadvantages on this account.

The attention with which exports and export subsidies are being considered here might appear unduly great. Concerning closedness and its consequences, it is generally thought that it manifests itself chiefly in the restriction of imports and that it strikes potential importers. The simultaneous application of several methods promoting exports may create the impression that in such systems exporters do not suffer any drawbacks but on the contrary: they are very fortunate. However, this is not always so: extensive subsidies to exports are frequently the surest sign of the unintentional dispreference of exporters.

Also it follows from the extensive application of export support and import restriction measures that in closed economies rates of exchange can exert an economic influence only if combined or replaced by others. Various instruments of commercial policy applied in addition to exchange rates may change together with, or irrespective of, the exchange rate; these changes may be conflicting or working in the same direction. For the purposes of economic analysis it is the net effect of changes that matters. Yet to conduct such an analysis, one needs the proper concepts. One of them is the concept of *de facto* rates* providing a general picture of the combined effect of the *de jure* rate and

*The literature dealing with trade policy and foreign exchange regimes of developing countries calls the concept termed here "de facto rate", the "effective exchange rate". The reason why we use

other instruments (restrictions and subsidies) influencing transactions between the domestic and foreign markets, interpreted as surcharges. In any country, there are of course just as many *de facto* rates as there are official instruments wedged in between the external and home economies. Accordingly, there are *de facto* export and import rates of exchange; their average (thus their divergence from the official rate and from each other) as well as their disperson may be interpreted.

Several attempts have been made to quantify the *de facto* rates of developing countries. Behind these attempts there was the assumption that the impact of all instruments influencing transactions between the foreign and home economy must be expressed in the divergence of domestic and world market prices and, therefore, it could be expressed in some equivalent rates [9, 11, 12]. However, the concept can be fairly well used even without this assumption. Notably, the point is not so much exact quantitative magnitude of the *de facto* rates, but rather that we be able to link the rate of exchange with incentives and restrictions applied, ostensibly, independently of it. This gives a key to the examination of relationships between closedness, the distance between *de jure* and average *de facto* export and import rates of exchange and the dispersion of *de facto* rates of exchange. The more closed an economy is, the more the average *de facto* rates of exchange will deviate from the official ones and the more individual *de facto* rates will be dispersed ([9] pp. 78–82). The empirical verification of this statement is naturally limited by the circumstance that it is the most closed economies that employ the most sophisticated barriers and incentives which are difficult to quantify. Yet if we interpret dispersion in a wide sense – namely, in a not precisely quantifiable way but as one that provides a picture of the frequency and impact of the various instruments applied – then the previous statement certainly remains valid.

From the above one may derive conclusions appropriate for the method of treatment of Hungary's past experiences with exchange rate policies and for the exchange rate policy to be pursued under the reform package.

First, let us have a look at the experiences.

Hungarian experiences

From the preceding sections it may have become clear why I think that experiences gained from the changes in the Hungarian rates of exchange cannot be interpreted in themselves; and what is the trouble with applying, to domestic conditions, models and reasoning patterns that are apt for the treatment only of effects of changes in the rates of exchange. Past modifications of the rates of exchange have not changed the basic characteristics of Hungary's foreign trade regulations, wherein *de facto* rates of exchange largely differ from the official one and show a wide dispersion. There have always been many instruments other than the rate of exchange in use; the decisions of firms on export

here a different terminology is that with the term "effective exchange rate change" we refer to the weighted average change of the exchange rate of the national currency. (See, for instance,[10].)

and import have been strongly influenced by such instruments and by their changes – in most cases, even more strongly than by the level of and changes in the rate of exchange. These instruments, applied with the intention of either support or restriction, have often changed together with the official adjustment of the exchange rate in opposite direction, and on other occasions again independently of it.

Here I merely want to touch upon the question of whether the seemingly significant measure of exchange rate changes, officially declared since 1982, has really been sizeable – especially if we measure the nominal changes in a basket other than the one used by the National Bank of Hungary and, on the other hand, if we compare changes in the exchange rate of the Forint against the rate of the accelerated domestic, and in the meantime slower foreign, inflation (in fact, frequently even declining prices).* Many authors have arrived at the conclusion that the devaluations (measured in a basket other than the official one, and corrected with the ratio between foreign and domestic inflation) up until late 1986 were not significant. Moreover, certain calculations question the official claim that devaluations took place at all.**

However, I do not want to dwell long on these, by no means uninteresting, questions. I mention them because I am trying to draw attention to the fact that the problems of interpretation – emerging with regard to the economic impact of official exchange rate changes (re- and devaluations) – would still exist if we measured the change in the exchange rate in a basket other than the official one and correct it with various relative price indices. Unlike similar indices related to open economies, these indices in Hungary have no economic meaning in themselves.*** As it is, changes in exchange rates (real effective re- and devaluations) interpreted according to such indexes are not certain to be perceived by the firms. Moreover, if, as usually happens, the instruments of commercial policy supplementing the rate of exchange (and meant to influence the importance and extent of exports and imports) change simultaneously with the changes of exchange rates, then the firms will certainly sense something other than the re- or devaluations computable with the indices in question. Thus the relative price and income changes as between competitive and non-competitive sectors, or the price behaviour of exporters and the development of their absolute and relative profitability (i.e. things considered by models condensing the experiences of liberalized economies as a function of exchange rates) all depend here on the development of *de facto* exchange rates.

I wish to stress that these comments are not meant to suggest that, provided *de facto* exchange rate changes are placed in the foreground of the analyses of past practice (instead of changes in the *de jure* rates), then we might get a picture completely different from the one obtained with the above controversial method. That is, the picture concerning the price flexibility of Hungarian exports and imports would be no more

*This type of index is called a real-effective exchange rate index in the international literature. (See e.g. [10].)

**See for instance [8, 13, 14].

***This is why I regard as highly disputable the analysis by *Tarafás–Szabó* of Hungary's exchange rate policy in the years between 1980 and 1984 [15].

different than with the previously disputed method, nor would the impact of income proportions between the competitive and non-competitive sectors on the balance of trade – although this cannot be precluded.

I want to avoid such an impression because, as I have already mentioned, I very much doubt that, under the present circumstances, these would be the questions of importance. It is true that the existence, diversity and variability of the system of *de facto* exchange rates do not simply influence the development of various price and income ratios but, as manifestations and consequences of the economic closedness they constrain companies (hence existing and potential exporters and importers) in responding to changes in prices and incomes, as required by macro-economical efficiency, then the really important questions are related to the consequences of the differentiated system of *de facto* exchange rates. Also, they are related to the problem of whether the exchange rate policy might play a role in winding up the adverse consequences and if it can, what this role might be.

In Hungary, the strong differentiation of the system of *de facto* exchange rates has had, much in accordance with experiences in other parts of the world, several unfavourable effects: the efficiency of export activities shows wide dispersion; export activities with very low efficiency represent a large part of the exports and tend to persist, while export activities of average efficiency have a relatively modest share in the exports. Importers are getting a sort of rent; import substitution with low efficiency is being given explicit or implicit support; the possibility of import purchase and the efficiency of its use get separated. Powerful forces are working against the efficient use of resources and for the withholding of performances; a part of the resources and efforts available for productive goals are spent on rent-seeking and – from the macroeconomic aspect – decidely unproductive activities or, in extreme cases, negative production. (Examples of the latter include export activities with no or even negative foreign currency earnings – something that may regularly happen to exporters with access to imports at the official exchange rate and receiving high subsidies.)

Some of the adverse phenomena listed here are the direct result of the differentiation of the system of *de facto* rates, and some others are the result of their variability. Yet among the afore-mentioned phenomena there are some that are related to the differentiation of the system of *de facto* exchange rates but are not solely or basically a consequence of it.* The point in question is the substantial dispersion of the efficiency of export activities, the important weight of activities with extremely low efficiency and the prolonged existence of such activities. No doubt these are symptomatic not only of exports or imports but, as Tarafás [2] correctly stresses it, of the entire economy as well. In my view however, (as distinct from Tarafás's) it does not follow that the reason for the existence of the differentiated system of *de facto* exchange rates is the *a priori* rigidity of the economic (and export) structure. The reason rather is that the maintainance of the differentiated character and volatility of the *de facto* exchange rate system – which

*For these correlations see [5, 17, 18, 19, 9, 20]

hampers or expressly prevents structural changes – is consistent with the mechanism regulating and institutional system which serves the maintenance of closedness and which *in general,* and not just in the case of foreign trade, hinders economic adjustment and structural change.

If, however, we try to think over the question about what role exchange rate policy can play in winding up the consequences of the differentiation and volatility of the *de facto* system of exchange rates, and what exchange rate policy should be included in a programme package that seeks to change the economic environment to which the differentiation and variability of *de facto* exchange rates are closely related, then experiences of developing countries deciding to open up their economies offer a good starting point.

Opening and exchange rate policy

It may sound strange, but I think that if we look through Hungarian eyes (i.e. rather egoistically and keeping chiefly our own troubles in mind) at the confusion, inefficiency and economic irrationality reported on developing countries by many studies that attribute all these to closedness and the differentiation and variability of the system of *de facto* exchange rates, then we might have reason for a measure of guarded optimism. Upon studying such studies we must realize that the economic troubles and inefficiencies that mark our foreign trade are not specific Hungarian features; in many respects, countries pursuing an inward-looking strategy and operating a corresponding regulation and institutional system elsewhere in the world have been struggling with similar difficulties.* These problems are therefore not the particular features of the "resource and soft budget constrained" Eastern European economies but the typical consequences of a kind of economic strategy, economic policy practice and the corresponding institutional and regulation system. On the other hand, and this is from where we can actually draw confidence and guarded optimism, there is an abundance of empirical evidence proving that many closed economies have been able to open up, and this has often been the source of their future success.** Of course, we are pleased that others have succeeded, but for us it matters just as much how they managed to wind up their closedness. According to the World Bank report already quoted ". . .the simple most important factor providing the spur to trade liberalization has been crisis – either of the country's own making or imposed from outside. Its most common form has been an economic stabilisation crisis springing from exessive budgetary and balance of payments deficits and rising inflation" ([9], p. 108)

It is not self-evident and it may even appear as a paradox that it was just such crises (primarily the aggrevating problems of the trade balance becoming more and more unmanageable by customary methods) that gave the strongest impetus to economic policy shifts geared to opening. But there is no contradiction here; the phenomenon is

*On the troubles, dysfunctions and losses similar to ours and already mentioned before, see for instance [21, 22, 11, 12, 9].

**The relevant experiences are detailed by a World Bank study [9].

logical from both social (political) and economic aspects. Although for the purposes of this paper economic aspects are the most important, it is worth indicating that the underlying causes of an obvious dysfunction of the system are preserved not by the law of inertia alone; there are also groups with sizeable social bargaining powers interested in them.*

Crises may upset the positions of such groups and, what is highly significant for the assertion of the economic logic underlying the shift, it might also attack the schemes in which the causes and nature of problems, such as that of the balance of payments, were previously formulated as well as the possibilities for handling them.

From the viewpoint of economics, and from the viewpoint of our present subject, exchange rate policy, the point is that prior to the growth of emergency situations into balance-of-payments crises, huge amounts of money and subsidies had already been injected into export-related activities; also, imports had been largely restricted.

In such situations the differentiation of *de facto* exchange rates and the variety of its forms may reach an extent where it is tantamount to a caricature of the milder forms of the system. One can witness a spectacular emergence of all dysfunctions, disorders and illogicalities that have been, though less obviously, there before but they have merely been revealed by neglected economic analyses. In cases like this the additional and differentiated subsidy given to exports is increasingly ineffective. This is partly because less exporters are willing to export without additional subsidies and allowances, and partly because export activities are also physically restricted by the powerful and unpredictable import cuts; it is also because the actors of the economy feel that the system cannot function; sooner or later the national currency has to be devalued; exports are postponed and import orders are brought forward.

All these will of course accelerate the coming of the crisis. But when it has already happened, they facilitate and what is more, they force the critical rethinking of the consequences of the differentiation and variability of the system of *de facto* exchange rates.

Such situations may unsettle the positions of groups interested in maintaining the existing economic policy and regulations, while they may also discredit reaction patterns of economic policy previously considered as self-evident. This is when it may become clear that occasional and individual allowances granted to exporters keep back the exports instead of promoting them. The increasingly severe administrative control of imports is unable to prevent the deterioration of the trade balance, while it becomes the source of incalculable economic disturbances, difficulties, and uncertainties which also make exports more difficult. This is when it might be recognised that the expansion of efficient exports and the prevention of problems related to the external balance may only be accomplished by genuine export orientation. It is then that it may become obvious that it can be served not by occasional and individual export incentives meant to offset

**Olson's* [23] book elaborates on this, and many other related and afore-mentioned problems that can be only briefly mentioned here. On the theory of Olson and its relations to Hungarian conditions see the article of A. *Nagy* [5].

losses but by opening up and liberalization of imports; and only this can end the absolute and relative disadvantages which hit relatively effective exporters and contribute to the efficient promotion of exports. Once the concept, previously considered absurd, can break through that says that the liberalization of imports does not necessarily weaken, but instead may even improve the external balance, then the exchange rate policy, too, may override the seemingly unsolvable, and anyway not genuine dilemma of considering anti-inflationary objectives or the improvement of the external balance (slowing down its deterioration) as its main task.

It has become clear that the termination of the dysfunctions of the differentiated system of *de facto* exchange rates calls for the simplification and standardization of the system of *de facto* exchange rates. Here the exchange rate policy plays a role; moreover, under such circumstances this is where its actual role is.

Devaluation models worked out for convertible currencies provide no clues as to how the exchange rate policy should play this role. As things are, under such circumstances the goal is not to change the relative prices between the competitive and non-competitive sectors (or other specific price and income ratios manageable by such models) but to achieve that losses of efficiency, disorders and irrationalities caused also by the differentiation of the system of *de facto* exchange rates be discontinued, or at least reduced.

On the other hand, the exchange rate policy cannot simply aim at "replacing" the existing differentiated *de facto* exchange rates, i.e. all the available subsidies and limitations, by the exchange rate. The reassessment of the exchange rate policy may be triggerred by the recognition that the existing differentiated system of subsidies and limitations functions poorly and causes damage. Thus this system need not, and luckily cannot, be replaced by the exchange rate.

For the exchange rate policy to play a role fitting a reform programme which seeks a way out by opening up the economy, the concept of compensated devaluation* seem to offer a basis.

These models offer methods for the treatment of the question regarding what changes in exchange rates are called for by a substantial cut-back of restrictions on imports and subsidies to exports. This is the relevant question if economic policy wants to use exchange rates not as an instrument for influencing the external balance, but to reduce the dispersion of the system of *de facto* exchange rates and to bring it nearer to the *de jure* rates, i.e. to unify the *de facto* exchange rates.

Without going any deeper into alternative models and methods, I would like to mention one common problem of these models. Namely, that conventional methods start from the seemingly logical assumption that import restrictions are indeed capable of restricting imports and export subsidies can indeed promote exports; consequently, their

*As far as I know, this term was first used by the authors of a volume edited by *Balassa.* [11]

lifting (or reduction) proportionally increases imports and reduces exports, respectively. Methods trying to quantify the measure of devaluation meant to offset the presumed deterioration of the balance of trade resulting from the lifting of restrictions and subsidies are based on this assumption.

However, experiences (especially those related to pre-crises situations) indicate that administrative import restrictions are not certain to restrict imports in general but they will in all likelihood hamper exports. As for differentiated export subsidies, they more often than not stifle exports instead of promoting them while tend to increase the demand for imports.

There is no method of telling exactly how large a devaluation is needed to accomplish the unification of the system of *de facto* exchange rates, essential for openness. One thing is sure: the position and possibilities of relatively efficient exporters not preferred by the old level of exchange rates, and the activities capable of using imports efficiently must be improved. Losses ensuing from the differentiation of the system of de facto exchange rates can hardly be reduced otherwise – to do so, a certain devaluation of the national currency cannot be avoided. However, it is not certain but rather, very much doubtful that such large a devaluation is needed that – assuming that other factors remain unchanged – strives to counterbalance the presumed adverse balance of trade effects of lifting the existing restrictions and subsidies.

To put it more bluntly and to keep our circumstances also in mind: it is more than just doubtful that the necessary extent of the devaluation should be determined by the consideration that with an unchanged export and import structure, all existing – or known (but in most cases extremely inefficient) – potential exports be profitable under the new exchange rate. This is so because the maintainance of the existing foreign trade structure, – influenced, or rather, deformed also by the differentiated *de facto* exchange rates – would imply impossibly large, just as senseless, as unrealisable devaluations. But it is this that is not necessary at all.

I want to close this paper with two remarks. One comments on the other elements as well as the whole of the programme package already containing the devaluation, and the other on the circumstances of the introduction of the programme.

I did not dwell on the fundamental question of what else the package should contain beside the sort exchange rate policy I tried to discuss in the foregoing. However, I did not want to create the impression that I thought that devaluations in themselves could solve anything. On the contrary, I believe that an exchange rate policy serving the goals as outlined in the foregoing can be successful only if the package is consistent. Namely, not only should the exchange rate policy be harmonized with the programme as a whole but other elements of the package, too, should support the efforts to advance the exchange rate policy. I could not, and in fact did not want to discuss other elements of the package in this paper (like financial policy, policies aimed at increasing mobility of factors of production); but concerning most of them I agree with the authors of "Change and reform" [1].

The other closing comment is this: my treatment of the problems of economic policy and exchange rate policy changes might give the impression that I thought that

such programmes – meant to bring about opening up of the economy and a fundamental change in exchange rate policy – could not be introduced without deep crises.

No, I did not want to suggest anything like that. On the contrary, I completely agree with the report of the World Bank when it states: "history should not be taken as presciption: countries that do not face such crises should grasp the opportunity for reforms that stability offers". ([9], p. 108)

References

1. Antal, L.–Bokros, L.–Csillag, I.–Lengyel, L.–Matolcsy, Gy.: Change and reform. *Acta Oeconomica* Vol. 38, Nos 3–4 (1987). pp. 187–213.
2. Tarafás, I.: Discussion of "Change and reform". *Acta Oeconomica,* Vol. 38, Nos 3–4 (1987).
3. Wolf, T. A.: The simultaneity of effects of devaluation: implications for modified planned economies. Lecture delivered at the 1986 roundtable meeting of US and Hungarian economists. To be published in *Acta Oeconomica.*
4. Lányi, K.: Nyitott gazdaságú ország-e hazánk? (Is Hungary an open economy?) *Figyelő,* March 20, 1986.
5. Nagy, A.: Open we must! *Acta Oeconomica,* Vol. 37, Nos 3–4 (1986).
6. Köves, A.: Is opening still topical? *Acta Oeconomica,* Vol. 37, Nos 3–4 (1986).
7. Pásztor, S.: Nyitott-e a magyar gazdaság? (Is the Hungarian economy open?) *Közgazdasági Szemle,* 3. 1987.
8. Oblath, G.: Az árfolyampolitika és az infláció (Exchange rate policies and inflation). *Figyelő,* March 20, 1986.
9. World Bank: Industrialization and foreign trade. In: *World development report.* Published for the World Bank, Oxford University Press Washington D. C. 1987.
10. Maciejewski, E. B.: Real effective exchange rate indices: a re-examination of the major conceptual and methodological issues. Staff Papers, Sept. 1983.
11. Balassa, B. and associates: *Development strategies in semi-industrial countries.* Johns Hopkins University Press, Baltimore 1982.
12. Krueger, A.: *Liberalization attempts and consequences.* Ballinger Publishing Co., Cambridge, Mass. 1978.
13. Balassa, B.: Az „új növekedési pálya" Magyarországon (Hungary' "new growth path"). *Gazdaság,* 2. 1986.
14. Kún, J.: A valutakosárról (On the currency basket) *Külgazdaság,* 4. 1986.
15. Tarafás, I.–Szabó, J.: Hungary's exchange rate policy in the 1980's. *Acta Oeconomica,* Vol. 35, Nos 1–2 (1985).
16. Krueger, A.: The political economy of the rent-seeking society. *American Economic Review,* June 1974.
17. Riecke, W.: Árfolyam és áralakulás (Exchange rate and price development). *Figyelő,* 26. 1985.
18. Pásztor, S.–Berényi, J.–Kulcsár, P.: Exportösztönzés egy importhelyettesítő gazdaságban (Export promotion in an import-substituting economy). Ipargazdasági Intézet, Budapest 1986. Manuscript.
19. Oblath, G.: Foreign trade regulation and exchange rate policy in Hungary: some timely leasons of an old debate. KOPINT, Budapest 1985. Discussion paper.
20. Oblath, G.: Konvertibilis elszámolású kivitelünk szabályozásának néhány jellegzetessége és következménye (Some characteristics and consequences of the regulation of Hungary' dollar exports). Budapest 1987. Manuscript.
21. Bhagwati, J.: *The theory of commercial policy: Departures from unified exchange rates.* Princeton University Press, Princeton 1966.
22. Bhagwati, J.: *Anatomy and consequences of exchange control regimes.* Ballinger Publishing Company, Cambridge, Mass. 1978.
23. Olson, M.: *The rise and decline of nations.* Yale University Press, London–New Haven, 1982.

МЕСТО ПОЛИТИКИ ВАЛЮТНЫХ КУРСОВ В ПАКЕТЕ РЕФОРМ

Г. ОБЛАТ

Ни опыт венгерской политики валютных курсов, ни теоретические модели валютных курсов, действительные для либерализованных и располагающих конвертируемой валютой экономик не могут сориентировать в том, какая политика валютных курсов должна входить в пакет таких глубоких реформ, которые направлены на изменение возможностей хозяйственнын субъектов и характерного для них поведения. Венгерская экономика в смысле торговой политики является замкнутой; а реформа предполагает ликвидацию замкнутости, либерализацию торговой политики. Для либерализации необходимая девальвация внутренней валюты; и в отношении целей, степени и предпосылок этого подходящие для использования выводы представляет опыт стремящихся к внешнеэкономической открытости развивающихся стран.

Acta Oeconomica, Vol. 39 (1–2), pp. 95–109 (1988)

WESTERN TECHNOLOGICAL POLICIES AND THE APPROACH OF HUNGARIAN INDUSTRIAL POLICY

B. GRESKOVITS

The management of Hungarian industry attentively watches the trends of western industrial development but experience shows that the foreign tendencies of development only influence the ideals visualized by Hungarian industrial policy, not its practice. As well as reviewing some tendencies appearing in the technological policies of the advanced countries, this paper attempts to analyse whether or not the ideals of development influenced by western examples are tailored for, and should be followed by, Hungary. The author arrives at the conclusion that not only is the practice of Hungarian industrial policy untenable but also its ideals for development are inadequate.

Hungarian industrial management, according to its conservative practice, regularly misunderstands and selects improperly the western examples which form its vision of industrial development. It exaggerates, one-sidedly and without criticism, the dirigent elements (or the elements that can be interpreted as such) which can directly be built into the domestic way of thinking. At the same time it takes no notice of the dangers inherent in such development. Also it ignores western alternatives to the dirigent way of development and fails to recognise the importance of the economic control mechanisms which are able to prevent or counterbalance the mistaken decisions of the governments in the advanced market economies.

Present Hungarian industrial policy and international experience

The analysis of trends of industrial policies in the advanced countries is made important by the fact that, as experience shows, Hungarian industrial policymakers study the international tendencies of industrial development. References to worldwide tendencies of industrial development often emerge in technical literature, in official declarations and suggestions of industrial policy. What is more, they often occur in the arguments surrounding the preparation of important decisions.

Let us mention a few examples:

In those concepts according to which the share of the R+D expenditures within the GDP of Hungary ought to be increased, references are made to the technical and scientific revolution going on in the world, and these are compared with Hungary's backwardness.

When defining microelectronics and biotechnics as key sectors of R+D in the 6th and 7th five-year plans, the major international trends of state subsidization were considered as relevant factors.

Also, when the Hungarian interest in the "Comprehensive Programme of the Scientific and Technical Progress of the CMEA Member Countries up to 2000" was

formulated, one reason for becoming involved was the challenge of the big government and regional research and technology programmes of the advanced countries.

An opinion which is currently gaining ground claims that the main task of Hungarian industrial policy – following the examples of the western countries – is to revise its earlier mistaken sectoral priorities. Thus it should – like the western countries – concentrate on the selective development of "pioneering", or "pulling" sectors.

Finally, certain institutions in the high-technology sectors of the leading western countries (the industrial and scientific parks, the organizations for technology transfer, the innovation banks and venture capital firms) and the observed government activities for developing them, served as justifications for the domestic institutional innovations which are destined to support the objectives of industrial policy.

This list of examples could be continued. Yet even the examples listed above demonstrate that the areas where Hungarian industrial policy exhibits contact with western processes are each connected with the positive side of structural changes, with restructuring.

It is well-known, though, how alarming and deplorable the situation of Hungarian industry is precisely in respect of successful adjustment, and how powerless Hungarian industrial policy has proved to be so far from this point of view.

From all this one has to understand that in the declarations, requirements and measures demonstrating harmony with the global tendencies, it is the "better face" of Hungarian industrial policy which appears in the improvement ideal – yet this is by no means the reality.

As regards the reality and praxis of Hungarian industrial policy, it follows a path entirely different from that of the industrial policies of the market economies. It is a policy of centralized capital investments and, over the past four decades, it has invariably spent most of its human and financial resources on investments for the manufacture of basic materials, semifinished products and energy. R+D programmes have been subordinated to the above-mentioned investment programmes and, in the last fifteen years considerable sums have also been spent on structure-conserving subsidies granted to lagging sectors.

When considering whether the described vision of ideals really relies on world-tendencies which can and have to be followed by Hungary, all this has to be mentioned in advance.

I think it is both desirable and justified to take these details into account. The domestic initiatives arrived at by referring to the experience of internationl industrial policies do not reflect the current actual situation of our industrial policy. However, they still present some information about the type of future industry which is envisaged by industrial management as providing an alternative to the present one. This raises the question: do the political endeavours related to technology (hidden in the periphery of Hungarian industrial policy) represent a promising vision, tailored to the actual opportunities?

In order to get an answer let us first review the characteristics which can be observed in the trends of industrial policies in the advanced capitalist countries.

The trends of transformation and unification in the industrial policies of the advanced capitalist countries

There are many signs showing that in the industrial policy trends of the advanced capitalist countries – though there still are a lot of national differences – in the 1980s a certain unification is taking place. This process is demonstrated by the following:

First of all state intervention is growing more uniform, and within it, so too is the intellectual and mental environment influencing the potential patterns of intervention by industrial policy. This type of environment is more suspicious and sceptical than it was earlier in regard to state intervention, especially state intervention in its powerful forms.

A process running parallel with the decreasing legitimacy of state intervention is the declining weight of the state budget which, after all, is *the basis of such intervention.*

Even within the reduced sphere of state intervention the *subsidies* for the sectors, enterprises and activites *struggling with structural difficulties* are also diminishing – though they still make the majority of the demands on the financial resources available for the industrial policy.

Since, in the most of the advanced countries, the experiences gained from the earlier paternalistic methods of treating the structural troubles were unfavourable, in these areas of industrial policy more *market-related methods* are appearing. These require stricter preliminary quarantees and heavier burdens have to be laid on the enterprises and society.

In harmony with this, the positive side of the structural changes (i.e. *the pushing forward of the new, dynamic sectors,* enterprises and activities, *as well as the structure-creating industrial policy* connected with it) is gaining increasing worldwide attention.

Supporting the developing new structures and directing the processes of renewal require methods, tools and institutions different from those used for the subsidization of the traditional or lagging branches. *Thus several new elements* can be found in the *means, methods and institutions of industrial policy.*

The typical trend towards the uniformity of industrial policies can be considered the resultant of the afore-mentioned transformation processes; I wish to emphasize the facts, reasons, potential consequences and lessons which can be drawn from these.

The essence of the tendency is that *in the industrial policies of the advanced countries technology and innovation are gaining increased significance.* It seems to be a permanent feature of development that R+D, innovation, the support and encouragement of the transfer of technology, and the development, renewal and adoption of the institutional system linked to them, are becoming more and more important elements in the industrial policies of the leading industrial countries.

This is also demonstrated by the fact that, although in most of the developed countries the restriction of support and the lessening of state intervention in enterprise decisions are the issues of the day, the funds serving R+D and innovation are usually left untouched. In fact, in some cases these funds are increased by decisions concerning expenditures to be financed from the state budget.

In the five big leading countries (the USA, Japan, the FRG, the UK and France – which represent more than 90 percent of R+D inputs of the OECD area) *research-intensity* – or the proportion of spendings on R+D in relation to the GDP, is both uniformly and simultaneously on the increase in all of them, ever since the late seventies. Thus the policy for technology, due to its growing significance, fits into the rising trend of R+D-intensity in the advanced world. Although its methods and extent vary from country to country – it is one of the major factors contributing to this ascending tendency. (This can be assumed even if the technology policy of a given government does not in every case and under any conditions lead to a growing research-intensity.)

The convergence of the national technology and innovation policies

The fact that the national (or regional) technology policies themselves – despite the many differences between them – show great likenesses* in respect of some of their important characteristics, also underlines the tendency of convergence.

This similarity reveals itself in the following ways:

State financing of the R+D activities is not concentrated on the support of basic research or on stimulating scientific work in general, but on financing *R+D projects closely related to the market.***

In the advanced capitalist countries state support of R+D greatly *focuses on similar objectives.*

The state subsidies to R+D are alike not only in their distribution by objectives, for great similarity can also be found in the activities and sub-sectors to which the technology policy of the government is directed in the five leading countries.***

On the institutional side, an additional feature of the similarities in R+D state priorities is that the most important groups of bodies authorized to dispose of the state funds are almost of the same composition in each of the five leading countries. In many cases even the rank order of the most important bodies is the same.****

When evaluating the similarity of R+D methods, priorities and institutions it is important to avoid – especially in Hungary – two premature conclusions.

On the one hand, it would be an error to draw the conclusion that the widespread praxis of financing projects closely linked to the market by similar state institutions and according to similar priorities, *indicates a world-wide tendency of extending state intervention in R+D matters.* The western agencies of R+D – in contrast to the East European ones – even in relation to the financing of a definite project, very rarely give the enterprises detailed instructions as to what, how, for what amounts, in collaboration or

*In this section I rely strongly on the study of Klodt [11] and the paper of Török – Kolláth [18].

**Klodt [11] p. 36.

***Ibid. pp. 33, 35 and 41.

****Ibid. p. 21.

jointly with whom they should carry on research and development. Also, it is even rarer for agencies to tell enterprises on which market and for how much the resulting products should be sold.

On the other hand the widespread financing of market-related projects which are based on similar priorities, and the success of western R+D activities on the market do not justify the conclusion that the western bureaucrats of technology have discovered an infallible method of foreseeing future market successes and the task of their East-European colleagues is merely to learn it from them. It is unlikely that the officials of the ministries of research and technology in the advanced countries know any more than their East-European colleagues whether or not a subsidized research programme will bring about a market success in the future. For this reason they do not thrust their ideas on their partners in the research institutes or enterprises. In fact, it is the reverse that can be found. Since they consider successful programmes to be monuments of their careers, there is a great temptation to "jump on the bandwagon", i.e. to support the ideas of enterprises or research institutes which would anyhow soon appear on the market – with or without their support. [13]

The priorities of the technology policies in the advanced countries are further unified by the concentrated and coordinated R+D programmes started in the particular countries and regions (e.g. the programmes of the SDI, EUREKA, or MITI – which we shall call in the following the "Big Programmes"). Although in regard to their size and methods the Big Programmes embody technology development philosophies which are different in many respects, each of them is (because of their excessive dimensions – especially the American programme) suitable for dictating the pace in the technological race and encouraging the initiation of novel and similar national or regional programmes in the competing countries. Such programmes have demonstrative effects reaching beyond the leading countries – what is more, even beyond the OECD area. In starting the scientific-technical Big Programme of the CMEA countries, the birth of the American programmes and, later on, of the EUREKA, obviously played a significant part.

While the technological policy, in its R+D programmes and methods, turns firstly to the *large enterprises* (in terms of project financing, the orders of the Big Programmes and the subsidies available to them are, in the majority of cases, granted to *large enterprises),* from the point of view that it is also an innovation policy, it is oriented rather to the *small enterprises.*

In the big western countries the technological policy can be characterized by the similar endeavours which are found more or less in each on of them – namely, endeavours that support and naturalize institutions where the dynamic development of top-level technologies can be accomplished. [18]

Silicon Valley, the most spectacular agglomeration of top-level technology in the world (and in the USA itself), exerted an impetus on, and is a model for, the efforts to be carried out by innovation policies.

Several government endeavours were made, aimed at reproducing in the particular countries or regions the specific system of conditions which was granted by Silicon Valley to the enterprises settling in the valley. These conditions were high level ones and

included a *technological infrastructure,* or at least some elements of it. This serves the integration of the various factors necessary for implementing the highest levels of technology. [16].

The afore-mentioned endeavours may have concentrated on the development or support of already existing agglomerations. Nowadays, the results of such efforts are evident in the regional technology complexes or development zones mushrooming increasingly in the USA, the UK, Switzerland, the FRG and in other countries.

On the other hand, innovation policy has everywhere been anxious to create (by state-financed infrastructural establishments, tax reliefs or other methods) *potential focal points,* i.e. such groups of institutions which might be expected to radiate powers of attraction which help to bring about agglomerations for top-level technological activities. The results of such endeavours in several advanced countries of the world are shown in the increasing number of *scientific or technological parks.* These provide for the symbiosis of research institutes of universities (some of them in private or state ownership) and enterprises intensely oriented towards technological development. The opportunity to become a point of agglomeration is also hidden in another institutional solution – nemely, spreading idea of creating so-called *"founding centers"* (Gründerzentren). In such centres in the FRG new entrepreneurs usually new to business, can rent for themselves – at a low cost – the minimum infrastructure needed for starting a business. This includes such common services as a secretariat, an accounting organization and a computer terminal. In addition to these, there are research laboratories for working out their ideas and facilities for starting production. [7]

The revival of small-scale enterprises is also reflected in some institutions of the current innovation-oriented industrial policies. Beside other reasons, this stems partly from the recognition of the importance of innovations produced by the small-scale enterprises and partly – very likely again from the American example – from the outstanding role of small-scale enterprise in structural changes.

The government programmes which establish small enterprises, and organize R+D and consultation for small firms, are proliferating in connection with this renaissance of small ventures. [3, 13]

The technology-transfer networks of the advanced capitalist countries consist of institutions founded by the state, by private entrepreneurs, or by a mixture of the two and they also constitute an institution system intertwined with organizations of consultancy centred on small-scale enterprise. [15]

Finally, the sphere of small ventures is also an active area for the spreading of *venture capital.* This is so not only in America but also in Europe. The owners of this capital, either private associations or other sources, are encouraged to be more active in business by government tax relief policies. The institutional bases of small ventures are becoming more multifarious by the association of venture capital with state operations or with programmes involving state participation.

The reasons for unification

Based on what has been said above it seems that in its ideals for industrial development, Hungarian industrial policy, by referring to the global tendencies of technological policies, identifies itself with processes of industrial policy actually existing in the advanced capitalist countries.

Putting aside our doubt as to whether the observed global trends can at all be followed, considering the constraints created by Hungary's small dimensions, its low economic performance capacity, and its situation of being closed off from the world economy, let us now deal with the other aspect of the problem: in principle, are they to be followed?

In principle, and very strictly only in principle, the examples of the most advanced countries mean the more a reliable basis of reference to the Hungarian management of industrial policy, the more it is true that the dynamism in technological policy is motivated and characterized in those countries by the rational recognition, based on government foresight, of the "requirements of internal economic development", the "objective progress and requirements of technological development".

The doubt connected with this assumption is rather justified – even though it is not quite accurate to call such an assumption nonsense.

What factors can explain the unifying and converging tendencies observable in the industrial policies of the leading countries?

Among the potential explanations, those have to be considered which interpret the phenomenon in question as a victory for the worldwide view of a new type of economic government. The hypothesis which attributes considerable significance to the failure of earlier, structure-conserving state intervention (and to disappointment caused by it) also belongs to this category. There are also those hypotheses according to which the pushing forward of technological policy is based on the recognition of specific concepts of economic science. These see the current comparative advantages of the developed countries as being hidden in the production and sales of R+D-intensive products; also, state intervention seems to be most justified in the sphere of R+D activities because, in accordance with the socialized returns of R+D, it will also socialize the costs of it.

Although there might be some truth in the explanations attached to the aforementioned hypotheses, when interpreting the pace and approach of the different technological policies, we must not forget the fact that *technological policy is: politics.*

In other words, in my opinion it is much more important to see that industrial policy pursued as technological policy is placed very favourably in the internal power field of politics. The forces which are developed in the advanced countries are of crucial importance. Among other things, these include the international political and economic factors, the domestic state organizations, the political parties and the different interest groups.

Which political factors do, in fact (in contrast to other possibilities) make technological policy successful and shape its concrete particularities?

a) Technological policy is suitable for ensuring that certain non-economic, military and world political ambitions of the western governments – as well as their consciousness of national responsibility – should take on concrete and legitimate forms and should become extricably merged.

In this context let us consider three relationships.

By referring to national safety and to the practice of states competing in world politics, it is easier to start Big Programmes of military significance. In other words, political acceptance of such actions by national and international public opinion – which otherwise might perhaps be sceptical about the usefulness of such actions – is achieved in a relatively uncomplicated manner. [10]

Reference to subsidies granted by competitors everywhere allows the interpretation of national and regional R+D subsidies as counter-subsidies (as retortion provoked by initiatives of other countries). Also, it makes them acceptable by economic ideology even in such fields as market-oriented R+D, where economic theory would rather suggest self-restraint on part of the state.

Within the framework of technological policies the governments of the advanced countries can follow national economic objectives. They are able to acquire a powerful national economic position or weaken the positions of other countries in the world market. And they can thus do so without pushing against the barriers of the international agreements which define their scope of movement, e.g. those of GATT. [11]

b) An active technological policy is a government policy suitable for opposing the industrial policies offered by other political parties.

It fits appropriately into the market-oriented economic ideologies of the conservative parties which at present govern in most of the leading advanced countries. Such a policy means less intervention and more conformity to the market than, for example, direct investment targeting. This contrasts with the concept of the "New Industrial Policy", currently emerging in several advanced countries as an oppositional tendency. [17; 8]

It is, at the same time, spectacular enough not to remove from the industrial policy of the government its particular aspects and characteristics. By implementing some elements of the industrial political endeavours of the opposition, a government can – to a certain degree – take the wind out of the sails of the opposition.

c) Technological policy *meets the needs of the government bureaucracy* without letting the fear of "central planning" and "dictatorial guidance of the economy" become too loud.

d) Technological policy is *flexible* – it is able to suit the interest of strong economic groups and various types of enterprises.

e) It is partly international relationships and partly reasons related to the political and sociological operating mechanisms of the technological bureaucracy that determine the typical *parallel behaviour* of bureaucracies. This produces the *identities* that can be observed in the increasing technological policy activities of the state, in the R+D projects of the Big Programmes, in research and in the industrial priorities of the national policies.

In forecasting the unknown technological successes of the future, the technological bureaucracy is *uncertain.* Therefore, when developing its own behaviour, priorities and institutions of technological policy, it often examines not the *future* but the *present.* It follows the examples of other countries with regard to the institutions successful for development. Or it looks at the *past,* and supports those technologies, sectors or enterprises which have already been proved to work. [21; 12]

To summarize the above: it has been found that the forging ahead of the technological policies in the advanced countries is dependent on a number of non-economic, political and sociological factors.

Certain important facts related to the convergence of technological policies – precisely those in which Hungarian development policy is trying to find its justification – can be explained not by a definite system of objectives relying on conscious foresight but often just the opposite: by the *lack of central far-sightedness,* i.e. by imitation that is the result of limited foresight.

Along with the overlapping and parallel developments of technology policies, the special literature already calls attention to some potential *dangers.* National technology policies which attempt to imitate the main points of R+D and the methods of support, could direct enterprises towards technologies and markets which are becoming overcrowded. By doing so they may accelerate the formation of future *crisis sectors* which would be characterized by over-investment and excess capacities. [13; 11]

Based on what has been said so far, it is doubtful whether the tendencies of technology policy experienced in the advanced countries are confirmation of wise foresight in industrial policy. The correct impression seems to be that the described trends of industrial policy are *not direct examples to be followed by Hungary.* Maybe, in the innovatory institutions of the leading countries more elements can be found which can offer direct lessons to Hungarian industry. Let us now study this possibility.

Is the convergence of industrial policies leading towards uniform development paths?

Will the actual development paths of the leading countries grow more uniform in the future, owing to the convergence of their industrial policies?

Is it a feasible assumption that the similar methods and uniform institutions of the advanced western countries will direct development along the same path and towards identical results?

As history bears witness to it, this would be both surprising and unusual.

By analysing the facts of the 19th-century European industrial revolution, Gerschenkron arrived at the conclusion that there are various potential ways of catching up with industrial rivals. The majority of the different ways follow from employing such special institutional means which differ specifically from each other along the particular development paths. [6]

While in the industrial development of England in the 19th century the accumulation of enterprise capital played the main part, in the western part of the European continent industrial development was pushed forward by banks specializing in financing long-term investments. In East Europe this role was fulfilled by state institutions.

Without trying to apply Gerschenkron's theory in its original form to the current and future circumstances, it is worthwhile drawing attention to a lesson that might be important in view of the present train of thought, i.e. the lesson that progress is, in general, not a uniform process.

Even today industrial development proceeds along different paths, and these are also specific from institutional aspects. Thus it is worth investigating the other side of the problem connected with the possibilities of institutional adaptation.

How far can the specifically successful institutions of a given development path be adjusted to circumstances different from those which helped them to unfold? Will the weight, expansion possibilities and influence of the adopted institutions be the same in an environment which is different from the original one?

To such questions there is no simple answer.

In the foregoing I emphasized the identities and the tendencies of the convergence of the industrial development objectives and institutions of the leading western countries. In the framework of the present paper I cannot undertake to estimate the perspectives and the extent of the convergence which demonstrates the scope, the effects and the success of adaptation. I am merely able to present a few examples showing the incidental constraints on the possibilities of such adaptation.

The examples are related to the adaptation efforts of the innovatory institutes of the United States in the FRG.

a) *Enterprise network and state consulting network.*

The *enterprise network* is the totality of all the institutes, persons and relationships which take part in putting a technical innovation on the market.

This type of enterprise network has developed to a very high level in the gravitation field of the agglomeration in Silicon Valley. This development was spontaneous and basically without the support of the government. [16]

Where such a focus for agglomeration (which collects the various constituents of an enterprise network into a single area) has not developed, it may be tried to replace it. The technological, innovatory and enterprise centres established in the FRG can be considered as such attempts. In these the state has tried to create the functions of the agglomeration centres. Such institutions are striving to replace the *spontaneous concentration of the elements* constituting an enterprise network.

As shown by experience, this experiment has not brought about a totally adequate substitution.

A typical feature of any agglomeration of high technology is that, by a plentiful, demonstrative and comparable offer of enterprise factors, it urges the entrepreneur to obtain *direct* information, to make well-founded and highly responsible decisions, i.e. to pursue a *full-value enterprise function.*

However, if entrepreneurs – due to the lack of such a concentrated offer – accelerate the gathering of the factors needed for realizing their plans by resorting to the consultation centres which collect pertinent information, they unavoidably confer a certain part of their enterprise functions to these intermediary organizations. [13]

This, on the one hand, will deter some entrepreneurs from making use of the services of the intermediary organizations.

On the other hand – depending on the degree to which the consulting institution actually becomes a partner in the enterprise, – external points of view will make themselves felt in the undertaking, and the responsibility for the decisions made will be shared by the intermediary institution (although it is actually unable to take real financial and proprietary responsibility).

b) *Two ways of enterprise development: by spontaneous agglomerations and by state-owned "founding centres"* (Gründerzentren).

It is well known that Silicon Valley demonstrated extraordinary dynamism in inspiring the foundation of enterprises, and it became a medium of education for a number of new enterprises.

The establishment centres and technology parks which were created with state support in the FRG have tried to provide an appropriate educational environment.

However, with regard to the role of competition in encouraging enterprises, there is a significant difference between the two types of education bases for enterprises, i.e. between the spontaneous and the planned ones.

The new enterprises of Silicon Valley are brought up in a competition of over-average intensity and this is enhanced by the unusually high regional concentration of suppliers' and customers' markets.

Entering into the establishment centres of the FRG, on the contrary, provides in many cases exemption from competition. In other words new undertakings are in an exceptional transitory position. [14] To create appropriate conditions costs money, a part of which is government money. Since it is not the intention to charge new enterprises for the, albeit limited, favourable conditions, the opportunities are not open to anyone. Thus, the applicants are selected not by market competition but by an "admission committee", and the advantages gained by winning admittance are not granted because of real results but at most because of a probable aptitude for making business.

The given examples represent narrow samples of experience. Yet they show that the attempts to approximate the institutional bases of technological policy do not always result in a true copy of the reality and contents of the original model. Thus Hungary should learn that institutional simulations have their own limits, and success or failure on the world market depend to a great extent on a successful compromise. This compromise has to be brought about between the requirements of some growth path and the possibilities of development created by the institutions conforming to the conditions of the country taking this path or by those which can be developed from them.

Summary of the conclusions and lessons for Hungary

1. The technological and economic development of the advanced capitalist countries is *not exclusively, not even primarily* promoted by the industrial and technology policy of the state, and the same can be said for its trends and characteristics. In the market economies technical development and innovation are primarily enterprise issues, i.e. factors of competitiveness. They could be carried on even if the state remained, for any reason, inactive. In the capitalist countries this reduces the responsibility of the bureaucracy for industrial policies. The economy can be kept on a successful path, or directed towards it by the sensitivity to the competitive position existing on the market, and by sensible enterprise decisions in response to the competitive position (even if state bureaucracy has not foreseen, or has erroneously interpreted the possible technologies and markets of the future). The mistaken decisions of the bureaucracy can be corrected or counterbalanced by correct enterprise decisions.

2. The responsibility borne by the bureaucracy with regard to industrial and technological policy is much greater in countries, like Hungary, where the development of the economy and the determination of the development trends are, in the main, *centralized.* Here the enterprises have little opportunity to correct the mistakes stemming from the limited foresight of the bureaucracy. This is because means are granted to the enterprises according to their significance – a significance they often are able to fight for – within the central priorities. Hence, in the countries following centralized development policies economic success requires the correct interpretation of global tendencies. Such a realistic evaluation would be far more important than in the developed market economies (at the same time it is even more difficult for them than for the latter).

3. Hungarian leadership – like the advanced capitalist countries – *strives to increase R+D-intensity.* However, it is not absolutely sure that this can be done by the state, nor is it clear that there is an unambiguous relationship between R+D-intensity and economic performance. It is equally uncertain as to whether such a policy is appropriate for the specific Hungarian case.

4. *With its high-technology priorities* for R+D, Hungary follows a trend which is growing uniform in the technology policies of the most advanced countries. However, the convergence in this area is not due to the far-sightedness of the state – on the contrary, it is because of its limited character. What is more, this approach may result also – in accordance with past experience – in exhausted or saturated markets. The enterprises of those countries where research and development in high-technology areas are based on budgets far greater than Hungary's national income will be immersed in this situation. This could occur even though they produce and use their products in economies which are incomparably more flexible and competitive than our domestic one.

5. Hungary – like the most politically and militarily advanced capitalist countries – has a Big Programme for technology, for it is part of the Comprehensive Programme for the Scientific and Technical Progress of the CMEA Member Countries up to the year 2000.

6. In Hungary – as in the most advanced capitalist countries – there are *innovation banks* which handle the central development funds in a decentralized form and distribute them partly on the basis of business criteria. The existence of these is a positive, rather than a negative phenomenon. Trouble is caused by the fact that the business criteria are usually subordinate to the priorities of national technological development. In other words these criteria are directly linked to central development programmes. Enterprises have to satisfy the requirements of the CMEA market – where the results of technological development will most probably be sold – and this results in a selection which is contrary to the viewpoints of technological development. Even the limited presence of business criteria is only conditional; several important guarantees are missing from the organization and mode of operation of the innovation banks, as well as from the economic environment which could confirm them.

7. Another problem is that Hungarian development policy has attempted to finance the most risky individual innovations (which promise the highest profit), by using the *venture capital* of the small banks. However, this has been successful in only some of the leading capitalist countries up to the present. Yet in Hungary there are no institutions – simple competitive commercial banks – for financing the less risky innovations merely on business considerations. Also, the venture capital activity itself cannot rely on a capital market and enterprise background, although these would be indispensable for its operation. Hence, it is not worth asking whether venture capital is an appropriate means for accelerating the innovation processes in Hungary, or it would be more appropriate to search for other methods or institutions. (Perhaps other institutions and other methods for other purposes.) Similar doubts can, however, be felt in respect of the most recent institutional attempts, linked to the plans to set up innovative, technological and industrial parks.

8. From the above points it can be seen that Hungarian industrial policy, where it is not peripheral or provincial, identifies itself in its ideals with certain selected processes and characteristics of the technology policies followed by leading countries – not with the practice of other, dynamic or increasingly vitalized regions. This identification is at the same time an *over-identification.* It seems that from the technological policies of the most developed capitalist countries the trends of convergence and unification had and still have the greatest influence on the idealistic image of Hungarian industrial development. The impacts and conclusions that can be drawn from the specific motives, limits, and accidental disadvantages of convergence have much less been considered. Despite the fact that – as I mentioned earlier – this is not the greatest problem confronting Hungarian industrial policy, the spectacular scenes of technology policy may have their own unfavourable effect: they may cover up the development paths which offer more realistic opportunities for catching up, as well as distract attention from the tasks necessary for entering such paths.

9. If increasing the share of R+D-intensive products in production and trade really belongs to the vision of the future of Hungarian industrial policy, this can also be made in a less questionable way. This way has been shown to be successful in the world economy and more suitable for small countries. In order to find this, it is by no means necessary to

follow the unification tendencies of the technological policies of the leading advanced countries. It is not these countries that should be watched. There are also other global trends. One of the most important of these shows that the development of telecommunications has allowed for a separation of some areas of R+D from those of production in certain R+D-intensive sectors. The examples of more than one of the higher level smaller capitalist or developing countries show that production and export performances can be achieved without the spectacular (albeit favourable) means of an "activist" technology policy – even in R+D-intensive branches. Of course, such successes also have their economic, political and institutional conditions: such as the legal and environmental preconditions for direct foreign investment. In addition, there need to be educational and training opportunities which are especially relevant for the R+D-intensive sectors. National R+D activities must be grouped around and built on the sectors vitalized by capital imports. The organizations for technology transfer, innovation and capital should spread the results of these sectors far and wide in the economy. Above all, the enterprise sphere must be in direct contact with the world market.

References

1. Advisory commission on industrial policy: a new spirit for industry, June 1981, The Netherlands.
2. Arrow, K. I.: Economic welfare and the allocation of resources of invention. In: National Bureau of Economic Research (ed.): *The rate and direction of inventive activity: economic and social factors.* Princeton University Press, Princeton 1962.
3. Bienkowski, M.–Allen, K.: *Industrial aids in the U.K.: 1985. A businessman's guide.* Centre for the Study of Public Policy. University of Stratchlyde. Glasgow.
4. Der Europapessimismus ist verstummt. *Süddeutsche Zeitung,* July 11, 1986.
5. John von Freyend, E.–Linkrohr, R.: *Europäische Struktur- und Industriepolitik.* Rationalisierungs-Kuratorium der Deutschen Wirtschaft. April, 1986.
6. Gerschenkron, A.: *Economic-backwardness in historical perspective.* Harvard University Press, 1962.
7. Hoffmann, D.: Förderwettlauf der deutschen Bundesländer. Das Beispiel Baden-Württemberg. *Neue Zürcher Zeitung,* August 25, 1984.
8. *Industrial policy movement in the United States: is it the answer?* A staff study prepared for the use of the Joint Economic Committee, Congress of the U.S. Government Printing Office, Washington, 1984.
9. Johnston, Ch.: The institutional foundations of Japanese industrial policy. *California Management Review,* Vol. 27, No. 4, 1985.
10. Junne, G.: Das amerikanische Rüstungsprogramm: ein Substitut für Industriepolitik. *Leviathan,* No. 1, 1985.
11. Klodt, H.: *Wettlauf um die Zukunft. Technologiepolitik im internationalen Vergleich. Schwerpunktstudie im Rahmen der Strukturberichterstattung an den Bundesminister für Wirtschaft.* Institut für Weltwirtschaft an der Universität Kiel. Kiel, March 1986.
12. Michalski, W.: Leitlinien für eine Politik der positiven Strukturanpassung. In: Erfolg und Misserfolg sektoraler Strukturpolitik. *Beihefte der Konjunkturpolitik, Zeitschrift für angewandte Wirtschaftsforschung,* Heft 31. Duncker und Humblot, Berlin, 1985.
13. Staudt, E.: Innovation durch Technologiepolitik? *Berichte aus der angewandten Innovationsforschung,* No. 40. Institut für angewandte Innovationsforschung E.V. Duisburg.

14. Starbatty, J.: Verführung zum offensiven Merkantilismus zur Technologiepolitik. *Frankfurter Allgemeine Zeitung,* February 25, 1985.
15. Täger, U. Ch.–Uhlmann, L.: Der Technologietransfer in der BRD. *Schriftenreihe des IFO-Instituts für Wirtschaftsforschung.* Nr. 115. Duncker–Humblot, Berlin–München 1984.
16. *Technology, innovation, and regional economic development.* U.S. Congress. Office of Technology Assessment, OTA-SII-238. Washington D.C. July 1984.
17. Thurow, L. C.: The need for industrial policies. The case of the U.S.A. *Annals of Public and Comparative Economy, 1984,* Vol. 55, No. 1.
18. Török, A.–Kolláth, Gy.: Nyugati iparpolitikai eszközrendszerek (Western systems of industrial policy instruments). *Külgazdaság,* 4, 1986.
19. Vernon, R.: International investment and international trade in the product cycle. *Quarterly Journal of Economics,* Vol. 80, 1966.
20. Vernon, R.: The product cycle hypothesis in a new international environment. *Oxford Bulletin of Economics and Statistics.* Vol. 40, 1979, pp. 255–267.
21. Zeppernick, R.: Mehr Staat oder mehr Markt? Die Forderungen nach einer neuen Industrie- und Forschungspolitik. *Hamburger Jahrbuch für Wirtschafts- und Gesellschaftspolitik.* Tübingen J.C.B. Mohr (Paul Siebeck) Vol. 30, 1985. p. 75.

ТЕХНОЛОГИЧЕСКАЯ ПОЛИТИКА ЗАПАДА И ВЗГЛЯДЫ НА ВЕНГЕРСКУЮ ПРОМЫШЛЕННУЮ ПОЛИТИКУ

Б. ГРЕШКОВИЧ

Руководители венгерской промышленности следят за западными течениями в области развития и модернизации промышленности, однако, как показывает опыт, западные направления развития создействуют скорее на идеалы, а не на практику венгерской промышленной политики. В связи с обзором отдельных тенденций технологической политики развитых стран в статье рассматривается то, подходят ли они для Венгрии, то есть можно ли и нужно ли следовать идеям развития, подсказываемым западными примерами. Автор приходит к выводу, что не только практика венгерской промышленной политики несостоятельна, но и идеи ее развития также не могут быть реализованы.

Руководство венгерской промышленностью в соответствии со своей консервативной практикой систематически превратно толкует и отбирает западные примеры, формирующие его идеи развития промышленности. Некритично и односторонне усиливаются директивные (или же толкуемые как таковые) элементы, которые могут быть непосредственно перенесены в собственную концепцию. В то же время не замечаются ни опасности директивизма в области развития, которые можно видеть и на Западе, ни западные альтернативы этого, ни важность тех механизмов хозяйственного контроля, которые в развитых рыночных экономиках могут предупредить или же компенсировать ошибочные государственные решения в области развития.

Acta Oeconomica, Vol. 39 (1–2), pp. 111–122 (1988)

WILL THE INDUSTRIAL PYRAMID BE SET AFOOT?

The Development of Enterprise Size Structure in Hungarian Industry in the 1980s

I. SCHWEITZER

The developments in industrial organization have reflected the changes carried out within the "industrial block" – the sphere of industrial authorities and large enterprise management – as well as in its power relations *vis-à-vis* the financial authorities of the government. The organizational decentralization of state industry had hardly begun in 1980–81 when it was interrupted. The dominance of large firms, i.e. the so-called "reversed pyramid" of size distribution, has been maintained. Meanwhile the number of small cooperatives has increased. A series of new possibilities has opened for small ventures, bringing substantial changes at the bottom of the size scale. The size distribution of firms has ultimately become highly polarized, implying that in industry as a whole the proportion of medium-size companies is very small.

Achieving a balanced size distribution requires the enforcement of a consistent financial strictness towards large enterprises. It is expedient if this is coupled with the decomposition of firms attached to restructuring and liquidation procedures. The financial strictness may also lead to a considerable autonomy of units within the internal relations of large enterprises, resulting in their becoming independent enterprises, in an economic sense. Providing an open way for the growth of new small ventures would also improve size structure. Finally, the author questions the view – widespread among reform economists, too – that the decentralized size structure is needed for the sake of domestic competition. He points out that in a small country like Hungary no genuine competition can exist without the gradual, but radical, liberalization of imports – that is, without a strong import competition.

In my paper I will analyze the changes which have occurred in the size structure of industrial firms since 1979. To put it in another way, I will examine how – as presented in my book "Company size" – the reversed pyramid of enterprise size distribution has been evolving. In this situation, unlike in market economies, large firms are dominant while the number of small and medium-size companies is very low. [1]

Analyzing the figures would, in itself, not be too productive; it is indispensable to deal with broader social and economic relationships as well. This is all the more necessary because – as I pointed out earlier – the new situation created in company size structure by amalgamations in 1963–1964 was accompanied by changes in the overall system of industrial management: a structure of large firms was developed and an economic system based on the supply-responsibility of these firms was established [2]. This system is characterized by a consensus which has developed in formal connections between large enterprises and the macroeconomic management.*

*The main features of the system are similarly described by László *Antal* [3] and Tamás *Bauer* [4].

Since I wrote the book I have obtained a better insight into the division of labour among the main participants of the system based on supply-responsibility. An important element of the system is the "industrial block", that is, the circle of large firms and branch ministries, which jointly elaborate development programmes and are in a permanent bargaining relation with the government concerning the financing of these programmes. The "industrial block" is able to support the suitability or, moreover, the indispensableness of its plans by professional arguments, against which the argument of the government can only be the shortage of financial resources or the deterioration of equilibrium. Similarly, there is permanent bargaining between the "industrial block" and the financial organizations on matters concerning subsidies and the rescue of firms which happen to be in an unfavourable situation. The power relations in this circle keep on changing. The arguments and reasoning of the government is significantly lessened with the possibility of drawing on additional financial resources by borrowing from abroad.

The functioning of the system based on the supply-responsibility of large firms, introduced in 1963–1964 [2] was only temporarily and not too heavily disturbed by the 1968 reform of the economic mechanism. Beginning with 1972 – after the "rearrangement" – an informal and consensual system (between large enterprises and the government) that got over changes in regulators started to evolve with full strength. The physical approach in development programmes, being very typical of the "industrial block", offered no scope whatsoever for the effects of controlled market relations; also, many of the competent managers of industry did not understand the concept aimed at the increased role of market automatisms and considered the problems as soluble exclusively through a further concentration of resources in line with the endeavours of the "industrial block".* Even in 1976–1977, when the economic situation of the country severely worsened, the industrial management sought the solution by elaborating a conception of cent selection which relied on a pre-determined system of criteria, and would have required, if it had been implemented, tremendous additional development resources. ([3], p. 307)

However, in the summer of 1978 – under the impact of the accumulation of economic difficulties and the threatening crisis – the situation changed. The top-level political leadership rejected the conception of the "industrial block", which was pressing for a further concentration of resources, and decided on a strong financial restriction. This turn of events, namely the top-level intervention in power relations, had an effect on the industrial organization, too.

How has the industrial organization changed since 1979?

It is impossible to give a comprehensive answer to this question in the framework of this study; on the other hand, this cannot be an excuse for simplifying the question. The change has not had a definite trend: even in the given period there have been phases of

*Such proposals were presented in a summary of the sectoral proposals of a joint study by the National Planning Office and the Ministry of Finance, prepared in the programme "The appraisal of the organizational system of industrial enterprises and the direction of its further development" in April, 1976. (See László Antal [3], p. 303)

progress and setback, and different stages can be recognised. The movements have taken place not only in enterprise organization; the organization of industry as a whole, and the position and "actors" of the "industrial block" have also changed.

I would emphasize two developments which unambiguously suggest the temporary shaking of the position of the "industrial block" in the first half of the period under consideration; one of them is the amalgamation of branch ministries, the other is the setting up of a committee for studying the organization of large firms – with the aim of bringing about their decomposition.

The amalgamation of the three (heavy industrial, light industrial, and metallurgical and machine industrial) branch ministries was completed in 1981 with the pronounced objective that the Ministry of Industry should not directly control enterprises. Its character was intended to be near that of the functional ministries and, primarily, it was to be the industrial adviser of the top-level economic management. At the beginning there were actually hints suggesting this kind of change in function. In this way, the governmental component of the "industrial block" fell out from the game for a while. Consequently, the representation of the interests of large firms within the government diminished and their position in bargaining for financial resources worsened.

In close correlation with this shift in power relations, for the first time in the history of Hungarian central planning (apart from a short period in the late 1960s), the tendency of organizational *decentralization* became dominant in state industry. The decentralization was carried out by governmental measures. The process, however, was very limited: some trusts were decomposed (with the member-companies being given autonomy) and, furthermore, some units were detached from some large enterprises and made independent. Some of the large firms threatened by decentralization "escaped ahead": taking advantage of legal possibilities, they re-established, as subsidiaries, some of their units. This was to avoid their being detached later on.

In the final analysis, the increase in the number of companies suggests there were much greater changes than in fact actually took place. It must also be taken into account that a considerable number – some one-third – of the 350 new state enterprises stemmed from the decomposition of two service companies ("AFIT", specialized for repairs of motor vehicles, and "GELKA" for repairs of radio, television and other home devices).

The enterprise decentralization was a government initiative, and, as soon as the government pressure lessened, it faded away. It was the creation of enterprise councils within the new system of enterprise management that marked the end of this process and fully blocked the government-initiated organizational transformation of most state enterprises. This was because, ever since they had been introduced, any decision on the modification of enterprise organization had been in the scope of authority of enterprise councils.

It is probably not a misconception to attribute the relaxation, then cessation, of the government pressure for decentralization to the circumstances in which the critical external disequilibrium of the economy, culminating in 1982, (which also served as an argument justifying the dominance and long-lasting maintenance of the "manual control" of the economy in the policies of the government) considerably increased the role of large

firms. The government believed that the large firms had those reserves – primarily additional convertible exports – which could facilitate the escape from the difficult situation.

The economic system has, at all times, remained a system based on supply-responsibility, as well as on bargaining and consensus between the authorities and large firms. The questions that affected the incomes of the major part of industry – that is, the rates of taxes and subsidies as well as the development resources – have consistently been decided upon in a bargaining procedure which favoured large enterprises [5]. Market mechanisms have hardly functioned at all, and their influence has almost always been confined to smaller firms which have – voluntarily or involuntarily – been squeezed out from bargaining procedures with the authorities. The deficient functioning of market mechanisms is also demonstrated by the fact that the modifications of the regulatory system usually do not result in the desired outcomes.

With the practice of "manual control" becoming dominant, the bargaining relations between the central authorities and large firms became open and contributed to the consolidation of the positions of large enterprises. In this situation the Ministry of Industry changed its character, too: its functional role weakened, and, once again, the joint elaboration of sectoral development programmes with large firms became its main profile. The unity of the two poles of the "industrial block" – the circle of large enterprises and the central (ministry) management – has been re-established.

Meanwhile, however, the presumed "reserves" of large enterprises were exhausted, and it turned out that the production structure of large firms did not facilitate an escape from the increasingly severe economic situation. The acceleration of growth initiated by the "industrial block", after some success in the first stage, threatened to end in catastrophe. It became obvious that the restrictive policy should be continued, and, simultaneously, such changes should be made in the economy (and the society) which could promote its adjustment to external markets, a substantial and continuous improvement of economic efficiency, and the restoration of stable equilibrium conditions for the national economy. The problem the government is now facing is whether it can achieve this objective by introducing adequate conditions for a controlled market economy, i.e. by an economic reform (accompanied by a social and political reform); or will it make, once again, a hopeless attempt at overcoming the difficulties by maintaining the non-market-type consensual system based on the supply-responsibility of large firms.

In the first case, in line with establishing conditions for a controlled market economy, the issue of a government-initiated decentralization of large firms can be raised again. There are indications, however, that the government is trying to find a solution without doing that.

An evolutionary way: the erosion of the structure of large enterprises

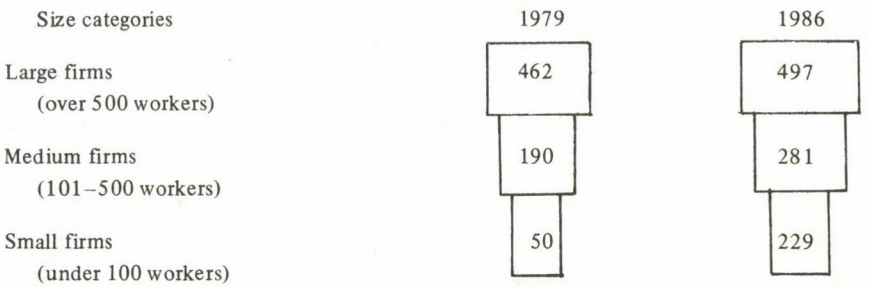
The existing structure of large enterprises was developed as the result of a centrally managed big industrial restructuring campaign in 1964. Since then the following question has been raised frequently: is it feasible that, without a centrally managed "re-organization" (decomposition and detachment) campaign, a size structure of industrial companies is able to evolve which makes it possible to create the conditions for, and to operate, a controlled market economy.* In my opinion, today this kind of transformation can also take place in an evolutionary way, by continuing and amplifying the "erosion" of the structure of large firms which is already under way.

What does the already proceeding erosion of the structure of large firms involve? How has the reversed pyramid changed since 1979?

According to data of the respective yearbooks of the Central Statistical Office (henceforth: CSO), the number of industrial state enterprises was 702 in 1979, and 1007 in 1986. During this period, the number of companies employing less than 100 workers – i.e. small enterprises by accepted international standards – rose from 50 to 229; that of medium-size enterprises (101–500 workers) from 190 to 281; while that of large enterprises (over 500 workers) from 462 to 495. The increase in the number of large enterprises can be traced back to the decomposition of trusts.

In respect of the circle of state enterprises, the size structure of industry has substantially altered and a tendency of decentralization has been experienced – yet the dominance of large firms remains unchanged. The shape of the reversed pyramid has changed in the following way:

The number of industrial state firms by size categories



The biggest change has been experienced in the engineering industry: in this sector the number of state enterprises, including subsidiaries, rose from 155 to 397, with a major part of the increment falling to small and medium companies. (More than 100 of

*This issue was discussed in the framework of a "mini debate" arranged by *Figyelő*, in which the participants were: Éva *Voszka*–György *Matolcsy* (March 26 and April 2, 1987), Iván *Schweitzer* (May 28, 1987), and Péter *Vince* (September 10, 1987).

those stem from the decomposition of AFIT and GELKA). As a result, in this sector the phenomenon of the reversed pyramid disappeared: in 1986, small firms represented 40 percent, medium firms 25.2 percent, and large firms 34.8 percent. The share of large firms dropped from 76.8 percent in 1979 to 34.8 percent in 1986. Their number, however, did not decrease, moreover, rose from 119 to 138 (due to trust decompositions).

Significant changes were carried out in the cooperative industry. As from January 1, 1982, small firms employing less than 100 workers were permitted – in both state and cooperative industries – to operate, and keep a simplified accounting system. The impact of this was not remarkable in state industry, but the number of small industrial cooperatives considerably increased (according to data of the Control Department of the Ministry of Finance, the respective figures are 79 in 1982, and 522 in 1986).*

According to CSO data, which comprise the number of small cooperatives as well, in 1978 670 industrial cooperatives were in operation, while in 1986 there were 1107. The number of industrial cooperatives with less than 100 workers was 90 in 1979, and 579 in 1986; the number of medium-size cooperatives (101–500 workers) dropped from 503 to 476**); and the number of "large cooperatives", with more than 500 workers, fell from 77 to 52.

Accordingly, an important role was played in the process of decentralization by the establishment of small cooperatives. What was an even more significant element in the expansion of the circle of small enterprises was the spread of – as they are commonly called – "associations". These comprise the new forms of small ventures which have been developing since 1982. In 1986, 17 367 small ventures belonged to this circle, of which 12 313 were enterprise economic worteams (VGMK), 3 385 were private economic partnerships (GMK), 1 641 were specialized teams, and 28 were civil law associations (PJT) and others.

Finally, the private artisans must also be taken into account, even though restrictive regulations concerning the number of workers they can employ prevent them from having an adequate role in production. The number of private artisans was 37 322 in 1979, and this figure increased to 43 530 in 1986.

All in all, from the above figures we can draw the conclusion that the phenomenon of a reversed pyramid in state industry has, on the whole, been maintained; in respect of industry as a whole a special *polarized* size structure has developed: large state firms constitute the upper pole, and small cooperatives, associations and private artisans represent the lower one. This situation is somewhat similar to that in agriculture, where the operation of large state farms and agricultural cooperatives is complemented by very small (household) plots. It is just possible that the example of agricultural organization, deemed as successful, also encouraged the authorities to urge industrial organization along similar lines.

*Only a part of this increase represents the establishment of new cooperatives; several already existing cooperatives were re-established as, or transformed their units into, small cooperatives.

**The decline in the number of medium-size cooperatives reflects a tendency towards the establishment of small cooperatives.

I would like to give utterance to some of my reservations concerning the development of the polarized industrial size structure.

Regardless of the situation, in industry – and probably in agriculture, too – an autonomous and irreplaceable role can be played by medium-size enterprises; that is why their absence leads to the same functional disturbances and inefficiencies as the lack of any other size category. Setting the pyramid of industrial firms afoot also presumes an increase in the number of medium-size firms, i.e. those with 101–500 workers. At the same time it is obvious that the surviving dominance of large firms in the circle of industrial state enterprises constitutes the basis of the system based on supply-responsibility. Also, the fact that in the circle of small firms there are almost exclusively non-state small ventures, reduces their ability of interest assertion. This may lead to the deformation of their position in the industrial structure. All this suggests that it is necessary, on the one hand, to "emaciate" a considerable part of the large industrial state enterprises and, also, to establish further small and medium-size firms in state industry; on the other hand, it is necessary to ensure the possibility of growth for small cooperatives and small ventures.

At this point we can raise the summary question: what components can thus play a role in the process of evolutionary elimination, or the gradual "erosion", of the structure of large firms?

1. In state industry, the emaciation of large firms can be achieved through the consistent enforcement of financial strictness, that is, through the abolition of subsidies.

This can only result in a more healthy size structure of enterprises – or in setting the reversed pyramid in motion – if the financial rehabilitation and liquidation procedures are consistently accompanied by the decomposition of the firms concerned, the detachment of units, and the regrouping of their employees and assets (allowing for the aspects of company size, too). The financial strictness and economic emergency may also substantially increase the number of those firms which decide voluntarily to detach from, give autonomy to, or sell some of their plants.

In the context of organizational changes, this would represent a shift from centrally determined movements towards "organic" changes called forth by economic developments.

2. The emergence of new medium-size firms can primarily be expected in the wake of the decompositions or detachments accompanying the financial rehabilitation or liquidation of large companies. There is, however, still another possibility. This case would arise if the financial strictness or the hardening of the budget constraint forces large enterprises with an extensive network of plants to change their operation significantly. The process, in the course of which the management of a large firm increases the autonomy of plants (establishments) and transforms itself into a representative, coordinating and capital-reallocating centre, could eventually reach a point, where these plants – even without being formally changed – are regarded as independent firms. It would be more appropriate, however, if the large companies could be transformed, also formally, into trusts, concerns, holding companies, or other similar types of industrial organization.

If their units were granted independence in market operations, they should be considered as enterprises – in terms of both the content and, of course, the size structure.

There is a frequent and justifiable argument against the creation of this kind of organization that – particularly if the structure of large firms and the system of supply-responsibility are maintained – there is a danger of their becoming medium-level managing authorities. These symptoms were also experienced in the state industry of Western European countries, notably in the case of Spanish and Italian state holding companies (INI–IRD). This is an additional reason why their artificial and centrally decided establishment would not be fortunate. However, it would be expedient if the state could provide the possibility of transformation into trust, concern, or holding company for those large firms which, under the increasing pressure of economic conditions, recognize the rationale in the re-establishment of their internal organization.

3. Beyond the expansion of the circle of medium-size enterprise, there are several other reasons why it would be in the interest of the national economy to provide the possibility of growth for those ventures within the circle of small companies which are able to create adequate conditions for such a development.

Small firms, small ventures and private enterprises play an important role in the improvement of supply for the population. In addition, their role in filling up the gaps stemming from the structure of large firms is often overemphasized, marking them not only as the "producers of shortage goods", but also as the "background industry", i.e. suppliers of parts, components, etc. In their present situation, however, this mission cannot really be performed owing to the unfavourable conditions of their operation and, in particular, to their technical backwardness. If there was a circle of small ventures, which – on the basis of its results in business – had an opportunity to purchase high technology, it would be capable not only of filling up gaps and acting as a "background industry", but also of achieving a significant development, specialization and world market success in adequate production and service activities.

It is clear that the starting and speeding up of these processes require, in the first instance, that the government treat enterprises of different sizes in a uniform way. There also needs to be financial strictness, the elimination of subsidies, and the consistent implementation of the inevitable rehabilitation and liquidation procedures. Furthermore, the ultimate progress of the reversed pyramid necessitates the abolition of the system based on supply-responsibility, as well as the establishment of a controlled market. This, in turn, needs a consistent reform process.

Enterprise organization and competition

The basis of the system of supply-responsibility is the monopolistic large firm. In 1963–1964, during the period of the amalgamation campaign which resulted in giant enterprises (at least, in the Hungarian context) the monopolistic position was an accepted and, moreover, institutionalized characteristic of the economy. The "profile-master" system flourished. In this system, through the central distribution and redistribution of

the production of certain groups of commodities (the so-called "clearing of profiles"), certain firms ("profile-masters") took responsibility for the supply of certain products. The central economic management delegated the right to determine the product pattern, the trading relations, and minor investments necessary for the maintenance of activity within the profile to the enterprises. The development plans were jointly elaborated by the enterprises and the branch ministries (the "industrial block"). This system was designed to eliminate competition from the economy. Surely, it was the interest assertion of the new large firms which played the decisive role in this development, but I would also emphasize the strength of ideology.

The system of supply-responsibility and the monopolistic large firms were developed in the belief – and this belief seems to persist unchanged in several representatives of the "industrial block" even today – that competition is a disturbing element in the economy. For these representatives the sound and efficient functioning of the economy is basically a question of appropriate organization. To a certain extent, the rejection of the role of competition can be traced back to the school studies of the majority of present-day managers: in the simplified interpretation of Marxism which they were then taught, competition was viewed as a source of anarchy as well as the cause of a great wastage of economic resources. The idealized planning based on the assessment of needs, which in their education represented the opposite of competition and the means for solving all possible problems, became fairly soon – in the early 1950s – discredited in practice. Later on, however, in opposition to the trends of economic reasoning, a certain technical approach became dominant in the elaboration of industrial development conceptions. This approach was inclined to attribute the emergence of economic problems partly to low levels of technological development and partly to the poor organization of production and trade. In this way of thinking the inefficiency of production is mostly the consequence of poor organization, and not of the absence of an economic system pressing for adjustment to the market.

In my opinion, the survival of this way of thinking is supported by the presence of several weaknesses in the argumentation in favour of decentralization, as well as the incomplete formulation of the conception of competition and a controlled market.

One of the frequently emphasized arguments supporting the decentralization of the structure of large firms is that it can increase the number of economic agents present on the market. This, in turn, is seen as a precondition for creating or animating domestic competition. I would not consider this as a decisive argument for organizational decentralization. It is true that, in some sectors, competition among numerous small and medium-size firms would in fact be desirable. Nevertheless, in the basic activities of most industries it would be absolutely impractical to encourage the establishment of a great number of such companies. This would probably not facilitate the creation of domestic competition in a small country like Hungary. It is necessary to take into consideration the fact that two or three firms functioning in a given area can, as an oligopoly, still virtually eliminate real competition.

It is obvious that in the small domestic market of Hungary the number of competitors necessary for real competition or market operation cannot – or, at least,

should not – be reached in most areas. This fact is considered by industrial managers – although not openly, since the open criticism of opinions is not customary – as an important argument for questioning the rationality and operation of a controlled market mechanism. A reply to these doubts can only be given by further developing the conceptions of competition and market. In conclusion, I would like to make a comment on this issue.

I believe that the achievement of the task of establishing a controlled market based on real competition, and the solution of problems raised by the current economic difficulties, can only be brought about in one way: by the economic opening-up of the country – which means the elimination of protectionism and the gradual, but radical, removal of barriers between domestic and external ("world") markets.

Competition in Hungary should not only mean the competition of domestic firms. Foreign companies should be allowed to operate in the country, and domestic producers should, at first, become competitive, *vis-à-vis* these firms, in the domestic market. This kind of opening-up presumes a definite conception and a consistent pattern of implementation by the central economic management. Above all, it requires a change in the approach to openness and import competition. These days it is export orientation which is usually underlined as a feature of the policy of opening-up. This is not inappropriate, but not enough. If we only try to achieve the closing-up of the Hungarian economy by attempts at export orientation, the success will remain just as fictitious as in the case of baron Münchhausen when he pulled himself out from the swamp by his own hands. The example of several countries, which have achieved good results in their adjustment to the world market, proves that it is feasible to open-up the economy through import liberalization even in a very difficult economic situation or with serious desequilibrium. On the other hand, the experience of many countries – including Hungary – shows that without import liberalization in Hungary, too; their further elaboration, coupled with adequate steps by the government, are badly needed. Switching over to the conditions of a controlled market is a precondition for the actual solution of Hungary's economic problems; this, in turn, can only be made successful by the institutional opening-up of the domestic economy. It needs to be effectively supported by regulators (particularly the exchange rate) and controlled by the government (including their acceptance of import competition). No reform package aiming at establishing this controlled market mechanism can be comprehensive without plans for import liberalization. The competition of the world market should also be going on within the boundaries of the country. This should ensure that the Hungarian enterprise organization is formed in the spirit of adjustment to the world market in every respect – including the enterprise size structure.

The reason why we need more small and medium-size firms (that is, why we want to set the reversed pyramid afoot) is – in my view – first of all not the creation of conditions for domestic competition and the increase of the number of participants in the domestic market. In my opinion, the industrial size structure in Hungary should change in the direction of decentralization because in this way – in conformity with market principles and, moreover, in the course of the adjustment process to the world market – a

rational division of labour among enterprises could be achieved. The functions served by the firms should be consistent with their size, and the activities which can better be performed by small and medium-size companies should not be done by large firms.

References

1. Schweitzer, I.: *A vállalatnagyság* (Company size). Közgazdasági és Jogi Kiadó, Budapest 1982. 147 p.
2. Schweitzer, I.: Some interrelations between enterprise organization and the economic mechanism in Hungary. *Acta Oeconomica,* Vol. 27, Nos 3–4 (1981).
3. Antal, L.: *Gazdaságirányítási és pénzügyi rendszerünk a reform útján* (Hungary's economic management and financial system undergoing reform). Közgazdasági és Jogi Kiadó, Budapest 1985. 361 p.
4. Bauer, T.: A második gazdasági reform és a tulajdonviszonyok (The second economic reform and ownership relations). *Mozgó Világ,* 11. 1982.
5. Matits, Á.: Mennyit ér a vállalatnak, ha nagy? A vállalatméret hatásainak statisztikai elemzése (How advantageous is it for the firm to be large? A statistical analysis of company size effects). *Gazdaság,* 1. 1986.

Bibliography

Bauer, T.: A vállalatok ellentmondásos helyzete az új mechanizmusban (The contradictory position of firms in the new mechanism). *Közgazdasági Szemle,* 6. 1976.

Ehrlich, É.: A termelőegységek méretstruktúrája 18 ország feldolgozóiparában (The size structure of economic units in the manufacturing industry of 18 countries). *Gazdaság,* 3. 1985.

Gács, J.: A gradual liberalization of the Hungarian import: conditions, chances and consequences. *Acta Oeconomica,* Vol. 36, Nos 3–4 (1986).

Laki, M.: A „háttéripar fejlesztése" (The "development of background industry"). *Gazdaság,* 3. 1980.

Laky, T.: Enterprises in bargaining position. *Acta Oeconomica,* Vol. 22, Nos 3–4 (1979).

Révész, G.: Iparunk vállalat- és üzemnagyság szerinti szerkezete (The structure of the Hungarian industry according to enterprise size). *Gazdaság,* 3. 1978.

Román, Z.: Ipari szervezet, verseny, teljesítmény (Industrial organization, competition, performance). *Figyelő,* March 5, 1987.

Szalai, E.: *Kiemelt vállalat – beruházási érdek* (Preferred company – investment interests). Akadémiai Kiadó, Budapest 1981. 140 p.

Tardos, M.: A kisvállalkozás Magyarországon (Small ventures in Hungary). *Külgazdaság,* 12. 1980.

Varga, Gy.: Enterprise size pattern in the Hungarian industry. *Acta Oeconomica,* Vol. 20, No. 3 (1978).

Vince, P.: Transformation of industrial organization – without genuine changes. *Acta Oeconomica,* Vol. 38, Nos 1–2 (1987).

Voszka, É.: Átszervezés, kampány, reform (Reorganization, campaign, reform). *Gazdaság,* 4. 1984.

ВСТАНЕТ ЛИ ПРОМЫШЛЕННАЯ ПИРАМИДА НА ОСНОВАНИЕ?

И. ШВЕЙЦЕР

Изменения, происшедшие в организации промышленности, отражали изменения, которые произошли внутри «промышленного блока», то есть в комплексе управления промышленностью и руководства крупными предприятиями, а также в соотношении сил между ними и органами финансового управления. Организационная децентрализация в государственной промышленности остановилась, едва начавшись. Превалирование крупных предприятий, т.н. «перевернутая пирамида» в размерах предприятий для государственных предприятий сохранилась. Количество мелких кооперативов возросло. Возник целый ряд возможностей для новых мелких предпринимательств, они привели к значительным изменениям в нижней части шкалы размеров предприятий. В конечном итоге, распределение предприятий по размерам стало весьма поляризованным, что означает также и то, что в промышленности в целом доля средних предприятий весьма низка.

Для достижения сбалансированного распределения размеров необходима последовательная финансовая строгость, проволимая в отношении крупных предприятий, которую целесообразно сочетать с разукрупнением предприятий в ходе проведения санации и объявления несостоятельности. Финансовая строгость может и во внутреннем хозяйствовании крупных предприятий принудить к большой степени самостоятельности отдельных подразделений, когда они становятся самостоятельными предприятиями в экономическом смысле. В заключение автор спорит с распространенной и среди экономистов-сторонников реформ точкой зрения о том, что децентрализованная структура размеров предприятий необходима в интересах внутренней конкуренции. Он подчеркивает; в такой маленькой стране, как Венгрия, настоящая конкуренция не может возникнуть без постепенной, но радикальной либерализации импорта, без сильной импортной конкуренции.

Acta Oeconomica, Vol. 39 (1–2), pp. 123–135 (1988)

ENTERPRISE BEHAVIOUR IN THE 1980S: BELIEFS AND REALITY
(Some Conclusions of Recent Case Studies)

K. LÁNYI

From enterprise case studies carried out in the eighties, in contrast to those written after 1968, it is impossible to obtain a coherent picture about the market behaviour of enterprises and their business conduct. The bargaining of the companies with the centre (with government agencies) became the focus of research. As the researchers began to examine exclusively the hierarchic relationship between the state and the enterprises, the belief grew that the lack of sensitivity to prices, exchange rates, and costs was characteristic of Hungarian enterprises. Furthermore, production as an end in itself, continuous compulsion to grow and a non-appeasable hunger for investment were also cited as typical characteristics. Setting out from the behavioural patterns presented in a detailed case study and tentatively analysing the self-presentations of 21 companies from 1985, the following findings were detected: some ensemble of rules for successful market (business) behaviour was found in 14 of the 21 enterprises; also, a coherent, elaborate system of rules was found in 7 out of the 14 companies. Among these rules a few criteria for success, well-known from the international management literature, were also found.

The case studies

In the economic research of the 1980s the renaissance of enterprise case studies has been a striking phenomenon, both in Hungary and abroad. It is easy to understand why, during the closing period of world economic recession, the success stories became especially popular: a collection entitled "In search of excellence" was published in New York in 1982 and it became a bestseller in the United States and in Europe [1]. The survey forming the basis of the British equivalent of this book [2] was carried out with a more extensive research apparatus. It looked for international comparison and typical phenomena in a period when it was already evident that the domestic and international market environment of the British companies had irreversibly changed in comparison to that which the representatives of the new trends of economics had grasped in the 1960s. These tendencies, such as the school of "industrial organization" [3], [4], or the institutionally-minded description of the market structures which set out from the concept of transaction costs [5], usually started not from enterprise or market case studies or from other wide empirical surveys. They usually set out with some kind of idea – based on rather obvious observations – and by applying this idea to well-known theorems of equilibrium or disequilibrium economics, they presented their subject on a considerably high level of abstraction. They left the verification of their arguments to later empirical research. Even *Olson,* who caused the greatest sensation of recent years

and who can be considered the father of a new stream of political or social economic science, from the outset used models which, in his own wording, assumed background experience to be well-known. Thus he simplified it in accordance with the requirements of theory-forming [6], [7].

I only know of one Swedish school which – while starting from the practical methods of marketing research – maintained its relationship with the market sphere created by enterprises and consumers. It has also chosen this type of market concept as the starting point of its theories. It collects worthwhile material from the painstaking exploration of cases. Yet the school is not widely known because its publications only rarely reach countries beyond the territory of the Swedish language [8], [9].

Local enterprise and field research is, however, progressing: the periodical *Management Case Studies* (published by Elsevier) reached its 3rd volume in 1987 and in the same year the European Association of Industrial Research, at its 14th conference in Madrid, devoted a separate section to case studies. Most recently, a volume containing comparative chapters has been published with the sponsorship of the World Bank (Tidrick – Jiyuan, 1987). This is based on interviews carried out in 18 Chinese enterprises, and is the collective work of Chinese, Western, and East-European economists.

What is the reason for this renaissance, for this so widely practiced return to the bases of empiricism – more precisely, to elementary experience?

The fact that the empiricism embodied in the case studies (which can by no means be used for deductive conclusions and in regard to induction also involves several uncertainties) could recently enter into the foreground of research is most probably due to the dissatisfaction with the state of economic science and with its scholars.

Last year, at the Vienna conference of the European Economic Association, E. *Malinvaud* enumerated the facts which economic science had failed to explain in the course of the last fifteen years emphasizing among them stagflation and the resulting permanently high unemployment [10]. Herbert *Simon,* the Nobel prize winner, proclaimed that economic science cultivated at a desk – or in an armchair – had come to an end. His programme consisted of exactly the opposite of what we had become used to, i.e. he says that empirical studies have to be used to verify or reject not the economic theorems themselves, but the assumptions serving as their background [11].

In Hungary the situation is somewhat different. Following the 1968 reform, large numbers of company and market studies were conducted in order to pinpoint, at the places they were carried out, the organization of the inter-firm relations and the ways in which the economic processes created by the system – the so-called 'new economic mechanism' – were realized [12, 13, 14]. The company managers at that time were not as reluctant to disclose their strategic objectives and to expound their business philosophy as they are today. Therefore, the Hungarian economy was indeed a paradise for the writers of case studies.

In Hungary, the revival of carrying out case studies also occurred in the eighties. (See e.g. [15].) Interviewing the company managers and state executives became the most widespread method of making studies (i.e. in-depth interviews). It is a very time-consuming method, and therefore it is no wonder that interviewers – mostly beginners in

research – put only those questions to their partners, or made notes about only scuh answers as were given to questions contained in the research plan issued by the institution which ordered the study. The research plans necessarily made a selection among the phenomena to be described and the basis of the selection often consisted of a number of assumptions – in lucky cases these assumptions about the topics which may belong to the subject, in less lucky ones assumptions about things worth to be asked from the interviewees. Thus, if the market behaviour of the companies was not a subject of the research project in question – and as far as I know, it was in none of the cases – then at the most only an incoherent picture of it might have been left to the interviewers. From this picture only some parts might have, by chance, been included in the finished product, i.e. in the case study.

For the sake of being objective we must mention that the elements of market behaviour are more blurred and more difficult to recognize in the specific Hungarian market structure than they are in the western market economies. To identify them is made even more difficult by the conventional language or phraseology often accepted by both the interviewer and the interviewee – the background content of which only consists of a number of beliefs.

The beliefs and the doubts about them

The above-mentioned beliefs are based on the following thesis: what has happened since 1968 is merely that enterprises are no longer given mandatory plan directives, but they are oriented towards the fulfilment of the central plans – not always successfully – in the framework of a so-called indirect management system. According to these beliefs the enterprise environment in its behaviour is homogenous, in so far as each firm lets itself be guided by the regulators, and shows almost no interest in other companies: a company either tries to evade the regulators or strikes bargains about them with the central bodies. If so, then all other phenomena seem to be a result of this, including the lack of sensitivity to prices, exchange rates and costs, the pursuit of production and development for their own ends, the continuous pressure for growth, an insatiable hunger for investment, a lack of interest in foreign markets, a lack of marketing activities, and resistance to any economic policy which proclaims market competition and structural adjustment. The arguments of many official reports and scientific studies begin with such or similar clauses: "Since the market in Hungary is inoperative". In fact, it would be unjust to attach a list of sources to such a collection of banalities. (It would be important, however, to reconstruct and trace back to its origin the system of concepts which is in harmony precisely with these commonplace statements.)

It is necessary to make here two short remarks. First: serious researchers and theoretical economists did not question the existence of a market or markets in post-1968 Hungary. They did not question it even by giving priority to the concepts of "double dependence" or "bureaucratic coordination", or by using the metaphor "neither

plan,... nor market" [16, 17]. Second: the 1968 reform changed at least three elements of the functioning of the economy: it eliminated the system of mandatory plan directives; it gave a free hand to the companies in choosing their partners both for purchasing materials and selling their products; and it made the first steps towards allowing the enterprises to decide on the use of their own financial resources (for purchasing, for wages, and for accumulation). Many people emphasize only the first one of these i.e. the abolition of the plan directives – whereas in fact these were only elements of guidance; it was the second one which gave the possibility of really creating markets; and the third one was destined to provide the opportunity for bringing about rational economic management and the unity of the market – and, as we know, this has been the least successful [18].

Therefore, if we examine how the state strives to guide its enterprises instead of using public plan instructions, and how the enterprises respond to this, however great and however accurate a mass of data we may obtain, it will not be appropriate for telling us how the market operates and what the market behaviour of the companies which constitute the market actually is.

It might take a form that can be imagined departing from the relationship between the state and its enterprises. For example, the existence of the phenomena listed under the title of beliefs has also been proved by numerous case studies. Contradictory ones only appeared sporadically, some of them here and there, embedded in other spheres of subjects (see e.g. [19]). Yet these were never given as a group of coherent characteristics which could describe the market behaviour of companies. The basis of the doubts is, however, linked not only to the methodology. Other sources of such doubts also exist: e.g. the enterprise and market studies from the period between 1968–1971 (which I have already mentioned); the macroeconomic studies of the eighties which – at least for the given period – do not verify the assumptions about the overall triumphant growth drive of enterprises, their investment hunger, or constant propensity to borrow; the results of enterprise interviews and business surveys (see e.g. [20]); other recent research into the powerful changes of the industrial structure in the present decade [21]; and the study conducted by the Institute of Economic Planning encompassing the data of 76 enterprises. The latter indicates that in recent years, from among the enterprise objectives, those of increasing profits have received a much higher order of priority. Also, among the informative relationships of the enterprises the horizontal ones are more frequent (measured by the number of visits) than the vertical ones [22, 23].

A research method: found, rather than selected

In the course of a quite different research project in the Jászberényi Hűtőgépgyár (Refrigerating Equipment Works of Jászberény, to be referred to as LEHEL – a brand name of it – from now on) – conducted in order to collect information about the external market organization of a few companies during a not too deep acquaintance the ensemble of enterprise endeavours (to be presented in the following) came quite clearly in sight [24].

Production and development focusing on sales

In the company under question the chief production engineer reports not to the technical manager, but to the commercial deputy general manager. The yearly, quarterly and monthly production schedules drawn up by the factory units are based on the delivery orders of the sales department, i.e. on their selection. This production programming is carried out on computers.

Development is in the main subject to the requirements of the exports to capitalist markets, and it is based on purchased licences and on foreign cooperation; the design of models partly relies on the demands of the customers and partly on watching the trends of the foreign fashions. In technical development – which is not too rapid in this product group – besides following the trends of styles, the change-over to energy-saving equipment is dominant.

Cost-conscious economic management

The prices of refrigerators were everywhere rising at a rate slower than that of inflation in the last two decades (in Hungary they were almost unchanged). In such a saturated market the most important condition for maintaining competitiveness is cost reduction.

When the licence for export activity was granted to the company, it radically reduced the costs of forwarding (within them, those of freight). Then, (in fact, past few years) standards were developed separately for each factory unit according to types of costs. The fulfilment of these costs standards is regularly monitored and the financial incentives of the leading staff of the factory units mostly depend on the reduction of the costs.

The marketing activities are powerfully built into the company organization

60 percent of the sales are exports. Most of the employees engaged in foreign trade work in the headquarters at Jászberény. They play a decisive part in drawing up the production programmes. They are, in turn, expected to provide orders which assure a uniform workload on the particular production units.

Good relations with the suppliers, reliable customer services

A very wide range of import components are purchased by the company beyond its own needs and these are made available for other enterprises. This is done in order to assure unobjectionable services for equipment imported and built-in by the company. The

leading principle is to develop the image of the company, in extending the retail shop network of its own models, or in undertaking to deliver within a few weeks the soda-water syphons in boxes designed by the customer. Similar attention is given to supplying the repair and servicing organizations (and its own shops) with components of domestic origin. To be able to achieve all this, good relations have to be maintained with the suppliers.

The company is interested in scheduled deliveries – of course, also for cost reasons – and it is able to organize its production and foreign-trade (forwarding) apparatus so as to keep itself strictly to the delivery schedules agreed upon with the client. It is also able to solve the regular exchange of used syphon cartridges with one of its partners in the GDR.

Internal planning, accounting and an incentive system, serving the enterprise objectives

The cost level and the profit strongly depend on the even loading of the capacities. The production plans are drawn up in accordance with this requirement and the incentives are linked to their fulfilment at the factory level.

The zeal of production, as we have seen, depends on the delivery orders collected by the commercial departments. In order that the trading department can forward the order to the factory units (or accept them from the clients) depending on costs or profits, the products are moved within the enterprise at internal accounting prices, defined on the basis of the rank of their contribution to enterprise returns. The employees of the commercial departments gain their bonus on the basis of the difference between the sales calculated at the accounting prices and the same calculated at selling prices. (It is worth noting that this system is nowadays starting to spread in Western Europe, too.) In addition, those concerned with foreign trade are also interested in accelerating the payment of the returns from sales. The question of how far the offers correspond to these criteria is analysed by personal computers; the turnover, the development of the costs and the economic results are measured on a monthly basis.

* * *

The LEHEL story is not a story of success. It only shows, as an example, that if, in the course of collecting the material for an enterprise case study, we do not limit our investigations forecefully to the vertical relationships of the company, we may get some information about its market behaviour and economic management. The fact that in the cited example characteristics emerged which are diametrically in contrast to those listed in the first part of this study is mere chance. To be objective, it should be mentioned that in 1986, in the framework of the same study (what is more, even in another study) samples of contrary examples were also found (e.g. a foreign trade company not searching for the

clients but preferring that the customer make the initial step; a large nation-wide company which, operating in a comfortably growing market beside comfortably rising subsidies, was only concerned about the problem of not letting its factories become independent and yet was almost unconcerned about its costs).

Such examples gave me the idea that for the time being, and rather as an experiment, I should search for a group of constituents of efficient business behaviour similar to those found in the case of LEHEL. Such a search could possibly comprise a comparable series of finished enterprise presentations or case studies serving for other purposes (i.e. at least excluding the preconceptions of the researcher). The presentations of 22 company managers, which were given as successful examples of the then actual economic policy (revitalization) at a theoretical conference in 1985 seemed to meet this requirement [25]. The sample seemed appropriate because the criteria of selection were such that they neither excluded, nor made it unavoidable that the speakers should touch upon the rules of market behaviour and business philosophy adopted or considered desirable by their companies. Namely, the organizers of the meeting formulated the main characteristics of a type of company behaviour conforming to an economic policy aimed at vitalization as follows: the increase of the so-called income-producing capacity; an enterprise strategy aimed at technological renewal; and the taking into account of human factors. As could be expected under domestic circumstances, companies which were permanently profitable and also such which were struggling with difficulties were included in the sample. (In his book review, M. *Laki* was the first to call attention to the presence of the latest trends of "scientific management" in nearly every manager's presentation. He also pointed out the fact that those enterprises selected as top-ranking ones did not prove to be successful in every case, especially with regard to the results of their economic management [26].)

The results of the experiment

The process adopted was the following: to the 22 presentations of the managers who came from 21 enterprises, I added two more lectures i.e. case studies published elsewhere about two of them. Of this series I first left out those which did not touch upon market activities and relationships with suppliers and customers, for they provided no data for the study. In the next step I sifted out the studies which included only one or two of the characteristics of the LEHEL case and did not include one or two others which had replaced some of the other characteristics. Finally, in 14 presentations of the 21 companies, some ensemble of rules for successful market behaviour could clearly be recognized. In 7 studies out of the 14 even an elaborate system of coherent rules could be identified.

The fourteen enterprises which remained were then marked by order numbers ranging from 1 to 14 and from among them the above-mentioned seven were marked with an asterisk (*). In the following they will appear in this way. This method of selection is, of course, arbitrary, and so is the interpretation of the details of the standard interviews,

although not more arbitrary than the latter. Furthermore, it is considered fair to put the question of how far the statements of the managers cover the actual praxis of the enterprise (as is the case with advertisements, too). The right consideration is, however, that the content of the presentations should coincide with the intended image of the company. Namely, it should at least be part of the company culture, whether or not it could be implemented in praxis. Among other things, this is also the reason why, in selecting the 14 enterprises, it was not a criterion whether in the year of the presentation the company in question was successful or not.

The following *Table 1* contains the behaviour characteristics obtained by interpreting the texts of the presentations and the ordinal number of the enterprises exhibiting the behaviour in question. Characteristics 1 to 5 are those described in the presentation of LEHEL. Those marked 6 to 9 are those which were often mentioned by the managers. The characteristics 10–12 conform with the original selection criteria of the conference organizers.

Table 2 is an incidence matrix with a content similar to the foregoing. In this the mark "x" shows which characteristic, marked with the given ordinal number, can be assigned to the various enterprises – also marked with ordinal numbers on the basis of interpretations of the presentation texts.

The enterprises marked with an asterisk were selected in the following way: considering ordinal numbers 1, 3, 4, 8, 9 as directly describing the market behaviour,* was given to any company where characteristics 1, 3, 8 or 1, 4, 8 could be found and, in addition, where at least two more of the first nine characteristics were evident (number 8 shows open profit-orientation); furthermore, to any company which evinced numbers 1, 3, 9 or 1, 4, 9 and at least one more of the first nine. It is interesting that among the 14 lines of the obtained matrix, there is not one where every cell belonging to column numbers 1, 3, 4, 8, 9 would be filled. Also, there are only five among the seven marked with an asterisk where the second cell (cost sensitivity, cost reduction) is not empty.

All of the numbers 1, 2, 5, 6, 9, i.e. characteristics, which we can call strategic ones, – appear in two of the enterprises marked with *, i.e. in 3* and 9*. As seen in *Table 3,* the enterprises which exhibit elaborate and coherent features with respect to market behaviour also show similar positions with regard to strategic characteristics. Only one can be found in the table (13) which is in a higher position strategically than it is in the market relationships.

Though not demonstrated in any of the tables, it is worth mentioning that three managers (those of companies 4, 6 and 11) emphasized that it is a very important element of enterprise policy to assure the greatest possible autonomy for the factory units and subsidiaries belonging to the enterprise. At the same time, many of them referred to the importance of traditions within the company.

Table 1

Characteristics	Enterprises' ordinal numbers						
Those of LEHEL							
1. Sales-oriented production and development	1* 8*	2 9*	3* 10	4 11*	5 12*	13	7 14
2. Cost-conscious economic management	8*	9*	10	3* 11*	4 12*	13	6
3. Integration of trading activities into the company organization[1]	1* 8*	2 9*	3*	4 11*	5*	6	14
4. Good relationships with suppliers, reliable customer services[2]		2	10		5* 12*	6 13	7 14
5. Internal planning, accounting and an incentive system serving the objectives of the company	1* 8*	2 9*	3* 10	11*	5*	6	7
Other frequent characteristics:							
6. Strategic planning, formulating the business strategy of the company	1* 8*	2 9*	3*		5* 12*	13	14
7. Modern organization systems, computerization	1* 8*	2	3 10				14
8. Strong, open profit-orientation	8*	9*	3*	11*	5* 12*	13	
9. Market policy, competitive activity		9*	3*		4 12*	13	
Selection criteria:							
10. Income-producing capacity[3]	Mentioned in every presentation						
11. Innovation[4]	1*	9*		4	5*		7
12. Human factors (beyond incentives)[5]	8*	2	3		5* 12*		

[1] In the case of trading companies the productive and service activities come into this group.

[2] Companies acting as integrators in vertical or horizontal integrations are also included here.

[3] Some speakers did not use this terminology but were talking similarly about profit.

[4] Readiness to carry out technological renewal, which was an item among the original criteria, is obviously a concept wider than that, though difficult to interpret. In some form all of the speakers were talking about technological development.

[5] In regard to incentives see characteristic number 5.

Table 2

Company, No.	Characteristics of LEHEL					Other frequent characteristics				Selection criteria		
	1	2	3	4	5	6	7	8	9	10	11	12
1*	*		*		*	*	*		*	*	*	
2	*		*	*	*	*	*			*		*
3*	*	*	*		*	*	*	*	*	*		*
4	*	*	*						*	*	*	
5*	*		*	*	*	*		*		*	*	*
6		*	*	*	*					*		
7	*			*	*					*	*	
8*	*	*	*		*	*	*	*		*		*
9*	*	*	*		*	*		*	*	*	*	
10	*	*		*	*		*			*		
11*	*	*	*		*			*		*		
12*	*	*		*			*	*	*	*		*
13	*	*		*		*			*	*		
14	*		*	*		*	*			*		

Table 3

Company, No.	Characteristics of market behaviour					Strategic characteristics				
	1	3	4	8	9	1	2	5	6	9
1*	*	*			*	*		*	*	*
2	*	*				*		*	*	
3*	*	*		*	*	*	*	*	*	*
4	*	*			*	*		*		
5*	*	*	*	*		*		*	*	
6		*	*				*	*		
7	*		*			*		*		
8*	*	*		*		*	*	*	*	
9*	*	*		*	*	*	*	*	*	*
10	*		*			*	*	*		
11*	*	*		*		*	*	*		
12*	*		*	*	*	*	*			*
13	*		*		*	*	*		*	*
14	*	*	*			*			*	

The criteria of success

The quoted American factors of success were – in a brief summary – the following [1].

1. A bias for action
2. Closeness to the customer
3. Autonomy and entrepreneurship
4. Productivity through people
5. Hands-on, value-driven
6. Sticking to the knitting
7. Simple form, lean staff
8. Simultaneous loose-tight properties.

From the British survey referred to, the following rules can be derived [2]:

1. Leaders are visible, guiding rules are clear
2. Autonomy (entrepreneurship) and incentives for ventures
3. Control: strict but flexible
4. Involvement with the company (incentive)
5. Market orientation
6. Zero-basing (staying with the fundamentals of the business)
7. Innovation
8. Integrity (public image, correct behaviour towards partners and employees).

The studied enterprises were put into both the American and the British samples according to these very severe conditions. The two series of eight factors each formulate sensibly the surplus needed (or deemed necessary by managers) for outstanding success and not the minimum that is required for the maintenance of an existing position. When comparing them with the 12 characteristics listed in Table 1, and with the two others mentioned later on, it is found that they are also present in the ways of thinking followed by the Hungarian managers. Such are the American items 1, 2, 3, 4, 5 and the British ones 2, 4, 5, 7.

The conclusion of the experiment

This can be summarized in the following way: Hungarian company managers do not conceal their activities in economic management, the elements of their market behaviour, or even their business philosophy; what is more, they welcome the opportunity to talk about them even when they are not exactly asked about these issues. In favourable cases their declarations reveal a coherent system of rules that is comparable with that of the foreign companies.

References

1. Peters, Th. J.–Waterman, R. H. Jr.: *In search of excellence.* Harper and Row, New York 1982.
2. Goldsmith, W.–Clutterbuck, D.: *The winning streak. Britain's top companies reveal their formulas for success.* Weidenfeld and Nicholson, London 1984.
3. Caves, R.: *American industry: structure, conduct, performance.* Prentice-Hall, Englewood Cliffs 1967.
4. Bain, J. S.: *Industrial organization.* John Wiley, New York 1968.
5. Williamson, O. E.: *Markets and hierarchies: analysis and anti-trust implications.* The Free Press, New York – London 1975.
6. Olson, M.: *The rise and decline of nations. Economic growth, stagflation, and social rigidities.* Yale University Press, New Haven–London 1982.
7. Olson, M.: Microeconomic incentives and macroeconomic decline. *Weltwirtschaftliches Archiv,* Vol. 120, 1984. No. 4, pp. 631–645.
8. Möller, K. E.: A review of M. Elsässer: Market investments: Two case studies on the establishment of subsidiaries in foreign markets. Liber Förlag, Stockholm 1984. *International Journal of Research in Marketing,* Vol. 2, 1985, No. 4, pp. 298–305.
9. Johnson, Th.–Hagg, I.: Extrapreneurs – between markets and hierarchies. *International Studies of Management and Organization.* Vol. XVII, 1987, No. 1, pp. 64–74.
10. Malinvaud, E.: The legacy of European stagflation. *European Economic Review,* Vol. 31, Nos 1–2, Febr.–March 1987. pp. 53–65.
11. Simon, H.A.: The failure of armchair economics (an interview). *Challenge,* Vol. 21, No. 5, November–December 1986, pp. 18–25.
12. Laki, M.: Importverseny a fogyasztási cikkek piacán (Import-competition in the market of consumer articles). Konjunktúra és Piackutató Intézet, Budapest 1972. Manuscript.
13. Laki, M.: Importhatások a rádió- és magnetofonpiacon (Impacts of imports on the market of radio receivers and tape recorders). Konjunktúra és Piackutató Intézet, Budapest 1973. Manuscript.
14. Hare, P.G. (ed.): Hungarian enterprise behaviour. *Eastern European Economics,* Vol. XXI. Nos 3–4. Spring-Summer 1983 (Part I): Vol. XXII. No. 1. Fall 1983 (Part II).
15. Inzelt, A. (ed.): *Lehetőség, kockázat, valóság* (Possibility, risk, reality).. Közgazdasági és Jogi Könyvkiadó, Budapest 1986.
16. Kornai, J.: The Hungarian reform process: visions, hopes, and reality. *Journal of Economic Literature,* Vol. 25, No. 4, December 1986, pp. 1687–1737.
17. Bauer, T.: The second economic reform and ownership relations: Some considerations for the further development of the New Economic Mechanism. *Eastern European Economics,* Vol. XXII. Nos 3–4. Spring-Summer 1984. pp. 33–87.
18. Tardos, M.: The role of money: economic relations between the state and enterprises in Hungary. *Acta Oeconomica,* Vol. 25, Nos 1–2. (1980), pp. 19–35.
19. Laki, M.: *Uj termékek bevezetése és a piaci alkalmazkodás* (The introduction of new products and market adjustment). Közgazdasági és Jogi Könyvkiadó, Budapest 1979.
20. Csányi, T.–Csollány, É.–Hann, P.–Nagy, Á.: *A konjunktúrateszt alkalmazásának első hazai tapasztalatai* (The first domestic experiences of the application of business surveys). A lecture delivered at the scientific session: "World economic environment and the Hungarian economy. . ." October 1987.
21. Gács, J.: *A magyar ipar termelési és külkereskedelmi szerkezetének változásai az 1978–79 óta tartó restrikciós időszakban* (Changes in the prduction and foreign trade structures of Hungarian industry in the restrictive period since 1978–79). Konjunktúra és Piackutató Intézet, Budapest 1987.
22. Demeter, K.–Mohai, Gy.: Vállalati magatartás – a tervkészítés tükrében (Enterprise behaviour as reflected in planning). *Tervgazdasági Fórum,* 2. 1987. pp. 95–104.

23. Bod, Á.: Strukturális alkalmazkodás a középtávú vállalati tervezés tükrében (Structual adjustment as reflected in medium-term enterprise planning). Lecture at the 4th Conference of Industrial Economics. *Ipargazdasági Szemle,* 1–2. 1987. pp. 97–101.
24. Lányi, K.: A jászberényi Hűtőgépgyár külső piaci szervezete (External market organization of the Hűtőgépgyár of Jászberény). Konjunktúra és Piackutató Intézet, Budapest 1986. Manuscript.
25. Milei, L. (ed.): *Gazdaságpolitikánk az élenjáró vállalatok gyakorlatában* (Hungarian economic policy in the practice of the top-ranking enterprises). National theoretical conference, Győr, May 28–29 1985. Kossuth Könyvkiadó, Budapest 1985.
26. Laki, M.: Gazdaságpolitikánk az élenjáró vállalatok gyakorlatában (Hungarian economic policy in the practice of the top-ranking enterprises) (a book review). *Külgazdaság,* Vol. XXX. 6. 1986. pp. 72–74.
27. Antal, L.: A stratégia és a szervezeti struktúra összefüggései a BUDAFLAX Lenfonó és Szövőipari Vállalatnál. In: *A vállalatok környezete, céljai és szervezete* (The interconnections between strategy and organization structure in the "BUDAFLAX" Flax Spinning and Weaving Company, Chapter II in: The environment, objectives and organization of enterprises). Közgazdasági és Jogi Könyvkiadó, Budapest 1986.
28. Martos, I.: Racionalizálási program és első eredményei a Medicornál (The rationalization programme and its initial results in Medicor. A lecture held at the 4th Conference of Industrial Economics). *Ipargazdasági Szemle,* 1–2. 1987. pp. 145–150.

ПОВЕДЕНИЕ ПРЕДПРИЯТИЙ В 1980-Е ГОДЫ: ХИМЕРЫ И РЕАЛЬНОСТЬ

(Некоторые выводы из новых конкретных исследований)

К. ЛАНИ

Среди экономических исследований в 1980-е годы выделяется расцвет конкретных исследований предприятий как в Венгрии, так и за границей (от США до Китая). В то же время в венгерских исследованиях последних лет мы найдем немного примеров показа характерных для рыночного (делового) поведения венгерских предприятий особенностей поведения, стремлений.

У одного из средних венгерских предприятий — в ходе исследования в совсем другом направлении — весьма определенно проявился следующий комплекс целей предприятия: производство, в центре которого стоит сбыт; хозяйствование при сознательном отношении к затратам; встраивание торговой деятельности в структуру предприятия; хорошие связи с поставщиками; надежная служба покупателей; нацеленные на указанные цели плановая, отчетная и стимуляционная система.

Это подсказало автору идею, чтобы в порядке эксперимента выявить на основе проведенных также с другой целью (то есть исключающих по крайней мере заранее сформулированную концепцию) конкретных исследований или собственных материалов предприятий сходный или подобный обнаруженному у завода холодильного оборудования комплекс черт, характеризующих эффективное деловое поведение. Этому требованию хорошо отвечали доклады руководителей 21 предприятия, которые были представлены на одной из конференций 1985 г. как хорошие примеры актуальной тогда экономической политики (оживление). Из 21 предприятия у 14 можно было обнаружить: какой-либо комплекс правил успешной рыночной стратегии, у 7 из них они были представлены в качестве разработанной системы правил. Среди названных правил были и известные из международной литературы по менеджменту критерии успеха. На основании этого эксперимента можно с большим основанием предполагать, что исследования, направленные на изучение рыночного (делового) поведения венгерских предприятий, могут увенчаться успехом.

Acta Oeconomica, Vol. 39 (1–2), pp. 137–154 (1988)

RESTRUCTURING OF THE SOVIET FOREIGN TRADE MECHANISM AND POSSIBILITIES FOR INTERFIRM COOPERATION IN THE CMEA

L. CSABA

The article tackles the issue how radical the subsequent reforms of the Soviet foreign trade mechanism were. The major question to be answered is whether the room to do business directly with Soviet partners has increased for Hungarian and Western firms. As a background recent Polish, Czechoslovak and GDR regulation of direct interfirm relations is surveyed.

The series of reforms that are under way in the Soviet Union raise a range of questions worth an independent analysis, both in itself and regarding its impact on intra-CMEA cooperation. The present study however, focuses on a much narrower – though quite relevant – subject, which may become decisive from the practical, business point of view. Among the various alternatives it seems certainly legitimate to examine, whether and to what extent the room for direct business transactions of Hungarian companies increases on the East-European markers, owing to recent modifications, in the Soviet foreign trade mechanism, as well as to the novel legislation adopted by some other CMEA partners (an issue to be outlined later in a nutshell).

There is certainly no self-evident answer to the question at hand. The process of restructuring in the Soviet Union is characterized by a peculiar duality. On the one hand, the political leadership, experiencing the sluggish pace of actual changes in the system of management and control, outlines an increasingly comprehensive and radicalising reform programme. The economic components of this concept have been translated into concrete measures by the reports, approved by the June 1987 Session of the Central Comittee of the CPSU and by the July 1987 Session of the Supreme Soviet, respectively, further by the Resolution adopted by the CC of the CPSU at its above mentioned meeting and also by the Law on the State-Owned Enterprise and Associations [1, 2, 3, 4, 5]. The target model outlined in these documents is to function in practice from 1991 on. This implies a rejection of the mandatory planning model, which is to be substituted by a model of indirect control. On the other hand – reflecting the Soviet leadership's sober evaluation of the present situation – it is not even implied that a radical reform were an accomplished fact in the practice of economic management in the USSR. Neither is it assumed that it is merely a question of more intensive legislative and propaganda activities and the objective could be attained at one stroke, within weeks or months. This is demonstrated by the envisagement of a relatively long transitory phase. These years happen to overlap the decisive stage of the Hungarian consolidation and stabilization programme.

Thus, what is the Soviet transitory foreign economic mechanism like, namely the mechanism which is presently under restructuring? For an appropriate contextual evalua-

tion of the later described facts and measures it seems worth recalling that in any country regulation of foreign trade can hardly be more advanced than domestic control is. Furthermore, as a rule large countries and planned economies tend to treat their external (market) relations as a strategic issue, thus state control remains here usually tighter than in other areas.

The regulation, valid from January 1987

The decree adopted by the August 19, 1987 meeting of the Politbureau of the CPSU and promulgated in September [6] sets out from the fact that the present forms and methods of Soviet foreign trade have become out of touch with the requirements of the world economy and of technological progress. Therefore in the wording of the decree the Soviet loss of ground in the world markets is chiefly attributable to the obsolete (ustarevshiye) arrangements applied in foreign trade sector of the country.

From among the changes decided at that time, establishment of the *GVEK* (State Committee for External Economic Relations under the Council of Ministers) has to be mentioned. This functions as a Bureau of the Presidium of the Council of Ministers, superordinate to all bodies and sectoral organs entering into any form of international intercourse and it brings under uniform control both the various ministries and the different foreign markets. Its first deputy chairman is the Soviet representative in the CMEA indicating that integrational relationships are treated as organic parts of the country's overall economic relations with the outside world. 20 sectoral ministries and 70 associations were granted foreign-trade rights; gradual extension of this range is under way. It is worth mentioning that the extension of foreign trade rights to *sectoral ministries* is in fact the continuation of earlier practice [7]. Associations and sectoral organs are allowed to raise separate foreign exchange funds which can "freely" be spent on importing non-consumption goods. Fulfilment of the export plan becomes a constituent part of the overall evaluation of management in meeting their plan targets; missing its indicators has to be compensated from the foreign exchange fund. Furthermore, these ministries and associations are also* entitled to enter into direct relations with organizations of other CMEA countries for implementing the Comprehensive Programme for Scientific and Technological Progress in the CMEA countries until the year 2000 (henceforth: Programme). Their freedom of action is substantial in setting the terms of the deals including prices, but these rights are strictly confined to production cooperation agreements. The joint ventures and international associations can operate as financially independent units, (na polnii khozraschet), fitting organically into the domestic Soviet economic mechanism.

In early 1987 more detailed legal provisions were promulgated pertaining both to the entire foreign economic mechanism and to *joint ventures* (the ever green hit for the

*Beside the so-called coordinative head organisations (golovniye organizatsiyi, from thereon: GO) that are entrusted with organising practical deals stemming from the Programme. Since these are often research centres and other R+D institutions that often had no previous foreign trade experience, the two groups are far from being identical.

Western media). These, for one part, translate the fairly general guidelines into concrete measures, and for another part indicate certain shifts in emphasis (reflecting the deterioration in Soviet foreign economic position). In a preliminary assessment, the chairman of the GVEK emphasized [8] that within the framework of direct relations all organisations participating in the Programme are entitled to engage in the exchange of documents, may conduct joint research and experiments, they may send samples and pay visits to one another. However, questions related to the production and sale of commodities are not even mentioned. In turn, he formulated the objective that, already in 1987, 20 percent of total foreign trade, 40 percent of machinery trade and 60 percent of machinery exports was to be performed by companies, subordinate to ministries and associations with foreign trade rights. Furthermore, one of his important statements was that, applying new foreign exchange coefficients creates an *accounting relation* between Soviet producers and the external market.

The promulgated legal provisions apply partly to all foreign trade relations and partly to intra-CMEA trade. According to the *decree on foreign trade* [9], not only the Ministry of Foreign Trade and the *GKES* (State Committee for the External Economic Relations)* are subordinated to the GVEK but also the customs authorities, the Foreign Trade Bank, the committee on foreign tourism, as well as any division of any other organisation engaged in economic intercourse with the outside world. The *GVEK* may issue decrees, grant foreign-trade rights, and may order the organisations subordinate to it to render account of their activities. While a lot is said about the extended rights of the associations and sectoral ministries, Para. 12 of the decree states that the Ministry of Foreign Trade and the *GKES* continue to represent and assure all-state interests on external markets. Para. 13 sets limits to decentralisation in terms of commodity groups. Accordingly, final decision on the sale or purchase of raw materials, machines, foodstuffs, and in fact *any article deemed to have national economic significance* remains the prerogative of the Ministry of Foreign Trade. The incomes of foreign trade transactions are converted to Soviet Rbl by *differentiated* foreign exchange coefficients (the decree gave yet no details whether the differentiation depends on enterprises, commodity groups or on markets, or on all three, thus its difference from the conventional methods is far from obvious). A maximum 10 percent of the foreign exchange fund can be drawn away from its proprietors by the higher authorities, which is important as such funds existed already in the 1960s. However, at that time [10] and ever since it has been general praxis [11] that the inflows that were thus generated were actually "utilised in a centralised order", i.e. they were simply spent by the authorities instead of the companies. The January 1987 decrees envisaged – but did not elaborate – the possibilities for credits in foreign currencies. The whole export incentive system is yet to be tackled since,

*This organ, merged with the Ministry of Foreign Trade in January, 1988 used to be entrusted with organising Soviet technological assistance to foreign countries, Soviet direct foreign investments and, recently, with joint investments in the Soviet Union (where non-CMEA partners were involved). Thus it was a rather technical, executive organ that should by no means be mixed up with *GVEK* (though the literal translation of its name into English may course some trouble). The latter is a suprabranch top-level governmental bureau thus is, by definition a political decision making body.

as is well known, a large number of Soviet enterprises consider any exporting task as a punishment, since the extra efforts it requires a are not rewarded in any reasonable way.

In the decree on foreign trade with socialist countries [12] the most important novelties are outlined hereunder. From 1987 on the foreign trade plan will not be broken down to enterprises, but only to sectors or republics (while the structure and dynamics of the total turnover continue to be determined by the state planning comission). This implies – and it is emphasized thus in official interpretations too, [13] – that in this concept in the course of coordinating – plans within the CMEA, sectoral ministries are to play a vital role. Accordingly, the central planning organs are to concentrate on conceptual issues and on balancing inter-sectoral flows and proportions. According to Para. 6 of the decree, the free hand for the enterprises in issues of production cooperation practically means that their obligations originating from the draft contracts will be incorporated in the state foreign trade plan of the Soviet Union, thus organically fitting into the arrangements of the planned turnover.

Direct relations constitute a separate major chapter of the decree. In its wording, direct relations are major prospective forms of intra-CMEA integration. Within the confines of this institution, the Soviet sectoral ministry or association is free even in the choice of its partner. In settling accounts originating from direct relations the Bucharest pricing principle has to be applied. It was a novelty of the January, 1987 decree that, beside the credits in transferable rouble (TR) the Soviet Foreign Trade Bank was entitled to extend loans also in the national currencies of other CMEA countries.

This obviously means that direct relations can only operate over and beyond the frames of planned flows, as supplementary forms of intra-CMEA cooperation. This is because – if adequate monetary techniques are used – this is the easiest way to overcome the impediments stemming from the TR system, i.e. by using the national currencies. It is doubtful whether under pronounced features of national shortage economies and the concomitant centralisation in setting the tasks and in allocating resources, the possibility of using the national currencies could actually function. That would imply – and presuppose – anonymous commodities and independent partners among the enterprises who have a right to and interest in making economic decisions following the signals of national prices. (The question applies, of course, first of all to the Soviet Union itself.) In other words, what has to be eliminated first: is it the deficiencies of the accounting system, or the lack of enterprise autonomy and of market clearing prices?

An important innovation of the August 1986 Soviet regulation is that the ministries and associations with foreign trade rights are entitled to spend freely that part of their "TR income", which derives from the sale of *finished products* to CMEA countries beyond the planned quantities, on importing consumer goods. These items will not be included into the central all-union funds and balances of consumer goods. (Though it is true that they can only be sold to the employees of the purchasing firm.) Hence a very strong incentive has been created for the Soviet producer to carry out transactions involving the export of its finished products and the buying of consumption goods. This has been one of the objectives of Soviet commercial policy for years. The most important new feature is that hereby the very exporting Soviet firm is stimulated to carry out

continuous intensive additional market research for consumer goods in other CMEA partner countries (after having concluded the five-year and annual interstate trade protocols).

Among the novelties in the third part of the decree dealing with *joint ventures and international* associations, it promises priority treatment of these units in the overall system of Soviet material-technical supplies (snabzheniye), contains an explicit guarantee for the invested capital and provides the opportunity to repatriate the profit share of the foreign party. The establishment of joint ventures can be initiated by the *sectoral ministry* – provided the idea is based on an *inter-governmental agreement.* As a rule, it has to be approved by the *GVEK.* An important arrangement is that, though the sectoral ministries are authorized to sign general agreements on cooperation in production, the resultant export and import deals have to be individually approved, item by item, by the State Planning Commission. (Part II, Para. 18)

Thus, the above regulation can be described as an improvement of the traditional mechanism, (sovershenstvovaniye) rather than its radical reform. Yet, this is far from insignificant a progress in a country where enterprises with a significant export quota, even in 1986 did not know who the foreign users of their output were. Moreover they were not even invited to the relevant foreign- trade negotiations, and the export price received for their products was withheld as confidential by the ministry of foreign trade [14].

The new regulation of joint ventures

Let us now survey the decrees on joint ventures . The first interesting feature is the great similarity between the rules pertaining both to the CMEA and to western countries. This is so not only in their approach but also in their dispositions. It is all the more conspicuous because there are a number of differences between the motives and functional characteristics of establishing, running and closing down of companies in the two socio-economic systems.

As far as the *socialist* countries are concerned, in the regulation passed by the Council of Ministers on January 13. 1987 [15], it is an important advance that it contains no limitations, in regard to either sectors, areas, or spheres of activity. The decree strictly separates the areas for joint ventures and for international economic associations. The former are common properties, operating in a system where the parties are interested in the profit proportional to their share in the equity. The latter come into being in order to coordinate – to various degrees – certain activities of partners, but which continue to be based on national ownership. Both forms can only be established on the basis of already previously concluded *inter-state agreements.* Enterprises may only initiate them provided it stems from *expressis verbis* stipulations of some inter-governmental agreement. The regulation forcefully *protects the interests of the supervisory sectoral ministries. Those wanting to* set up a joint venture or an IEA have to apply for licensing by the GVEK, but this must be submitted through the sectoral ministry – thus it is not possible to go immediately to the political level. If the sectoral authority approves the project, it has to

be checked with the State Planning Comission, the Ministry of Finance, and with all the other sectoral authorities concerned. The application for establishment can only then be submitted to the central agencies: joint ventures are decided on by the Council of Ministers, and international associations by the GVEK.

It is a favourable feature of the January, 1987 regulation that the detailed arrangement of any contestable issue or of *any problem which might become the source of conflict* is left, in essence, to the contracting parties, as they can elaborate the foundation deed without being constrained by the stipulations of standard formulae (tipovie polozhenia) so common in Soviet legal practice. Even where it does prescribe certain solutions, it is added: "if not otherwise stipulated by the parties". It is very important that any substantial issue can freely be regulated in the foundation deed – from the scope of application of majority decisions up to the procedure of liquidation. It is also a favourable new stipulation, that following the central approval of establishment or of liquidation the event is published in the press. In connection with this, the compilation of a catalogue containing the most important data of the existing international enterprises is in progress.

The decree otherwise retains the principle of treating the units operating in the territory of the Soviet Union as Soviet enterprises, though they are given no plan targets, and in the system of material–technical supplies they enjoy priority. The joint venture is reminiscent of a limited liability company, in so far as the Soviet founders are responsible for the liabilities of the firm only to the limit of their capital contribution and, in turn, claims arising against the Soviet State are not exigible against them. That they are treated Soviet enterprises is revealed by the fact that any conflict between the partners, including also the debates between themselves and the Soviet authorities, has to be settled through the Soviet State Arbitration Court, the *"Gosarbitrage"*. A further sign of this approach is the rule, according to which the chairman of the board of directors of the joint venture and the general manager can only be Soviet citizens. Moreover the legal supervision of the joint firm is exercised by the supervisory authority of the Soviet partner, and higher state agencies can also be contacted only through this superior. If it wishes to import or export products or services, *the joint venture is subject to the Soviet foreign-trade licensing system.* Unless it is not explicitly otherwise stipulated by the inter-governmental agreement, the account of the firm in foreign currency has to be kept with the Soviet Foreign Trade Bank *(Vneshtorgbank)* or the IBEC, the International Bank for Economic Cooperation, and the Rbl accounts with the *Gosbank* (the Soviet State Bank). Exchange rates to be applied in the activities of the joint venture, as well as the whole accounting system, are determined separately in each case by the Soviet Ministry of Finance.

The assets of the company are recorded in TR, and the share in the property can only be transmitted with permission from the *GVEK* – even then the Soviet partner has the pre-emptive right. From the point of view of its material and technical supplies the joint company is treated as a foreign firm, i.e. *it has to pay for its inputs foreign-trade prices.* If the joint venture wishes to invest, the partners have to apply conditions following the methodology elaborated by *"Gosstroy"* the State Committee of the

Construction Industry (for Soviet firms). The joint venture is free to set its foreign-trade prices, but it can ask for loans only from the Soviet or from the CMEA banks. Loans can be obtained from other banks or firms only with the licence of the Soviet Foreign Trade Bank. The Soviet and CMEA banks are entitled to control not only the joint firms' meeting the orderly terms of repayment, but the postulated rationality of the actual expenditures financed from their loans as well. After two years of tax holiday a 30 percent income tax is collected from the joint venture, and in the case of repatriation of a share of the profit, a further 20 percent tax will be levied on this amount.

Beyond the regulation of the international associations, which is in several respects analogous with the above surveyed rules on joint ventures the decree also prescribes the remuneration of the employees: this has to conform to *Soviet domestic tariffs,* the latter also applies to the foreigners, unless it is otherwise regulated *expressis verbis* by an inter-governmental agreement. The collective labour contracts have to be made in compliance with general Soviet practice and the social security contribution also has got to be paid accordingly. Liquidation of an international association can take place either by the will of one of the parties or by a unilateral decision taken by the Soviet Council of Ministers. In such a case a share of the capital, remaining after the full repayment of the debts of the association to Soviet and also to third parties, may be repatriated.

The novel decree permitting the establishment of enterprises in the Soviet Union by western and/or developing countries [16] contains basically similar provisions, thus it is enough to touch upon the different or specific solutions. Establishment is conditional on a licensing procedure, and application for such a permit is to be submitted by the Soviet contracting party to its supervisory control organ. The plan is subject to a similar multi-level coordinating and screening procedure as in the case of joint ventures with partners from other CMEA countries. The majority of the Soviet share is obligatory. The investment of the Soviet party has to be valued at world-market prices.* If this is not possible, it is valued at contractual prices. The western part of the invested capital has to be valued at the *official exchange rate* of the Soviet State Bank, and the balance sheet is kept in Roubles. Explicit guarantees are given in the decree against nationalisation or expropriation and the decree warrants the right to expatriate the profit, or, in the case of liquidation, that of the net capital share. Legal disputes can be submitted to any court by free choice of the parties. The joint enterprise produces at its own risk, i.e. on the one hand it receives no mandatory plan target, and, on the other, the Soviet party does not guarantee the sale of its output. In the course of marketing its products a recourse to Soviet foreign-trade organisations is *not* obligatory for the joint venture, even in the case of sale to other CMEA countries; this is only subject to licensing. When entering the domestic Soviet market the situation is different: transactions may only take place through the Soviet foreign-trade organisation (adjustment to prices on external markets does not suffice). The latter pays in Roubles, taking into account 'world market prices'.

*This is a provision which is difficult to interpret even in theory, and all the more so in practice, if we consider e.g. that land is state property according to the Soviet Constitution, thus it cannot be accepted as a Soviet company's contribution by any Western firm.

The Soviet-Western joint venture may borrow in foreign currency primarily from the Soviet Foreign Trade Bank, it can resort to other banks only by permission of *Vneshtorgbank.* Rouble loans may be raised only from the State Bank of the USSR. In both cases the Soviet banks are entitled to control the 'rationality' of the joint ventures' expenditures financed from their loans (in terms of their own postulates or criteria), they are not confined to the timely (orderly) repayment of the credit. All foreign currency outlays including the salaries and bonuses of Western employees of the common enterprise must be covered by its own exports.

The joint venture is obliged to make the commitment not to give any information to foreign government agencies and to reject any regular reporting to them. The majority of the employees have to be selected from among Soviet citizens who are subject to Soviet wage tariffs.

On comparing the two decrees with each other, it is not quite clear why they are so similar. Namely, anything accepted or customary in the practice of CMEA trade is not necessarily the same in East-West relations (starting with the Soviet general manager, up to the monopoly position and control rights of the Soviet bank). It remains to be seen how Western investors' disinterest can be overcome in a case when the official exchange rate of the Soviet Rouble values the currency three times higher than its quotations by Western commercial banks. This is a problem since all accounts of the joint ventures are to be kept in Roubles (i.e. an inconvertible currency). A frequently praised feature of Soviet regulation, requiring from the joint venture to be a continuous net hard currency earner in fact enhances the inherent conflict of interest between the two principal parties. Most of the Western capital is known to have a prime interest in penetrating the huge Soviet *domestic* market, rather than joining the Soviets (or other CMEA countries for that matter) in exploring new market possibilities in the world at large. It is conceivable that an investor may accept a 100 percent buy-back arrangement in order to expand its sales (or to get into a new market). It seems, however, less likely to find many business executives who are ready to live with a regularly negative balance sheet in convertible currency while the Soviet Rouble is three times overvalued, and it is far from trivial how profits earned in Roubles can be spent and/or re-converted into hard currency (and non-planned commodity deals that could provide a viable, even lucrative alternative are severly punished by foreign-trade controls). The conflict of interest was aggravated by the need to rely on those very organisations of Soviet foreign trade whose work has been earlier qualified – even by Soviet official evaluations – as cumbersome, slow, and inoperative. The obligation to value all Soviet inputs – except labour – at world market prices runs contrary to the basic principle of comparative advantage. The right of the banks to permanently oversee the utilisation of the loans they extended is contrary to the practice of market economies. Such a procedure is normal only against insolvent, bankrupt customers. All in all, it is quite hard to imagine a West German investor who would be ready *not* to inform the Tax Office of the FRG, the *"Finanzamt"*, about the development of his Soviet investment. Re-invested income or a part of it is eligible for being deduced from the base of tax assessment, whereas the probable returns on a good investment in the Soviet Union is equally of interest from the Western financial author-

ities' point of view. This set of problems is all the more relevant for Western state-owned firms.

The requirement to employ Soviet citizens – with Soviet wage tariffs and Soviet trade union rights – as a majority of the labour force may limit management and proprietory discretion in running the joint company to such a degree that it may question the whole sense of the very investment (as neither the stick, nor the carrot is at hand). Therefore it seems neither expedient nor possible to regulate a Soviet-Western joint venture as a purely domestic unit of the USSR, otherwise – potentialities inherent in the internationality of cooperation, as a peculiar institution, may fall victim to enforced uniformity in legislation.

Ways of further progress and the liberalising steps of October, 1987

The legislation passed in 1987 cannot, of course, be interpreted in itself, but only as an element of an evolving process. More precisely, it can only be interpreted as the first stage in a series of changes. This has been reflected, among other things, by the vivid and substantial public discussion about the earlier surveyed new measures regulating the external economy. This is a novelty under Soviet circumstances. In fact, it even pushed the conventional self-justifying statements of the authorities into the background. Almost all the above criticism on the new rules enacted in 1987 have also emerged in the Soviet press. What is more, even officials of the supreme authority, having formulated the regulation have qualified it as a tentative mechanism, immature in its details and to be further improved by advances based on practical experience [17] [18]. This is further justified by the fact that empirical evidence and its analyses published in 1987 both were indicative of a need for further liberalisation. In part tradition, and in part the worsening of the Soviet trade position (in all three main commercial relations) have induced officials and those issuing detailed legislation towards a quite narrow interpretation of the legal provisions of 1986–87. This trends was quite dissimilar to the overall trend at radicalising reform in the Soviet Union. Evaluating the changes of 1987, one of the most competent analysts noted that in foreign trade the real *khozraschet* principle still did not penetrate companies. Moreover, several lower-level rules contrary to the spirit of the new legislation have still not taken place, nor did the Ministry of Foreign Trade have a smaller say in managing daily business affairs since January 1987. In fact its role has even been growing due to its extended supervisory and control activities over Soviet controls firms' due observance of state interests on external markets [19]. Considerations of control dominate the rules of the Soviet Foreign Trade Bank on financing the multilateral CMEA Technological Programme and intra-CMEA direct relations in TR (and more recently also in national currencies). The latter are entitled to overdraft loans of 90-day maturity in national CMEA currencies, while maintaining the earlier surveyed prerogatives of control by the Vneshtorgbank. This is even more the case when foreign currency loans for 4 years are borrowed. Over and beyond the detailed technological and economic feasibility study that is normally required by the banks when companies apply for this type of loan, the

Soviet Foreign Trade Bank is also entitled to ask for an *additional* technological substantiation to be produced by the *sectoral authority*, supervising the applicant company. A further condition for the loan in a national currency is that the sectoral ministry vouches to warrant unconditional repayment by the firm. In other words in case of deviation from the plan (for whatever reason, including the delay of the investment project) the Foreign Trade Bank is entitled to draw away the missing amount from the separate foreign exchange fund of the ministry, without prior warning. In addition, it may examine several other details that are not immediately related to the debtor's liquidity position, as the utilisation rate of the imported machines. It may punish *these* deviations as well by raising the rate of interest or by prescribing earlier repayment [20]. Thus, all the traditional considerations of central control through the banks are in fact observed. However, it has to be asked whether the final economic effect of this will, in fact not be the retardation of the operation of the institution. This danger is also felt by an expert of the State Planning Comission, registering the survival of traditional features under the new foreign economic mechanism. For instance, producers remain unable to spend the inflows to their foreign exchange fund, since that is subject to licensing, moreover the equivalent of sums to be spent must also be deposited in Soviet Roubles [21]. All this is only added to the fundamental problem: the lack of incentives to export. Previously it has been found that a foreign exchange fund may induce some interest in exporting if foreign sales exceed 20 percent of the company's output whereas in most Soviet firms engaged in exports this share is around 3 to 4 percent. Moreover, unpublished additonal sectoral regulations have, in fact, precluded any major purchase from abroad [22]. Also, it is specifically pointed out by all the analyses, the possibility of spending the foreign exchange fund on larger investment is conditional on central allocation decision.

The size of the foreign exchange fund is, of course, a function of the official "exchange rate". While up to January 1987, the system of price equalisation functioned in its traditional totality, at the beginning of the year many of the individual titles of refunding were contracted.

While the system of individual coefficients for converting foreign currencies into Roubles remain, as traditionally, differentiated according to product groups and countries of destination/origin, whose size ranges between 0.3 and 6.0, their number has been substantially reduced to 3 thousand items [23]. It is still a remarkably large number in the view of the above quoted export, as practically individual enterprise costs are still honoured* (irrespective of their size).

This involves a neglect of efficiency considerations in foreign sales, since such a system provides automatic export subsidy. Moreover, the foreign trading firms are only formally profit-oriented, as they retained, in fact, their prime interest in increasing commercial turnover (since their incentive funds are much closer related to the fulfilment

*Others [24] express concern, that – due to the merger of titles – the new system does not perform this function in each and every case, for each and every product, thus even in its present modest form runs counter to current economic policy endavours to increase exports (practically at any cost).

of the plan of gross foreign exchange inflows) [25]. Thus – he concludes – a lack of meaningful khozraschet in foreign trade is itself a hindrance to the entire *perestroika.*

Having voiced so many criticism what is, after all, favourable in recent changes in Soviet foreign trade management? First of all, a relaistic assessment of difficulties, an increasingly open atmosphere for discussing also substantial issues, and the resultant flexibility of decision-making, its enhanced speed of reaction deserve attention. Thus the detailed rules on the finances of CMEA joint ventures make it no longer obligatory to apply the "exchange rate" of the Soviet State Bank – normally used for accounting and statistical purposes. Instead it envisages the use of bilaterally elaborated individual conversion coefficients [26]. In contrast with the previous system of surcharges on export sales, formation of foreign exchange funds is independent of the "previously achieved level", thus it has no built-in brakes on additional performance. Foreign trade companies will be organized in the republics and also the ministries of the republics will dispose of separate foreign exchange funds. In principle, these cannot be drawn away and their remainders can be carried forward to the next year. What is more, subcontractors will also be entitled to have their share in the foreign currency earned from the sale of the final product [27].

It is a favourable development, that interfirm integrational relations are not treated as a campaign. Therefore, a series of proposals to establish joint ventures have been rejected by *Soviet* central authorities; in these cases the projects submitted by the sectoral organs lacked sufficient technological and/or economic substantiation. Drawing the lessons from this experience, initiating the establishment of East-East joint ventures continue to be the prerogative of central control organs [28]. Thus, owing to the peculiarities of Soviet legislation, the Hungarian–Soviet intergovernmental agreement of November, 1986 could only provide the general framework for joint ventures, for the actual launching of a new joint company a separate governmental agreement is needed to elaborate the exact stipulations. Hence the restraint of senior Soviet officials in discussing this fashionable topic seems entirely warranted. According to the chairman of *GVEK,* [29] in the course of the current decade about 30 joint ventures can be set up with the five interested European CMEA partners.* In an interview [18] the director of the new foreign trade research institute put the tentative number of new Soviet-Western joint ventures to be established in the coming years at 20 to 30. This is no small number if we take into account that in mid-1987 altogether only 7 Soviet-Western joint firms were officially registered, the voluminous literature notwithstanding.

In October, 1987 new measures, adopted by the CC and the Council of Ministers were promulgated [30]. These modify several elements of the new foreign trade mechanism, valid as from 1 January of the same year, taking into account empirical evidence and some criticism voiced in professional discussions (and in literature).

The *first* set of measures simplify the *procedure of licensing* the establishment of joint ventures and of direct relations – a process severely criticised in the press for its

*As is well-known, at the Bucharest session in 1986 Romania did not sign such a framework agreement with the Soviet party.

being extremely sluggish. Thus, occasional deliveries deriving from the functioning of direct interfirm relations are no longer subject to licensing, nor is it obligatory to obtain the "umbrella" of an interstate agreement for this type of deal. It is legitimate to run the joint venture as joint stock company or as any other subject of private international law.

Interstate agreements to be signed by the Soviet Union on international scientific and technological cooperation will only cover major and intersectoral issues. – This might lead to some difficulties owing to the current stipulations that are in force in the GDR and in Romania. In this context it is worth noting that implementation of the multilateral CMEA Programme on technological progress is impeded – among other factors – precisely by the prolongued lack of competences of producers to enter into direct relations. In some cases they have been denied even those rights that would have been necessary to meet their obligations that stemmed immediately from interstate agreements [31]. In other cases, when they did receive the necessary competence, a different aspect of the same issue emerged. Namely, not even the coordinative head organisations (GO) could find partners who are ready to contract directly, since their partners are convinced of the actual commodity coverage of such a private law contract only if it is fully incorporated in the annual interstate protocol on deliveries [32]. All this is indicative of the inevitable feedback effects of the present state of multilateral CMEA mechanism on a partial change in any national system of managing foreign trade, which is a progress, *per se.*

The *second set* of measures, adopted in October, 1987 modify the rules of *joint ventures with Western participation.* Its major liberalising element makes it superfluous for sectoral organs to consult central authorities on any project, thus they are empowered with discretionary rights. In a substantial improvement for the joint venture it is free to choose both the currency of its accounts (bookkeeping) and the channel for its sales to Soviet and foreign customers alike. Thus equity capital may also be valued in convertible currency (valuation in Roubles is not obligatory any more). This is a substantial progress, since bookkeeping in hard currency and the free disposition over sales channels, in fact, eliminate constraints and risks stemming from the overvaluation of the official exchange rate of the Soviet Rouble. Artificial difficulties caused by the former obligation to include intermediary companies are also thus overcome. Especially the liberalisation of marketing channels is a relevant factor paving the way for genuine ventures (although licensing of its sales abroad and some other rules contrary to considerations of comparative advantage have still remained in force). It is a significant progress in approach that joint ventures may also be established in services and in the trade sector, not only in "productive" branches.

The *third* major set of measures promulgated in October, 1987 concern the *economic methods of control in foreign trade.* In accordance with the stipulations of the new Law on the State Enterprise it is permitted for any company to produce for exports, provided it possesses free capacities after having met its long-term contractual obligations vis-à-vis domestic partners and having fulfilled its tasks deriving from state orders. True, for the time being the right to engage in foreign trade is not a general possibility (as envisaged by the Law on the State Enterprise), but is confined to certain manufactures,

i.e. to a commodity group that has not usually enjoyed great demand on external markets. This is certainty of decisive importance for the quantity and structure of Soviet supply *over and above the quotas*. Therefore it also has a direct bearing on the type and quantity of products Hungarian companies are objectively able to purchase in various forms of interfirm cooperation, esp. if they act in tune with an overall policy of "import maximisation".*

The rules of October, 1987 improve the possibilities for spending the foreign exchange fund of Soviet producers. According to these provisions it is no longer necessary for them to coordinate their action with the specialised foreign trade organisations. Their demand (covered by the foreign exchange fund) must be automatically incorporated in the import plan (trade protocol) of the coming year. Inflows to the foreign exchange fund can be sold at free prices to other companies, and with the forthcoming elaboration of detailed regulation it will be possible to invest them abroad. From 1989 on a free currency market will be introduced. True, this market will first be developed for TR only. Furthermore, in the wording of the decree, sectoral ministries are not only entitled, but positively obliged to oversee (!) the 'rationality' of utilisation of the foreign exchange fund (which may in principle be freely spent). On the other hand, the scope and maturity of loans in foreign exchange, extended by the *Vneshtorgbank* will grow. The Bank may grant such self-liquidating loans with a maturity of 8 years, or credits for two years bridging the transitory costs of an expansive export policy. Considerations of control and the need for a warranty by the sectoral ministry, as detailed above, have not changed.

Regulation of direct relations and of interfirm cooperation in some other CMEA countries

Recent literature on direct relations is quite unclear – on occasion positively misleading. This has also brought about some confusion in the business practice of the last few years. Since major points about this issue in a wider context deserve a separate analysis [34] let me just recall: direct relations constitute an independent institution of integrational policies, as distinct from any foreign trade deal, from joint ventures and international interstate associations, from specialisation and cooperation agreements. Their substance is an instensive search for business partners, that goes beyond an exchange of information, but falls short of a trade deal or of a cooperation agreement. Thus it canot be mixed up with other forms of integration without causing serious troubles. Therefore it is not only the Hungarian Foreign Trade Act of 1974, but also the Soviet regulation currently in force that interpret this notion much narrower than recent literature tends to. It is instructive that a Soviet firm is *not* entitled to pass on to its partner in direct relations either a licence, know-how, or scientific invention, or any discovery that may be of immediate commercial use, whatever price it could extract for

*For a critical analysis of this policy see [33].

it [29]. As far as the multilateral technological programme is concerned which, in theory is also based on direct relations, Soviet legal sources [35] emphasize two peculiarities.

a) In implementing the Programme not even the subprogrammes or the detailed programmes, signed by national control organs involve automatically a trade deal with concomitant material and financial obligations. Moreover, even the agreement between the coordinative head organisation (GO) and the participating firm (soispolnitel') is essentially a framework agreement. In order to transform it into a commercial deal, a *separate contract of international private law has to be concluded.*

b) In so doing, the coordinative head organisation (GO) is obliged to involve the Soviet all-union foreign trade association, *Vneshtekhnika** in elaborating delivery conditions (prices included). As far as the financing of technological cooperation is concerned, this must come primarily from national budgets. This factor was strengthened by the decision of the boards of management of CMEA banks, ruling that from 1 January, 1987 these institutions extend loans only to such production, which is to be marketed according to the interstate trade protocol, whilst the International Investment Bank, being a profit-oriented establishment in theory, is by definition precluded from financing fundamental research [36]. The latter constitute a far from negligible part of the concrete tasks, enumerated in the Programme.

Although the issue of direct relations usually emerges as a Soviet-East European bilateral issue in the present stage, it is not without interest to survey some basic features of relevant legislation in other CMEA countries. This is accessible to a varying degree. In *Czechoslovakia* a detailed regulation was promulgated already in 1986 [37]. This resembles the contemporary Soviet arrangements, that used to be in force until late 1986. In managing direct relations the issue of plan-fulfilment and overfulfilment has come to the fore. Prerogatives and the control functions of sectoral ministries and of intermediate-level management organs (VHJ) have been strengthened. Direct relations are strictly separated from foreign trade deals, but the licensing procedure of establishing direct relations has become significantly simpler. Although it remained subject to prior licensing, the initiative and also the full risk is borne by the enterprise. The company is only entitled to engage in preliminary talks on establishing direct relations. Should direct relations develop into a commercial deal, the respective specialised foreign trade enterprise has got to be involved from the very outset in the elaboration of the terms of delivery. If the company in question posesses foreign trade right of its own, deals stemming from direct relations also fall under the conventional licensing procedures. As a rule, only those direct relations are exempted from licensing wich are immediately related to the implementation of interstate agreements or protocols. The wording of the decree states explicitly that neither the maintenance of direct relation, nor the resulting foreign trade deal entitles Czechoslovak firms to any subsidy, or to additional inputs from the system of material-technical supply. It is an important provision of the decree that prices have always got to be set prior to signing an agreement, thus it is more restrictive in this

*"Vneshtekhnika" is responsible for any transactions in engineering products, innovations, licences, know-how etc.

point then contemporary Soviet arrangements were (which already at that time did allow for some forms of technological and scientific cooperation to go on even if prices could only be settled *ex post*). Thorough analyses interpreting the new Czechoslovak legislation point out that although the narrowly understood direct relations are no longer subject to licensing, this does not imply a widening in scope of those foreign trade deals, in whose conclusion the authorities' involvement is not required [38].

In *Poland* 320 companies have been designated for establishing direct relations with Soviet organs. Most of them had already prior experience in this specific area. The bilateral Soviet-Polish intergovernmental committee on economic and technological cooperation acts – in the words of its Polish co-chairman [39] – as a peculiar "marriage broker" in bringing the partners together. Separation of direct relations from foreign trade deals, the principle of self-financing – i.e. the rejection of claims for subsidies – and possibilities to raise loans in national currencies of other CMEA countries (whose arrangements are similar to the ones described in the Soviet case) are characteristic features of current Polish regulation. Discussing their experience with direct relations Polish business executives stress the role of positive promotion by the state authorities. Citing a favourable case, it is emphatically noted that the Polish-Belorussian joint R+D centre on introducing industrial technologies would never have come into being unless the President of the Soviet Academy of Sciences, Gurii Marchuk had lent his personal support on their side [40]. Among the further gains the increased use of global value quotas, expansion of exchange of technical documentation on a commercial base, further the improvement in professional partnership, with its direct bearing on commercial decisions are listed by the business executives.

It is instructive, how little experiences of Polish firms on intra-CMEA direct relations differ from those of their East German counterparts, although the systemic differences between these two countries are striking, indeed. While in Poland the mandatory planning model as such has been discarded at the political level, in the *GDR* the presently functioning highly centralised system, based on combines, is considered not only as proven, but even as being of theoretical value. Thus it is hardly a surprise, that both the Soviet–GDR intergovernmental agreement of November 1986 [41] and the unusually scarce, but unanimous literature, interpreting previous experience and new arrangements list analogous areas of cooperation, no matter, whether it is produced by officials [42] or by general managers of combines [43]. Accordingly, in the GDR it is primarily cooperation in research, and the role of already existing professional relations that is to be promoted. Practice of the 1970's is praised as proven, and the exchange of technical documents and organisational experience is as free as before (although their potentialities are to be better utilised). Emphasis is laid on clarifying who wins exactly what from this and other forms of interfirm relations or joint ventures – this must be quantified by the East German participant. Both officials and managers maintain, that direct relations may turn into a tangible programme for activities and production only if and when they are incorporated in the state plan on foreign trade. In other words, it should be translated into obligatory plan tasks that are guaranteed by the authorities through adequate material-technical supplies. These considerations and formulae might be

representative of the role interfirm relations may play in the economic mechanism of Romania, Cuba and Vietnam. All this may suffice to illustrate, how far-fetched are the not unfrequently voiced theoretical statements – typical of certain quarters –, maintaining that direct relations in the present stage of CMEA integration must not be confined to implementing plans, moreover that the resulting agreements on specialisation and production cooperation, including contracts between coordinative head organisations (GO) and participating organs (firms/soispolniteli) manage and control *directly* the processes of production, rather than through the national plan-mechanism; thus coordinative head organisations (GO) should act as general contractors [44]. Proposals and statements of this breeding obviously disregard actually prevailing intra-CMEA conditions, therefore these may neither serve nor even contribute to improving business relations.

Concluding remarks

It is an established fact that the state of the multilateral CMEA cooperation system is a function of the domestic economic mechanism of the member-states, primarily of the Soviet Union. The autonomy of foreign trade management is relative, all the more so in large countries. Its actual shape is much less dependent on the overall political climate, than on the conditions prevailing in the internal economic system, and on the technicalities of management and control, which is being molded by the considerations, level of professionalism as well as by the interests of those elaborating it. Therefore it is anything but surprising if business practice experience a fair degree of continuity even if the elements of change are also increasingly present.

The cause of cooperation may be served not so much by the impressive slogans, always containing a modicum of wishful thinking, as by a sober analysis taking reality as it is. Other approaches in practical terms would most probably only induce losses both to the participants and to the entire CMEA. This holds primarily for the frequently voiced proposal to "liberate" joint ventures and direct relations from the "burden" of strict bilateralism, the need to equilibrate each and every deal, and to grant them the right to free pricing [45]. In the actually functioning "market" of the CMEA nothing can substitute for bilateral macroeconomic equilibration in ascertaining both national and immediate commercial interest, where the central setting of prices is a derivative. Giving up bilateralism under the present arrangements may only be conductive to a peculiar "equalisation" among national markets with grossly varying intensity of shortage. In other words the free hand of enterprises could only undermine the meticulously elaborated balance of mutual advantages, which is a prime result of usually 3 years of efforts in coordinating plans. Other institutions for harmonising interests would be desirable, but they will not automatically evolve, nor can they be created in a random order of sequence. Therefore, only a *package* of *radical* reform measures can be of real help. Well-meant but premature proposals, especially if they are raised as isolated measures can, in the last resort, only do more harm than good to the cause of integration.

References

1. Gorbachov, M.: O zadachakh partii po korennoy perestroyke upravleniya ekonomikoy. *Pravda,* 26 June 1987.
2. Postanovlenie TsK KPSS "O zadachakh partii po korennoy perestroyke upravleniya ekonomikoy". *Pravda,* 27 June 1987.
3. Zakon SSSR "O gosudarstvennom predpriyatii (obyedinenii). *Pravda,* 1 July 1987.
4. Ryzhkov, N.: O perestroyke upravleniya narodnym khozyaistvom na sovremennom etape ekonomicheskogo razvitiya strany. *Ekonomicheskaia Gazeta,* 28. 1987.
5. Csaba, L.: Die Entfaltung der sowjetischen Wirtschaftsreform. *Österreichische Osthefte,* 2. 1988.
6. O merakh po korennomu sovershenstvovaniyu vnieshnieekonomicheskoi deyatel'nosti. *Ekonomicheskaya Gazeta,* 40. 1986.
7. Konstantinov, Yu.: Vneshneekonomicheskiy kompleks SSSR v novykh usloviakh. *Dengi i Kredit,* 1. 1987. p. 20.
8. Kamentsev, V.: Sovershenstvovanie vneshneekonomicheskoy deyatel'nosti (Interview). *Ekonomicheskaia Gazeta,* 3. 1987.
9. O merakh po sovershenstvovaniyu upravleniya vneshneekonomicheskimi svyazami. *Ekonomicheskaya Gazeta,* 4. 1987. (English version available in the supplement to *Foreign Trade of the USSR,* 3. 1987.)
10. Kulagin, G.: Nomenklatura, tsena, pribyl. *EKO,* 11. 1985. p. 94.
11. Konstantinov, Yu.: op. cit. pp. 20–21.
12. O merakh po sovershenstvovaniyu upravleniya ekonomicheskim i nauchno-tekhnicheskim sotrudnichestvom s sotsialisticheskimi stranami. *Ekonomicheskaya Gazeta,* 4. 1987. (English version available in the supplement to *Foreign trade of the USSR,* 3. 1987.)
13. Konstantinov, Yu.: op. cit. p. 25.
14. Babkin, B.: Rekonstruktsiya i put' na vneshniy rynok. *EKO,* 12. 1986. pp. 74–76.
15. V Soviete Ministrov SSSR. *Ekonomicheskaya Gazeta,* 6. 1987. pp. 14–15.
16. ibid. pp. 16–17.
17. Kamentsev, V.: Trade and joint ventures (Interview). *New Times,* 24. 1987.
18. Faminskiy, I.: Joint ventures: a new thing with many problems (Interview by V. Frisov). *New Times,* (Moscow) 17. 1987.
19. Grinov, V.: Restructuring the foreign economic complex. *Foreign Trade of the USSR,* 5. 1987.
20. Kobakidze, G.–Barkovskiy, N.: Vneshtorgbank SSSR – obsluzhivaya finansirovanie. *Press-biuleten' Sekretariata SEV,* 11. 1987. pp. 31–33.
21. Zverev, A.: Valyutnyie fondy predpriyatiy. *Ekonomicheskaya Gazeta,* 15. 1987.
22. Leznik, A.: Upravleniye mezhdunarodnoy nauchno-proizvodstvennoy kooperatsii stran SEV. *Planovoe Khozyaistvo,* 4. 1987. p. 25.
23. Zakharov, S.: Po valyutnym koeffitsientam. *Ekonomicheskaya Gazeta,* 29. 1987.
24. Grinov, V.–Abolikhina, G.: Novoye v sisteme upravleniya vneshneekonomicheskimi svyazami SSSR s sotsialisticheskimi stranami. *Planovoye Khozyaistvo,* 8. 1987. p. 112.
25. Bondarev, A.: K realnomu khozraschotu. *Ekonimicheskaya Gazeta,* 36. 1987.
26. Konstantinov, Yu.: Finansy sovmestnykh predpriyatiy, mezhdunarodnykh ob"edineniy i organizatsiy. *Finansy SSSR,* 6. 1987. p. 61.
27. Nozhnikov, A.: Normativy valyutnykh otchisleniy. *Ekonomicheskaya Gazeta,* 21. 1987.
28. Prusov, V.: Sozdayutsya sovmestnye predpriyatiya. *Ekonomicheskaya Gazeta,* 16. 1987.
29. Kamentsev, V.: Foreign economic aspects of restructuring. *World Marxist Review,* 6. 1987.
30. O dopolnitel'nykh merakh po sovershenstvovanyu vneshneekonomicheskoy deyatel'nosti v novykh usloviyakh khozyaistvovania. *Ekonomicheskaya Gazeta,* 41. 1987.
31. Novoe v mekhanizme mezhdunarodnogo vzaimodeystviya. *Ekonomicheskoye sotrudnichestvo stran-chlenov SEV,* 6. 1987. p. 8.
32. The beginning of practical realization. *CMEA Economic Cooperation,* 2. 1987.

33. Köves, A.: Widersprüche in der Einfuhrpolitik der RGW-Länder. *Europäische Rundschau*, 3. 1984.
34. Csaba, L.: CMEA and the challenge of the eighties. *Soviet Studies*, 2. 1988.
35. Braginskiy, M.–Trakhtengerts, L.: Sovershenstvovanie pravovykh norm nauchno-tekhnicheskogo sotrudnichestva sovetskikh organizatsiy s organizatsiyami stran-chlenov SEV. *Khozyaistvo i Pravo*, 11. 1986.
36. Konstantinov, Yu.: Finansirovanie KP NTP stran-chelnov SEV. *Dengi i Kredit*, 5. 1987. pp. 28–29.
37. Primé vztáhy socialistickych organizáci ČSSR s organizacemi clenskych států RVHP. *Hospodářské Noviny*, 38, 1986.
38. Ježek, J.: Direct relations in scientific and technological cooperation. *Czechoslovak Economic Digest*, 5. 1987. p. 17.
39. Dlugosz, S.: Bezposrednia współpráca przedsiebiorstw Polski i ZSSR. *Rynki Zagraniczne*, 3. 1987.
40. Busigin, B.: Odna golova khorosho, dve – luchshe. *Press-byuleten' Sekretariate SEV*, 9. 1987.
41. Betriebe der DDR und der UdSSR erweitern die direkten Beziehungen. *Neues Deutschland*, 5. Nov. 1986.
42. Weiz, H.: Neue Dimensionen der sozialistischen ökonomischen Integration. *Einheit*, 4–5. 1986.
43. Hoffmann, R.: Na novom etape. *Press-byuleten' Sekretariate SEV*, 9. 1987.
44. Gavrilov, V.: Pryamye proizvodstvenno-tekhnicheskiye svyazi vo vzaimodeystvii stran SEV. *Obshchestvenniye Nauki*, 2. 1987. pp. 35 and 39–41.
45. Vladimirov, V.: Cooperation in the whole innovation cycle. *CMEA Economic Cooperation*, 3. 1987.

ПЕРЕСТРОЙКА ВНЕШНЕЭКОНОМИЧЕСКОГО МЕХАНИЗМА В СССР И ВОЗМОЖНОСТИ НАЛАЖИВАНИЯ ПРЯМЫХ СВЯЗЕЙ МЕЖДУ ПРЕДПРИЯТИЯМИ В СЭВ

Л. ЧАБА

Данная статья анализирует меры, принятые Политбюро ЦК КПСС в августе 1986 г. и сентябре 1987 г. по коренному совершенствованию внешнеэкономической деятельности с точки зрения того, как эти постановления и налаживающееся отраслевое регулирование, а также организационные меры способствуют установлению прямых связей и созданию смешанных предприятий как со странами СЭВ, так и с западными странами. Подчеркивается повышенная роль промышленных отраслевых министерств. Анализируется роль валютного фонда, валютных коэффициентов и республиканских внешторгорганизаций. Делается попытка обзора дискуссий в связи с дальнейшим совершенствованием нынешнего (октябрь 1987 г.) регулирования внешнеторгового механизма в СССР. В заключение сопоставляется регулирования прямых связей внутри СЭВ в Польше, ГДР, Чехословакии. На основе сравнительного анализа делается вывод, что при господствующих в настоящее время условиях международного механизма сотрудничества СЭВ предложения предоставить предприятиям право на свободное установление цен и создание смешанных предприятий являются преждевременными.

Acta Oeconomica, Vol. 39 (1–2), pp. 155–169 (1988)

DECELERATION, DEPENDENCY AND 'DEPATERNALIZATION' SOME CONSIDERATIONS CONCERNING THE CHANCES OF THE SOVIET UNION AND EASTERN EUROPE IN THE COMING DECADES

T. BAUER

The trend of falling growth rates in the Soviet Union and Eastern Europe since the war is likely to prevail also in the future. A temporary recovery following the recent slowdown seems possible in the Soviet Union but not in Eastern Europe. The dependence of Eastern European countries on the West will increase while their dependence on the USSR may weaken. Instead of comprehensive reforms of the economic system, the governments of the USSR and most East European countries may respond in the same way in the future as did Hungary and Poland in the past: reducing paternalism in respect of households by means of strengthening the role of money in consumption.

Introduction

In this paper* I shall take the liberty of speculating on the future. I do not think, however, that one should focus on the future. Also, I do not think that one should focus on quantitative estimates. Both external economic and domestic socio-political conditions, the two main determinants of economic development, at present are extremely difficult to forecast in these countries. One should, in my view, rather focus on the likely qualitative changes or lack of changes when discussing the future possibilities. It seems most appropriate to identify the trends prevailing in these countries so far. We can then raise the question whether these trends are likely to continue in the future or a break in the trend can be expected. There is also the possibility that some trends observed in the past in one or a few countries will appear all over the region.

The following discussion will cover the Soviet Union and the East European six: Bulgaria, Czechoslovakia, The German Democratic Republic, Hungary, Poland and Romania.

Deceleration

The long-term trend in the changes in growth rates of NMP (net material product) is illustrated by *Table 1*. This table has a double message. First, it shows a clear tendency of deceleration. Economic growth was rapid throughout the Soviet Union and Eastern Europe during the fifties (particularly the early fifties) but it slowed down later, arriving at rates hardly different from stagnation in the early eighties.

*Thanks are due to András *Köves*, Mihály *Laki*, András *Nagy*, Károly Attila *Soós* and László *Szamuely* for their valuable comments on the first draft of this paper. The full responsibility for all mistakes remains with the author.

At this point it should be noted that the growth rates of NMP published by Bulgaria, the GDR, Romania and the Soviet Union are markedly distinct from zero. The statistical methodology used in these countries is, however, not comparable with that used in Czechoslovakia, Hungary or Poland – not to speak about the West. The price indices underestimate price changes and, accordingly, the growth of NMP is overestimated. Soviet economists and politicians have recently made it clear that economic growth during the last few years can be characterized as stagnation.

The explanation of long-term deceleration can be found in the basic systemic features of the Soviet-type planned economy. Josef *Goldmann* and Karel *Kouba* established the fact of 'decline of the dynamics' in their famous book [1]. They identified the causes of retardation as the so-called "leakages". For instance, excessive growth of inventories and of unfinished investment, the high level of per unit inputs and the losses emerging in foreign trade due to inappropriate choice of export product-mix and declining competitiveness. They explained the presence of the leakages by such systemic characteristics of the traditional system of centralized planning as the inflexibility of production, the waste of all resources (labour, capital, raw materials and energy), reluctance to innovate and rigidity of the decision-making hierarchy [2].

Our present knowledge prompts us to add three points. First, although the economic reform implemented in Hungary made the operation of the economy somewhat more flexible and considerably weakened such adverse effects of the traditional system (i.e. rigidity and clumsiness, ignorance concerning impulses from external markets at the level of the firm or the ratchet principle), most 'leakages' were preserved. It turned out that the concentration of the bulk of social capital in a small number of large firms and cooperatives, the centralization of the function of initiating innovations, the central control over the greater part of investment, the wide-scale manipulation of prices and finances and frequent interventions in commodity transactions etc. are sufficient, even without mandatory planning, to bring about most of the 'leakages'. Second, the seller's market is not only a consequence of the system but turns into a cause of its poor performance since the reluctance of producers to meet other producers' demand has feedback effects on quality and assortment of production. Thirdly, isolationism from the external world (the policy of regional autarky) separates these economies from the world-wide diffusion of technology and frees domestic producers from the pressure of competition on external markets. Moreover, isolationism prevents these economies from identifying and making use of comparative advantages and, thus, forces them to develop inefficient industrial structures.

These are permanent adverse effects of the system which, in the early phase of industrialization, were compensated by the mobilization of additional resources of all kinds (labour, capital, raw materials and energy). (This is called 'extensive growth' in the literature.) The reserves of available resources were gradually exhausted during the sixties and seventies in the countries under discussion, and this has resulted in the deceleration demonstrated in *Table 1.*

There is one more important point to be raised on the basis of *Table 1.* The deceleration has not been monotonous: one can observe a certain bloc-wide recovery in

Table 1
The growth of NMP in Eastern Europe
(average yearly growth rates in percentages)

Period	1951–55	1956–60	1961–65	1965–75	1971–75	1976–80	1981–85
Bulgaria	12.2	9.6	6.6	8.7	6.4	6.2	3.7
Czechoslovakia	8.1	7.0	2.0	6.9	5.7	3.7	1.8
German Democratic Republic	13.1	7.1	3.5	5.2	5.4	4.1	4.5
Hungary	5.7	6.0	4.1	6.8	6.2	2.8	1.3
Poland	8.6	6.5	6.2	6.0	9.8	1.7	−0.8
Romania	14.2	6.6	9.1	7.7	11.3	7.0	4.4
USSR	11.3	9.2	6.5	7.8	5.7	4.3	3.6

Source: National statistical yearbooks

the second half of the sixties that followed the marked slowdown in the early sixties. (In Poland and Romania no marked slowdown can be observed in the early sixties. The moderate slowdown in the late sixties was followed by a noticeable acceleration in the early seventies in both countries.) This recovery or acceleration seems to be explainable by such temporary factors as the positive effects of the economic reforms of the mid-sixties, the expansion of East-West commercial and financial relations and the structural shift from coal and iron to oil, gas and synthetics in industrial growth. All these factors turned to their opposites during the mid- and late seventies and early eighties – this explains the marked retardation in growth.

Our questions at this point are the following. First, is the deceleration likely to continue in the coming decades? Second, is a recovery, analogous to the one that followed the downswing during the early sixties, likely to come about after the present slowdown?

If the deceleration can be explained, in general, by the operation of the traditional system of centralized planning, we now have to ask ourselves: is the economic system of the countries under discussion likely to change to a sufficient degree in the coming decades to eliminate the leakages discussed by Goldmann and Kouba?

A few years ago the answer was simple. During Leonid *Brezhnev*'s years conservatism prevailed in the Soviet leadership's attitude towards the economic system. Even in the first year of *Gorbachev,* when the emphasis was laid rather on acceleration *(uskoreniye)* than on reform *(perestroika),* the scepticism concerning the development of the economic mechanism continued to be justified. Similar conservatism prevailed during the seventies and early eighties in most East European countries, particularly in Czechoslovakia and the GDR.

Recently, the emphasis has shifted from *uskoreniye* towards *perestroika* in the USSR. The blueprint of a comprehensive reform was outlined by Gorbachev and approved by the Central Committee of the CPSU in June 1987. The use of such terms as 'radical reform' or 'new economic mechanism' (in the way it was used in Hungary in 1968) signs the determination of the Gorbachev leadership to introduce profound changes. The new reform blueprint goes considerably further than any preceding effort to reform the system in the USSR since the NEP, in that it allows for the elimination of mandatory plans and centralized resource allocation. Mandatory plans are to be replaced by government orders, 'control figures' and by direct inter-firm relations, while centralized resource allocation *(fondirovaniye)* is to be replaced by 'wholesale trade' in resources. The system of prices and wages is to be revised, and the existing system of motivation is to be replaced by 'long-term normatives'. The activity of Gosplan and of the ministries is to be limited to 'strategic' issues. However far-reaching the changes envisaged by the Gorbachev leadership are, and however likely it is that this time the economic system will be reformed and not only 'perfected' these changes do not seem to create the conditions for the elimination of most 'leakages'. To make this point clear, it is helpful to recall a few aspects of the present reform blueprint.

Although the reform blueprint allows for the creation of small-scale enterprises, existing state enterprises are to be grouped into strong, large associations (reminiscent of

the Polish WOGs from the seventies). While the ministries' daily interference into the production activity of the enterprises is to be eliminated, it is they who are supposed to become the 'headquarters' of innovations in each particular industry. This makes the rationalization of technical development and investment unlikely.

As far as planning is concerned, mandatory planning as the main form of controlling enterprise decisions is to be replaced by 'control figures' and government orders. It is well known, since the first experiment of replacing mandatory targets by 'orientating' ones during the late fifties in Czechoslovakia, how the latter turn into the former in practice. The idea of government orders seems to have been imported from Poland where, however, it has been introduced as a transitory measure and not as a standard element of the system – as the Soviet proposal seems to be. Anyone familiar with Hungarian and Polish experience will have doubts whether the set of 'control figures' and government orders will allow substantially more autonomy to Soviet firms than do mandatory targets and whether the firms will bear more responsibility for their decisions than in the past.

The reform blueprint includes the idea of 'full khozraschot', the application of long-term normatives to the financial relations between the state budget and the firms. The unification of these normatives is, however, not envisaged. This opens wide possibilities for bargaining over the normatives. (In this latter respect, the present Soviet reform blueprint does not seem to differ considerably from the concept of the July 1979 resolution.)

These few features of the reform blueprint make it clear that, in the main, the Soviet vision corresponds to Hungarian and Polish reality – something clearly distinct from Hungarian and Polish visions, and something that does not eliminate most of the leakages.

Perestroika has turned, in a certain sense, into a model for some East European governments. Its radicalism seems to be accepted only in words but the reform blueprint outlined by Gorbachev may be adopted (with all its limitations) by those countries which have not found a sound own reform concept so far.

For those countries which implemented comprehensive reforms earlier and made numerous concessions in the course of implementing their reforms (Hungary and Poland), the Soviet reform blueprint might have one of two effects (or both). Its radicalism, on the one hand, may strengthen those who argue for a further development of the reform in a more consistent way. On the other hand, the shape of the Soviet blueprint may provide a justification for the compromises.

Two conclusions may be drawn at this point. First, the Soviet Union and Eastern Europe are unlikely to turn their economic systems into 'market socialism'. So far market competition has not had a relevant role in the operation of the Hungarian economy. The Hungarian (or Polish) governments do not seem intent on liberalizing their respective economic systems to a degree which would imply the creation of the conditions for genuine market competition. The Soviet reform blueprint – serving as a model for others – approaches rather the less consistent Polish than the somewhat more consistent Hungarian version of the hybrid system that emerged from the inconsistent implementation of comprehensive reforms.

Before drawing the second conclusion two brief remarks are necessary. Soviet economists, and now even politicians, are aware of the adverse effects of shortages (of the seller's market) and of the need to achieve a certain level of "balance". Still, shortages will most probably continue to prevail in the Soviet economy in the coming years. The growth ambitions reflected by the slogan of acceleration are in sharp contradiction to the realistic growth estimates and this may result in growing imbalances. The heavy balance-of-payments tensions in the small East European countries also result, with the mediation of import restrictions and export drives, in imbalances in their respective domestic economies.

Second, the isolationist policy is likely to prevail also in the future in the Soviet Union and Eastern Europe. True, the Soviet Union promised and even started to introduce new forms of international economic cooperation. These efforts, however, do not question the priority of domestic links against international links and of intra-CMEA links against links beyond the CMEA, particularly in long-term development policy. This is clearly demonstrated by the new "comprehensive programme of scientific and technical cooperation", approved in the Gorbachev period.

The second conclusion follows from the first and from the two remarks just made: a radical change in trends in economic efficiency cannot be expected, and slow growth is likely to continue.

Yet are radical improvements in agricultural performance not likely to serve as a basis for a turn in the economy as a whole? After all, Soviet agriculture has performed particularly poorly during recent decades and it is plausible to assume that *perestroika* might bring a marked improvement, similar to the results of agricultural reforms in China and Hungary.

Rural reforms had spectacular results in China. However, these results were the products of decollectivization, resulting in the so-called 'family responsibility system'. One can only wonder whether a similar turn is feasible under Soviet or East European conditions, where a higher technological level prevails in the agriculture. Anyway, the intention to undertake such a change is clearly missing. A Chinese-like turn is, therefore, unlikely to come in the Soviet Union.

In Hungary, the agricultural reform implied both a business-like operation of the large collective farms and an advantageous combination of the collective farms and the household plots. This seems to be somewhat more likely under Soviet conditions. So far, however, Soviet leaders have not initiated changes in agriculture comparable to those started in Hungary during the sixties. Moreover, this type of growth in Hungary was very costly in terms of investment in agriculture and was only possible at a time when investment was growing at a high rate and the share of agriculture in national investment increased. Rapid growth of investment in the coming decades is hardly possible in the Soviet Union, and the planners intend to reduce the share of agriculture in national investment. The conditions for a Hungarian-like upswing in agriculture also seem to be missing. An acceleration of growth in agriculture will hardly contribute considerably to a marked acceleration in Soviet economic growth.

The reform to be introduced in the USSR, insufficient as it is for changing trends radically, may provide a basis for a temporary improvement, similar to the 1965 reform. There must be enormous and relatively easily accessible reserves in the Soviet economy, whose 'uncovering' and exploitation may contribute to a recovery. Much less can be expected in this respect in most of the small East European countries. The other factors which contributed to the recovery in the late sixties (and referred to above) are only partly present in the Soviet Union (where a new boom in imports of technology seems, despite opposite declarations by the leadership, possible) but are completely missing in Eastern Europe.

The recovery during the late sixties and early seventies was partly enabled by the fact that, after a short period of investment restrictions, numerous investment projects – already in process – could be completed. These projects contributed to the growth of production and to changes in production structure. The present situation is, however, different. *Table 2* shows that the restrictions on investment are much stronger and have lasted longer now than twenty years earlier. The growth of capital stock has slowed down considerably and even disinvestment has occurred in some countries. Structural changes in the economy have also slowed down.

We have to add that, as is clearly shown in *Table 3,* the big investment efforts of the fifties and sixties were reflected by the rapid growth of the capital stock only in the seventies; similarly, we can expect the effects of the recent investment restrictions on the volume, structure and technological levels of the capital stock only during the nineties and even later. This fact strongly weakens the chances for recovery.

Thus, while a certain recovery in the USSR seems likely, it is hardly possible in Eastern Europe. This is clearly demonstrated by recent developments. The lifting of restrictions and the following moderate acceleration of growth in Czechoslovakia, Poland and Romania immediately resulted in the deterioration of external and internal balances. The mere ambition of wanting to achieve a modest acceleration had the same effect in Hungary. Thus, the trend of deceleration will be maintained throughout the bloc, and together with it the tensions which this trend has generated in the recent decades.

Dependency

In the preceding section the recent crisis in Eastern Europe was described merely as the result of the decline in efficiency. There was no reference to the role of external factors.

I am fully aware of the role of external factors in the recent developments in Eastern Europe. The oil shock in the West, the following oil shock in the CMEA, and the credit crisis in East–West relations made all East Europeans realize how strongly, in contrast to widespread views, their economic fate depends on external impulses. As a matter of fact, there exists a dependency triangle: the small East European countries are dependent both on the West and on the Soviet Union, while the Soviet Union also

Table 2

The growth of investment in Eastern Europe
(average yearly growth rates in percentages)

Period	1951–55	1956–60	1961–65	1966–70	1971–75	1976–80	1981–85
Bulgaria	13.2	14.6	7.9	12.5	8.6	6.1	3.4
Czechoslovakia	9.7	13.1	1.9	7.2	8.2	3.5	–1.1
German Democratic Republic	12.5	14.9	4.8	10.0	4.5	3.4	–0.8
Hungary	1.2	13.2	5.5	11.8	7.0	2.4	–3.1
Poland	11.1	9.0	6.7	8.1	17.5	–3.0	–2.5
Romania	18.2	13.7	11.3	11.2	11.5	8.6	–0.5*
USSR			5.4	7.3	6.7	3.7	3.7

*1981–84

Source: National statistical yearbooks

Table 3

The growth of fixed capital in Eastern Europe
(average yearly growth rates in percentages)

Period	1951–55	1956–60	1961–65	1966–70	1971–75	1976–80	1981–85
Bulgaria		5.4	7.6	8.8	7.9	7.6	6.7
Czechoslovakia	3.1	3.8	4.0	3.8	5.4	5.6	4.8
German Democratic Republic	1.4	2.2	3.6	3.5	4.1	4.3	3.9
Hungary	3.9	3.3	4.0	4 6	5.8	5.7	4.4
Poland	3.4	4.0	4.4	6.1	8.1	8.0	2.7
Romania	4.6	5.2	6.7	8.6	9.6	9.2	8.3
USSR	9.0	9.8	8.6	7.5	7.9	6.7	6.0

Source: National statistical yearbooks

depends, to a growing degree, on the West. Dependency exists both in respect of trade and of financing; in trade technology, semi-finished products and food are the crucial areas.

The contemporary world is characterized by the interdependence of different regions and countries, and of different sectors and areas. Is it appropriate to speak about the unilateral dependence of Eastern Europe on the Soviet Union and on the West, and of the Soviet Union on the West?

The CMEA countries represent a small share in the foreign trade of the OECD countries – not exceeding 5 percent in OECD exports and 4 percent in OECD imports. The share of the OECD amounts, in turn, to one third of the foreign trade of the USSR and to slightly more than one quarter of the foreign trade of Eastern Europe. These proportions serve as a starting point for understanding the problem. They do not, in themselves, justify the use of the term "unilateral dependency".

In the trade between the Soviet Union and Eastern Europe, there exists a certain symmetry: the share of mutual trade is 40 percent on each side. However, the Soviet Union is one state while Eastern Europe consists of six countries, each of which, by itself, is a small partner for the USSR. Moreover, the importance (or, using the CMEA term, the "hardness") of goods delivered to the partner is different. Energy and raw materials continue to prevail in Soviet exports to Eastern Europe while machines still dominate the Soviet imports. This fact, again, does not result in dependency by itself. However, under the conditions of a chronic shortage of raw materials and energy in all countries of the region, the situation occurs as a product of the economic system. Under the present degree of competitivenesss of the small East European countries on different markets, imports from the Soviet Union are much more difficult to substitute by deliveries from elsewhere than imports of the Soviet Union from each particular East European country. As I have explained elsewhere [3], the slowdown in East European growth during the early eighties can be attributed to the slowdown in the Soviet extracting industries and, consequently, the slowdown of the related exports to Eastern Europe.

This unilateral relationship has, however, somewhat weakened in the last decade and will continue to weaken in the coming decade. Soviet deliveries of energy and raw materials do not and will not grow at earlier rates, and the share of machines in East European exports to the Soviet Union is currently decreasing in favour of food and industrial consumer goods which are in heavy demand on the Soviet market. Due to certain, though limited, achievements of Eastern Europe in joint ventures with the West, Eastern Europe continues to be an appealing partner for the USSR in respect of technology. On the other hand, following the post-1975 price explosion within the CMEA with a time lag, the East European countries have gradually accumulated debts (in transferable roubles) with the USSR and a certain financial dependence of East European countries on the USSR has emerged. (The new developments in CMEA prices may break the trend, for the small countries will realize surpluses in their trade with the Soviet Union and thus the debt may be reduced.)

The relations between industrialized western countries and Eastern Europe constitute the clearest case of unilateral dependence. This is, again, not a product of the

different market shares, mentioned above, in themselves but rather it is due to the differences in competitiveness on each other's markets.

For these small and medium-sized countries, whose economies used to be strongly linked with those of the rest of Europe before the war, but turned into seller's markets on which thousands of small items have simply been missing for years since the war, supplies from Western Europe figured as the last solution whenever something was not available either on the domestic market or from the CMEA partner countries. Thus, Western imports have remained important for these countries in terms of availability and quality – even during the years of cold war.

The significance of imports from the West increased substantially from the late sixties or early seventies, when first Romania, later Hungary and particularly Poland launched large-scale investments based on imports of Western technology. Imports of Western technology also gained importance in Bulgaria, Czechoslovakia, the GDR and the Soviet Union during the seventies. Together with the imports of technology, massive demand for semi-finished products, indispensable for running the new capacities, emerged in all countries, particularly in Hungary and Poland. These economies canot operate for a single day without the continuous flow of inputs from the West. This was demonstrated by developments in Poland and Romania, where the forced contraction of imports from the West resulted in declining production in particular industries (in Romania) or in the entire economy (in Poland). The functioning of the economic system and ill-conceived economic policies resulted in declining international competitiveness. Thus the countries have been unable to compensate for indispensable imports by efficient exports in an advantageous way. This type of dependency will increase further since, due to the growing technological gap between West and East, the East European countries cannot do without the imports of modern technology, and imports of the semi-finished products needed for its running, from the West.

In addition to dependency in trade, several small East European countries are heavily dependent on western finance. After the oil shocks of the seventies they were incapable of covering fully the increased import bills from their export reveneues and thus accumulated considerable debts. Consequently, the debt service ratios of the GDR, Hungary, Poland and Romania developed quite unfavourably. The latter two countries were forced to reschedule while the GDR and Hungary managed to escape rescheduling, but accomplished 'hidden rescheduling' under the favourable financial climate of the mid-eighties. Still, the four countries continue to be heavily dependent on the Western banking world.

Although their high debts emerged following the oil shocks, the deterioration of the above countries' terms of trade with the West, which resulted in indebtedness, should not be attributed primarily to the changes in the relative prices of the raw materials and energy needed for manufactures. These countries' terms of trade deteriorated within each commodity group. This fact suggests that the unfavourable developments should be attributed to the overall deterioration in their competitiveness.* Since this process is

*This problem was explained in a particularly convincing way by András *Köves* in [4].

likely to continue in the coming decades, the financing problems and the ensuing dependency are also likely to remain.

The relation between the Soviet Union and the West could be described more properly as that of mutual dependency in recent decades. Soviet investment policy has relied less on Western deliveries than that of East European countries. New capacities built in the Soviet Union with foreign technology have usually been more complex and their operation has not depended on deliveries from abroad. True, in some exceptional cases, like equipment for oil extraction or pipelines, western deliveries were indispensable for Soviet industrial development, but the operation of the industry has not been dependent on large-scale imports from the West.

Fuels have prevailed in Soviet exports to the West, and Soviet deliveries have played a considerable role in the energy supply to some European countries. Thus, the dependency has been mutual.

The massive Soviet imports of grain and other food products from a number of Western countries also created a mutual dependency, since the Soviet Union has been a large customer on a market often having excess supply. (This is shown by the fact that these transactions have often been subsidized by Western governments.)

It is, however, an open question whether these relations will remain as balanced in the future as they have been so far. The programme of acceleration implies a more rapid modernization of the Soviet economy with a more intensive transfer of technology from the West. At the same time, export revenues from the sale of fuels will hardly cover the growing costs of imports in the future (particularly if fuel prices remain at a low level), and the Soviet Union will have to rely more on the exports of manufactured goods. Thus, the importance of the international competitiveness of manufactured goods increases substantially. In this respect, in turn, the position of the USSR is hardly better than that of the countries of Eastern Europe. Thus, the balance of mutual dependency will also change in the same direction.

Financial dependency of the USSR, which has been extremely low so far, is also likely to increase as a result of the decline in hard currency revenues and the simultaneous need for maintaining grain imports and increasing the imports of technology.

Thus, we can conclude that the whole of the Soviet Union and Eastern Europe will gradually become economically more and more dependent on the West while the dependence of the West on the Soviet Union is more likely to diminish. The position of the entire group of countries in the world economy will be more and more similar to that of many third world countries, while their political and military position continues to be fundamentally different.

Obviously, the long trend of deceleration in growth and the increasing dependence on the West are strongly interrelated. In an economic system which is extremely weak in reallocating factors between sectors and industries, the deceleration limits the possibilities for restructuring and innovation. As a consequence, the technological gap is widening and international competitiveness becoming weaker. Declining market shares result in falling export revenues and in indebtedness and/or a need for import restrictions. This means increasing dependency. The wish to control dependence forces exports of low standard

goods and the repayment of debts under unfavourable conditions. This, in turn, limits the possibilities for promoting growth through technology transfer and through the discontinuation of inefficient industries. There is an obvious feedback effect to a further decline in economic efficiency.

'Depaternalization'

Comprehensive and radical reforms that transform the economic system into a different one, based on the operation of a genuine competitive market, also imply substantial political reforms; they require a historical move from the shortage economy to the buyer's market; they need renouncement of the policy of regional autarky, opening towards the West and integration into the world economy: these comprise the response to the unfavourable trends described above, and they seem desirable in the opinion of many internal and external observers and participants, including the present author. In some respects, as was explained above, such responses do not seem probable. Yet the governments of the Soviet Union and Eastern Europe must respond in some way. I shall describe one possible response, which would constitute the extension of a trend observed so far in Hungary and Poland to other East European countries and the Soviet Union.

In Soviet-type systems paternalism* is not limited to the relations between the state and the state enterprises and institutions. It also relates to the position of individuals (households) in the economic and social system.

One of the important aspects of paternalism is that the allocation of several important items of consumption is made fully or partly independent of the purchasing power of individuals (households), and is organized along bureaucratic channels of distribution. The criteria of allocation are mixed: the needs of households as assessed by officials, and the merits or the importance of each particular member of the society for the community (again as assessed by the officials), are the most important points.

Housing (particularly, but not only, in urban areas) and access to recreation facilities are the most important items whose allocation is strongly under bureaucratic control, and they are allocated to consumers at very low rates. In the Soviet Union, for instance, 70 to 80 percent of all new housing has been council housing in the last few decades. In the GDR, the share of council housing used to be similar during the sixties but was reduced to 50 percent during the seventies, in favour of cooperative housing under fairly favourable conditions. In the cases of council housing and of 'organized recreation' actual costs are covered by socialized funds (mainly the state budget and to some extent enterprise funds). In other cases (motor cars, foreign tourism) the meeting of demand is strongly constrained (by means of rationing or queuing) while those who still get access to them pay full prices.

Most consumer goods are on free sale in most countries (although shortages are frequent and from time to time rationing is reintrodueced). The pricing of these goods

*The term was applied to the analysis of Soviet-type economic systems by Professor János *Kornai* in [5].

contributes to paternalism: prices of basic foodstuffs and services (transport, heating and electricity etc.) are set at a low nominal price, making demand for them virtually independent of income (and thus contributing to the reproduction of shortages), while the consumption of many industrial goods (clothing, consumer electronics) is heavily taxed indirectly. (The consumption of basic foodstuffs and services has, in turn, to be heavily subsidized.)

The monopolization of employment by the state and the strict control over incomes obtained from official employment complete the system of paternalism.

All these features of the system, taken together, mean that a great part of decision-making on earning strategy and on the structure of consumption has been taken over by the state bureaucracy and the freedom of households has been strongly limited. This system has undermined the motivation of workers to perform better and earn more money; it has contributed substantially to the reproduction of shortages in the economy; finally, it has constituted an enormous burden for the state budget.

A process of erosion of this paternalistic system began in the mid-fifties in several East European countries, particularly in Hungary and Poland, and in some respects also in Bulgaria, Czechoslovakia and Romania.* The main intention of the respective governments was to spare budget expenses and to absorb consumers' purchasing power. New forms of housing construction were introduced in which a given part of the building costs were covered by households. (In Hungary, for instance, the share of private housing exceeded 60 percent, while that of council flats was reduced to less than 25 percent by the late sixties and early seventies.) The purchase of land for building houses and cottages was allowed. Commercial domestic tourism was developed, tourism abroad was allowed and the purchase of cars by the population expanded.

On the other hand, the state monopoly of employment has also been eroded. In Poland, agriculture remained mostly private and private handicrafts and retail trade also were consolidated during the late fifties and sixties. In Hungary, household plots have played a growing role following the collectivization of agriculture, and an extensive 'grey' economy emerged in the building and service sectors during the sixties and seventies. Recently the legal private sector, which used to be marginal, was revived, due to the introduction of several new organizational forms in Hungary.

In Poland, the share of the 'non-socialized' sector in the economy which fell (according to its participation in the NMP) – to 16 percent in the late seventies – exceeded 20 percent by the mid-eighties. In Hungary, the share of private and semi-private sectors (the latter being household plots and petty cooperatives) exceeded 12 percent by the mid-eighties, after having been reduced to 5 percent during the early seventies. As a comparison, the share of the legalized private sector (excluding household plots) was 0 in the USSR and below 0.5 percent in Bulgaria and Czechoslovakia in the late seventies.

Important changes also took place in the price system. The prices of basic food products and services (transport, heating etc.) have been raised several times in Hungary,

*I have analyzed this process and the ensuing differences between the countries in [6].

although subsidies have not been fully eliminated so far. The relative prices of industrial goods have, in turn, somewhat declined. This price policy has contributed to a market supply which is fairly good in East European terms. The Polish government made several similar attempts to improve the price system but they faced strong resistance from the workers; major price increases were only introduced at the beginning and at the end of the period (in 1959 and since 1982). (Market supply has been considerably worse than in Hungary.) The USSR and the GDR have strictly insisted on a policy of low prices for basic goods, and on a stable price level in official statistics.

In Bulgaria, Czechoslovakia and Romania the governments could not fully maintain the low prices for food and fuels. Prices were raised on certain occasions, although to a lesser extent than in Hungary. In housing, a situation between the two extremes emerged with cooperative housing gaining in importance.

The economic tensions of the early eighties forced the Bulgarian and Czechoslovak governments to make important concessions, even before Gorbachev. Some limited possibilities for private handicrafts and trade were opened in both countries.

The reconsideration of numerous aspects of economic and social policy under Gorbachev is also related to the problems discussed in this section. Economists and sociologists now explain publicly how socially dysfunctional the subsidies to prices and housing rents are. Proposals for the reform of housing and for raising food and service prices are under consideration. "Individual labour activity" have been legalized by a decree, the first private cafeterias have been opened, and legalized private taxi cabs have appeared – and these are considered by experts and policy-makers to be only the first steps.

The experiences of Hungary and Poland show that a certain degree of 'depaternalization' can be achieved without a comprehensive reform in the economy controlled by the state. (Hungary before 1968 and Poland before 1982 had already advanced considerably in this direction. The economic reforms of 1968 and 1982, respectively, created more favourable conditions for further advance). Such 'depaternalization' is much more compatible with the vested interests of the ruling strata in Soviet-type systems than a profound economic reform. These are goods reasons for assuming that 'depaternalization' will be a marked trend in the Soviet Union and Eastern Europe in the next few decades.

The process of 'depaternalization' means that households will enjoy more freedom in forming their earning strategies and their consumption structure, but also depend much more on the consequences of their choice. This may lead to the appearance and diffusion of new behavioural patterns, new values and new social structures in the Soviet Union and Eastern Europe, as has been the case in Hungary and Poland during the recent decades. The role of prices and of money in general increases for the consumers. The role of allocations decreases in favour of acquisition – that is, households expect less from the state and more from themselves in respect of such needs as housing, recreation etc. The belief in the omnipotence of the state loses ground. This process may, therefore, improve the chances for a comprehensive reform in the future – which seems desirable but not very likely at present.

References

1. Goldmann, J.–Kouba, K.: *Economic growth in Czechoslovakia.* Academia, Prague 1969.
2. Op. cit. pp. 77–79.
3. Bauer, T.: *From cycles to crisis? Recent developments in East European planned economies and the theory of investment cycles.* Wiener Institute für Internationale Wirtschaftsvergleiche. Vienna, January 1988.
4. Köves, A.: *The CMEA countries in the world economy: turning inwards or turning outwards.* Akadémiai Kiadó, Budapest 1985.
5. Kornai, J.: *Economics of shortage.* North-Holland Publishing Co., Amsterdam 1980. Chapter 22.
6. Bauer, T.: A note on money and the consumer in Eastern Europe. *Soviet Studies,* Vol. XXXV. No. 3. July 1983.

ЗАМЕДЛЕНИЕ, ЗАВИСИМОСТЬ И ДЕПАТЕРНАЛИЗАЦИЯ

Т. БАУЭР

Тенденция снижения темпов роста, наблюдаемая в европейских странах-членах СЭВ в послевоенный период, по всей вероятности, сохранится и в будущем. Временное оживление после нынешнего замедления представляется возможным в СССР, но невероятным в малых странах. Экономическая зависимость малых стран-членов СЭВ от Запада усилится, а их зависимость от СССР может ослабиться. Вместо всеобщей реформы хозяйственной системы руководство большинства стран-членов СЭВ будет реагировать на сложившуюся ситуацию так же, как и руководства Венгрии и Польши в прошлом: ослаблением опеки (патернализма) в отношении семейных хозяйств путем усиления роли товарно-денежных отношений в области потребления населения.

Acta Oeconomica, Vol. 39 (1–2), pp. 171–183 (1988)

SERVICES IN THE WORLD ECONOMY

É. PALÓCZ

A new interest in the role of services in international transactions has been directly generated by the current discussions in the GATT on reducing barriers to trade in services. But the greater attention in recent years has been mainly the result of the increasingly important role of services in the economy of developed market economies, of the rapid technological development of some services (information and telecommunication services) which led to the internalization and tradeability of many services.

In his book published in 1981, Ronald K. *Shelp* [1] titled the chapter dealing with the theoretical issues of the trade in services "History of neglect". The title was fully apt and not even exaggerated: up until the late 1970s there was practically no book, article or study which looked into the complex issues of the world trade in services. There was relatively more attention paid to services closely related to the international trade of commodities (such as transportation or insurance), but they, too, analysed the role of services with regard to the trade in goods (for instance, the role of freight costs in the assertion of comparative cost advantages).

The cause of neglect was chiefly that services were identified with non-traded goods, that is, they were considered as goods that, with a few exceptions, could not be included in the mainstream of international trade. Although most foreign trade theories defined international trade as "the international exchange of goods and services" i.e. they included, in principle, services as well – this was the first and last time that the word occurred in particular theories: there has been no theory on foreign trade which cites examples from the sphere of services or deals with the special features of trade in services.

From the early 1980s onwards, however, interest in the trade in services has been significantly growing.

Debates in the GATT

The immediate cause of a sudden growth in interest was that in the wake of the GATT Ministers' Declaration of 1982, preparation of talks on the possibilities of liberalizing the trade in services at the new GATT round were started. The main initiator and force behind such talks was the US. At first, its efforts met with the resistance of several developing countries but the idea was not too well received in the industrialized world either. Some developing countries went as far as to doubt if it was necessary at all to talk about liberalization of trade in services and, if so, the GATT was the proper forum.

In time, the standpoint of most industrialized countries drew definitely closer to the goals of the US. Moreover, certain developing countries, like Hong-Kong and

Singapore, have been staunch supporters of the idea of easing protectionism in the trade of services. Other developing countries, however, (particularly India and Brazil) reject such a policy even now.

These developing countries are worrying for two major reasons:

1. They believe that liberalization of trade in services might put them in a disadvantageous situation, for in the trade in services they have comparative disadvantage as against the industrialized countries. Therefore a possible liberalization could in the short run result in a deterioration of their balance of payments.

2. Another set of arguments from the developing countries justifies the rejection of liberalization by stressing the necessity of protecting infant industries. It says that, in the long run, the competition of service companies from industrialized countries would lead to the decline of the domestic service industry and eventually to the dependence of the entire domestic economy on foreign countries.

Counter-arguments, voiced mainly by industrialized countries, stress that it is exactly protectionism, standing in the path of the trade in services, that prevents countries at various stages of development from enjoying the mutual advantages offered by the expansion of that trade.

Eventually, in 1986, it was finally agreed in Punta del Este* that the trade in services should, though separate from the issues of trade in goods, be put on the agenda of the next GATT round talks. Also, the member countries and their respective organizations (UNCTAD, OECD etc.) intensified their researches regarding the justification of the concerns related to liberalization. What were the possibilities of countries at various stages of development joining the trade in services (or how would this affect their balance of payments in the short run)? Also, what advantages and/or disadvantages would their participation in the trade in services bring in the long run?

It must be noted that it was not by chance that the issue of the trade in services, along with those of the agrarian and high-tech products, became the most controversial ones of the coming GATT round. The cause was that service industries in industrialized countries have undergone considerable structural and quality changes in the past ten or fifteen years. An important consequence of those changes has been that the rapid technical development in services has continuously widened the scope of tradeable services, and this has led to the internatinalization of services.

Therefore, two important aspects must be considered before we venture into a survey of the advantages hidden in the participation in the trade of services.

First, the major features of the changes that have taken place in the service industries of the industrialized countries must be identified and their overall effect on the production and competitiveness of those economies needs to be assessed. What are the new features, of economies having advanced service industries, that determine the possibilities and methods which enable the less developed countries to adjust and catch-up? In other words: under changing circumstances, what chances do the individual

*In the summer of 1986 preparatory talks on the topics of the new (Uruguay-) Round was concluded in Punta del Este with a Ministerial Declaration, Part II of which deals with services.

countries have to develop their services in a self-sufficient way? Secondly, given the internationalization of services, which services can become exportable and thus penetrate the international marketplace and how are they to do this?

Reasons for the expansion of the services sector

The thinking of economists about the macrostructural proportions of an economy and the function of the service sector has, up until now, been influenced by the so-called "three-stage development model". This was worked out by A. B. *Fischer* [2] and C. *Clark* [3] in the 1930s and 1940s. This is true even if several elements of the model have since been contested and have been made more precise or subject to modification. This is because economists still move in the same circle of thought and do not go beyond this paradigm.

The sweeping importance of the works of Fischer and Clark lies partly in the fact that they brought a total break with the concept represented by Adam *Smith* and Karl *Marx.* This concept separated productive and non-productive activities and treated non-productive ones as secondary, even to some extent harmful, activities. The "three-stage development model" actually views the expansion of the service sector as a natural part and prerequisite of development.

The model contains two basic statements:

1. There is a close positive linear interrelation between the per capita national income and the share of the servicing sector. That is to say, the share of the tertiary sector grows together with the growth of the GDP. In countries where per capita incomes are low, the population is forced to spend the preponderant part of its income on basic goods such as foodstuffs and agricultural products. Along with growing incomes the demand for *manufactures* also increases and when this can be satisfied without any difficulties, the society will be able to spend more and more of its income on *services.* The proportions of the macrostructure keep on changing because the income elasticity of the demand for the products of individual sectors varies.

2. Another important statement arising from the model is that *productivity* grows slower in the tertiary sectors than in the ones producing goods. Thus the *relative prices* of services (as compared to the prices of material products) *grow* continuously. The explanation of the latter phenomenon is the following: wages tend to get levelled within the economy. Increasing productivity in industry results in an increase of wages but, owing to the tendency of the levelling of wages, prices will increase also in sectors where it is not justified by a corresponding extent of growth in productivity. In the latter sectors, the rate of wage increases exceeds that of productivity and leads to price increases outpacing those of sectors with a rapid growth of productivity.

This is why the more developed a country is, the higher the relative prices of services will be at least in comparison to the prices of services of countries at a lower level

of development. Given the fact that services can never be as mechanized as industrial activities, the international differences in the productivity of services are always smaller than in the goods-producing sectors. In other words, the advantage in productivity of more developed countries as against less developed ones will be less in the service sector than that of the goods producing sectors – where they do can display a rapid growth of productivity. Since the productivity of goods-producing activities grows slower in less developed countries, the rate of increase of wages, too, will be lower, not only in the goods producing sectors but in the service sector as well. This is why in rapidly developing countries services become relatively more expensive as against other activities than they do in more slowly developing ones.

This statement holds not only for the comparison of countries at widely different stages of development but to differences between countries at more or less similar levels of development. A study by the OECD from 1985 [4] demonstrated, using developed industrialized countries as examples, that there was a significant correlation between the growth of the GDP and the relative prices of services.

At the same time the divergence of relative prices among countries at various stages of development makes the verification of the first statement difficult (and even more its *quantified* verification), namely, that along with the growth of the GDP, the share of services will also rise. As it is, differences in relative prices may cause sizeable deviations between statistically computed shares (i.e. computed on the basis of the given country's relative prices) and, in the case of comparison with another country, shares computed on the basis of relative prices of the other country. *Kravis–Heston–Summers* pointed out in several studies that in fact here was much less difference between the service shares of countries at low and high stages of development than statistical data reflecting the relative prices of those countries actually indicated [5].

Returning to the relationship between the two statements (growth of the share and relative increase in prices of services) a certain contradiction becomes quite obvious. Demand for "goods", the relative prices of which are continuously and inevitably rising, should sooner or later ebb, even if it is accompanied by a high income elasticity.

This relationship was pointed out by *Baumol*'s model of "unbalanced productivity growth". In this model, by comparing the production, price and employment shares of progressive and non-progressive sectors, he arrived at the conclusion that:

– the rise in the relative price of services leads to a decline in the demand for them, and consequently to a decline in their production. This situation will have widespread adverse effects on socio-economic processes, on the quality of life and on the possibilities of maintaining and eveloping the urban infrastructure;

– if the ratio between the production of the two sectors remains constant, this puts a brake on economic growth since more and more labour will move towards the sector in which productivity has not grown [6].

Structural and quality changes in the service sector

The shift of macrostructural proportions towards the service sector has nevertheless accelerated in the industrialized countries since the early 1970s. Explanations for this phenomenon may be found in the sudden *technological development* of certain services, and in the emergence and spreading of high-tech services. Primarily, this refers to the development and continuous coupling of telecommunication and information technologies. The driving force behind the expansion of the service sector has been this technological break through, and it has affected a growing segment of the sector: it has created new types of services (computerized data transmission systems, information networks), it has substantially transformed the nature of many conventional services (telecommunications, banking transactions etc.), and it has rapidly improved their productivity and, as a result, the demand for them.

Nevertheless, the trends and characteristics of aggregate sectoral structural changes in industrialized countries confirm the statements of the conventional explanation: the share of services grows faster at current prices than it does on the basis of figures at constant prices (this indicates a faster rise in the prices of the service sector). This restructuring is even faster in employment proportions (which is evidence of the fact that one unit of growth of production in the service sector requires a bigger growth of labour than it does in goods-production).

Hence the accelerated growth in the proportion of services has not been fully explained by the technical development of services.

Although regularities in the development of demand for services have not been fully clarified yet (i.e. there is no consistent answer to the question why, under what mechanisms and to what extent demand for services grows) the most probable answer is that there are *no uniform regularities* concerning the whole of the service sector. The likely explanation is that different regularities apply to different sorts of services and it is this difference that causes structural shifts within the service sector.

The service sector includes a very wide range of activities of most varied production factor intensity. This has always been the case; for instance, think of the differences between the nature and organizational systems of the highly capital intensive infrastructural services (public utilities, transportation) and the markedly labour intensive and "personal" consumer services. Owing to the sudden technological development of information and telecommunication services, the deviation between the various types of services has even increased in recent times. This heterogeneity follows partly from the "residual" treatment of the sector, for all "non-material" activities are contained within this single sector.

There are numerous methods for classifying and grouping service activities. Yet when looking into the expansion and technological development of the different types of services and into the characteristics determining their prices, it appears that the most appropriate method is one which groups services according to demand factors, i.e. that which divides services into producer (intermediary) and consumer services, and further divides the latter into private and public services.

The term 'productive services' refers not only to service inputs used for the actual production of goods and services but also all the service activities connected with the production and sale of goods. These include R+D, production organization and control, data processing, marketing, advertising and publicity, and services required to maintain business relationships among the participants of the production vertical (financial, legal and professional services, consulting, etc.). As for the consumer services, they include services meant for final consumption.

Such a division appears to be expedient because the various demand factors are known to behave differently. Other demand factors include the preferences, possibilities and scope of action and manouevring of households, companies and states. This is important from two aspects:

1. Demand for services meant for final consumption is much more difficult to explain on grounds of purely economic considerations than are company decisions. This holds both for public and private services. Though there exist computations quantifying the economic impact of sums spent on education or health care, states cannot act when prompted exclusively by cost-efficiency calculations because they must keep many more social and political considerations in mind. Also there are many non-rational elements in the behaviour and expenditure patterns of households, as against the essentially economic considerations of companies.

2. The income of the final consumers of services is limited, thus their demand cannot be expanded *ad libitum.* It is no use for the consumer to assume that by availing himself of a certain service his expenses per one man-hour will be less than his own imputed wage for his own time spent if, in an economy with excess labour, his ability to perform additional work and make more money is limited. The scope of action of states is even smaller. Seeing the rising costs of public services, they cannot increase their revenues (taxes) as they would like to. On the other hand, companies avail themselves of services in order to produce goods for sale. Thus services are inputs for the production, so the price of production may be confronted with a possible reduction of the relevant manufacturing costs or maybe with better sales possibilities (i.e. with the indirect profit of a particular service).

To some extent, these factors already explain the behaviour of the various demand elements. In the industrialized countries a treble process takes place in the sector of *consumer* services:

– we can witness standardization and mechanization, and as a result, price reductions in services (so-called 'McDonaldization');

– some of the services with rising prices are maintained by the preferences of consumers;

– on the other hand, other services are gradually pushed back within the service sector itself.

It is noticeable that a relatively large percentage of consumer services can be substituted with durables. This is the phenomenon that *Gershuny* called progress toward "a self-service economy" [7], [8]. But phased-out services are replaced by demands for new services and thus there is no danger that the consumer services would fall in an

absolute sense. However, the pressure of rising prices puts a lid on any significant growth of this segment of the service sector. A case in point is that of the *public* services. The state is caught in the crossfire of the population and the companies: the citizens (voters) demand better services and the companies want lower taxes, while the cost of public services keeps on growing. State budgets seek to ease this double pressure by trying to reduce their traditional tasks, while they must undertake new ones.

The most dynamic segment of services is the one rendering services for production. The expansion of services geared to production may be explained by three, closely interrelated, factors:

1. The service content of products is an increasingly decisive factor of *competitiveness.* Owing to the acceleration of technological development, the world-wide conformity in the tendencies of technological development, and the widening channels of the technology transfer, the competitive edge offered by any new product or technology quickly tends to disappear. Hence companies may gain a competitive edge only if they keep on adding to the scope of services related to development, production and sales.

2. However, as long as service functions grow within the manufacturing company itself, this does not change sectoral proportions, i.e. statistically they are not registered as services. As a matter of fact, statistics include service activities in the service sector only if they are performed by a separate economic unit. Another important factor related to the expansion of the service sector is precisely that the increase of the proportion of service activities within production results in the commodity-producing companies separating a part of their service activities from their original activity and *externalizing* them in some form (i.e. assigning them to another economic unit or, in the case of bigger companies, concentrating such activities in subsidiaries specialized for that purpose. In this way, the specialization enables the introduction of more advanced technologies and this again helps reduce costs.

3. A rapid decrease in the costs of telecommunications, data transmission and processing has the effect of enhancing the possibilities of dividing labour among manufacturers, of widening business relationships and of furthering the geographical expansion of companies.

The impact of changes in the service sector

The impact of the development and expansion of the service sector on the functioning of the economy may be summarized as follows:

1. Over the past two decades numerous service branches have undergone sudden and spectacular technological development. Such quick development is partly due to the fact that, owing to a slow increase of productivity, some types of services would have experienced a slump in demand – because of the continued increase of their relative prices – if they had not been improved. Another explanation is that with the division of labour among companies getting increasingly complex, it became imperative to update the telecommunication/information channels.

2. Services with stagnating or only slowly rising productivity are, *in the consumption sphere,* maintained according to the preferences of consumers, i.e. by the high income elasticity. In the production sphere services are maintained by the advantages companies may *indirectly* enjoy by availing themselves of those services. The *growing efficiency* and competitive edge incident to services form a prerequisitie of the expansion of production services.

3. The rapid growth of the proportion of the service sector has largely been due to the *externalization* of producer services. While, in the post-war period, the growth of service activities took place mainly within the industrial sector, from the late 1960s onwards a part of those activities started to flow rapidly out into the service sector [9].

4. The extent of externalization significantly affects the efficiency and productivity of both goods-producing activities and the related services. Thus the difference between countries with regard to the efficient integration of services into commodity production is not so much in the *volume* of services but rather in their ability to organize these activities into an advanced *market of services.* Thus the volume of services in countries with a low proportion of production services, as compared to their goods-production, is not necessarily proportionally smaller (for the manufacturers themselves perform most of the necessary services), but the quality and standards of these services are almost certainly poorer than those offered by specialized service companies. On top of this, in countries where the proportion of production/business services is low compared to the goods-production, service activities siphon off more resources from the economy than in countries where an extensive and advanced service industry is available [10].

5. The acceleration in the blending of goods- and service production activities has been a major feature of the new situation. Within it, both the externalization and internalization of the services can be witnessed; the former mainly in the production services and the latter in consumer' services. Since, in the sectoral approach, services may turn into commodities and *vice versa* simply through the fact that the same activitiy is being performed by another economic unit, the *border* between the characteristics of the production of goods or services gets eventually blurred. One aspect of this two-way process, namely, the *industrialization* of services and service production, is often emphasized. Given the generally accepted use of the concept that identifies high-productivity large-scale production with industry, this is true. The other side of the process is, however, that the nature of the industrial production, too, has been changed. Since services are increasingly integrated into the processes of industrial production and thus become a more and more important prerequisite of it, we may also speak about the "tertiarization" of industrial production.*

As it is, industrial production which is thoroughly interlaced with complex service functions does by no means display the characteristics identical with those of the large-scale industry up until the 1960s. The biggest contribution of the expansion of the service sector to the functioning of industrial production, and of the entire economy, is *flexibility.* Flexible production systems, adaptation to special requirements, quick respon-

*D. Riddle uses the term "servicization" [11].

ses to market signals, rapid changes in business relationships and the shaping of those relationships according to efficiency requirements almost at will – these have been primarily due to the availability of services. This is why companies relying on an advanced and extensive domestic service industry tend to have a meaningful *competitive edge* in the world market.

Internationalization of services

The internationalization of services first became possible with the emergence of new technologies. The technological development and mechanization of services partly *concentrates* and partly *fragments* the structure of companies. The establishment of computerized information networks and telecommunication systems is a highly capital intensive process, but expanding services (either in volume or in range) within an existing network involves very low additional costs. Because of the efforts to exploit the advantages of the economies of scale offered by the new technologies, in some sectors giant service conglomerates have come into being and they offer a diversified package of services (and goods). These include market research, advertising, legal consultation, financial and other services – all in one package. This is supplemented by a flexible system of small companies geared to satisfy special and/or local demand.

It is now obvious that the advantages bestowed by the economies of scale and the opportunities for expanding the range of advanced service technologies may best flourish in an *international environment.* The most significant change in the service markets of industrialized countries has been the global entanglement of service companies and the world-wide expansion of big service conglomerates.

Another phenomenon leading to the internationalization of services is the global aspect of the externalization process, already observed when looking into the domestic economic correlations of services. The service contents of products sold both domestically and abroad have been growing rapidly: sellers sell more and more services to the buyers – these being partly embodied in goods an partly related to their distribution. Hence in the course of production and distribution a great number of services are "absorbed" in the goods. This, however, does not register as trade in services since the services are "included" in the goods. But the process of separation can be observed in global trade in the same manner as in domestic production. That is, manufacturing companies seek, in the international market, the service companies from which they can get the required services at the lowest price or with the highest standards. The precondition for this is then provided by the aforementioned phenomenon: service companies which are strong on their domestic market and have consequently acquired experience and advanced technologies, appear in the international markets, too. (An interesting example of this is the growing international activity of accounting firms.)

Also, just as the externalization of domestic services results in the growth of the share of the service sector, so the global trade of separated service activities is similarly accompanied by the expansion of the trade in services.

Comparative advantages in the trade in services

Currently, one of the key issues in the debate on the trade in services concerns which countries have comparative advantges in this field.

According to the traditional theory of comparative cost advantages, the flow of trade is determined by comparative cost proportions between the individual countries.

Yet, the applicability of the theory of comparative cost advantages has been queried by several experts, with the argument that services cannot be stored, their production and consumption take place simultaneously. Consequently, services do not have a free market in the sense that goods have. Thus most service markets cannot be viewed as competitive markets.

By now, however, it has been almost generally accepted that although the trade in services does in many aspects differ from that in goods – and these differences must be taken into account – the inner logic of the theory of comparative advantages still applies. As Hindley and Smith wrote:

"Had Ricardo in his classic example specified wine and insurance policies instead of wine and cloth, his demonstration of the gains from trade would have still succeeded, it being dependent only on one country being able to produce insurance policies at a lower cost relative to wine than the other country" ([12] p. 374).

So if we could speak about the trade in services *in general* – namely, if any service were, just as goods are, exportable without limitations – then we might say that the comparative cost advantages are on the side of the developing countries, since here the prices of services converted at the current exchange rate are lower than in industrialized countries. If it is true that the more developed a country is, the higher the relative prices of services are, then less developed countries operating with lower prices might gain competitive advantages from the trade in services.

Anyhow, it must be taken into account that only a small, though growing part, of services may be the subject of international trade. In a study, *Sapir* and *Lutz* [13], arrived at the result that as far as the exportable services they studied are concerned (transportation, telecommunications, financial and professional services), the comparative advantages were on the side of countries well endowed with physical and human capital. This is, among other things, the basis of a widespread view that, since less developed countries suffer a comparative drawback in the field of services, the future division of labour among the regions should be modified in such a way that developing countries specialize in the production and export of goods and the industrialized countries in services, respectively.

Yet the situation is not as simple as this, especially if one takes into account the complex economic relationship and effects of services and the specific features of their "tradability", respectively.

Conditions of the "tradability" of services

Since services are being produced and consumed at the same time, their producer and consumer (and the subject of the service) must somehow be in contact during the provision of the service – even if this does not necessarily mean physical proximity.

The service transaction, that is, the contact between producer and consumer, may come about in four basic ways.

1. For services that are rendered with the express purpose of changing the location of goods (persons) this relationship is obvious, for the service itself is the activity causing and accompanying the movement of goods (persons); the service moves together with its object (as in transportation or postal and telecommunication services; in the latter case sound, images or signals forwarded by the servicing enterprise are the objects of the service).

2. The person availing himself of the service travels (the object of service is transported) to the place of the service. The best example of this is tourism or the utilization of various local services (port services, special health care or education services abroad).

With most services, however, high costs of transportation (more precisely, their proportion to the possible advantage) usually prohibit the recourse to foreign services instead of domestic ones. Moreover, such costs usually render it impossible even to fill the gap of shortages of local services with foreign (i.e. imported) services.

3. Another solution is if the producer, and not the consumer of the service, moves (transports its production factors) to the place of service. This can be capital and labour, or both. A common example for this is direct capital investment.

4. The producer and consumer of a service may establish a relationship with each other in other ways as well. These are enabled by advanced data transmission and telecommunication systems. By using the latest information techniques it is possible to render financial, legal, professional and technical services alike (e.g. tele-diagnostics on the basis of test results fed into computers; tele-conferences connecting experts with computers instead of staging costly scientific meetings etc.). In these cases, the execution of services and the spanning of distances are facilitated by other services.

Clearly, the biggest source of the expansion of the trade in services is the spreading of services facilitated by advanced techniques and not involving the physical proximity of either the producer or consumer of the service (i.e. the case described in Point 4). In this field, as Sapir's cited study proved, the industrialized countries and their companies, respectively, have a comparative edge on developing countries. However, if we take the case involving the movement of production factors and consumers (Points 2 and 3), then we also have to note that countries with different cost proportions have a wide range of possibilities enabling the best use of the deriving advantages. This is of course not a new feature. It is estimated that services transacted through foreign subsidiaries have been growing much quicker than the actual export of services. On the other hand, it was e.g. the relatively low wage costs that made Singapore Airlines into one of the most efficient airlines in the world.

However, the exploitation of advantages to be derived from differences in relative prices and production factor supply necessitate a freer worldwide flow of production factors. If we said that the ground gained by the service sector in the industrialized countries implied that industrial production and whole economies were becoming more

flexible, then the same can be said of the international trade in services. Countries at different stages of development may benefit from the trade in services if they allow a freer movement of production factors as well as of the consumers of services.

Some concluding remarks

1. The protection of domestic service industries is usually justified by arguing that they are sectors of vital importance for the functioning of the whole economy. Thus, every country must build up its own infrastructure. In addition, building up the infrastructure may give a sizeable impetus to the growth of the economy. The latter argument no doubt stands its ground but it must also be seen that the service industries of industrialized countries are marked by a keen technological competition and strong international entanglement. (An indication of this is provided by the stormy merger histories of West European firms in the telecommunications industry.) Under such circumstances it is impossible for any country to develop these activities from its own resources, and to catch up is just as impossible.

2. Since the service contents of products entering global trade have been growing, this not only provides huge competitive advantages for companies relying on an advanced service industry. For companies lacking these it implies the risk of being pushed out from markets and being forced to sell at very low prices. Thus it is not possible for a country to lag behind with its services but be competitive with its industrial products – this provides no alternative. The industrial products of a country with such a backward service industry will increasingly be restricted to the lagging industrial sectors.

3. So far I have dealt with industrialized and developing countries but not with Hungary. Of course, most statements concerning the less developed countries apply to Hungary as well. With its current per capita income it is a medium-developed country, but with regard to its infrastructure and service industry it is a rather underdeveloped one. My goal was to present world-wide tendencies to which Hungary, too, must adjust itself. I did not dwell on the method of such adjustment because this would call for a more detailed analysis of the current situation and its causes, and this should be the subject matter of another paper.

There is, however, at least one conclusion that closely follows from the afore said and it aplies to the alternatives open to Hungarian development. Since the development of service industries is nowadays only viable together with the widening of international cooperation, it is difficult to defend the relatively widely held view that it would be better to concentrate more resources on the development of the infrastructure because – according to this view – it is a less import intensive sector and therefore the development of the infrastructure may help ease the balance-of-payments problems. It is an obviously burning necessity to reduce the lag of service industries and to update the infrastructure of Hungary. However, a concept which combines the development of the infrastructure with the postponement of the opening of the economy (i.e. it interprets it as an alternative to the latter), does not appear a viable method – considering the aforementioned internationalization of service industries.

References

1. Shelp, R. K.: *Beyond industrialization: ascendancy of the global service economy.* Praeger Publishers, New York 1981.
2. Fischer, A. B.: *The clash of progress and security.* MacMillan, London 1935.
3. Clark, C.: *The conditions of economic progress.* MacMillan, London 1951.
4. OECD: International price levels and purchasing power parity. *OECD Economic Studies,* No. 6. 1986.
5. Kravis, J. B.–Heston, A. W.–Summers, R.: Real GDP per capita for more than hundred countries. *The Economic Journal,* June 1978.
6. Baumol, W. J.: Macroeconomics of unbalances growth: the anatomy of urban crisis. *The American Economic Review, June 1967.*
7. Gershuny, J. I.: *After industrial society.* MacMillan, London 1978.
8. Skolka, J.: Wende in der Arbeitsteilung. *Wirtschaft und Gesellschaft,* 4. 1985.
9. Gershuny, J. I.: *The new service economy.* Frances Pinter, London 1983.
10. Bauer, P. T.–Yamey, B. S.: Economic progress and occupational distribution. *The Economic Journal,* 61. 1951.
11. Riddle, D. I.: The role of the service sector in economic developments: similarities and differences by development category. In: Giarini (ed.): *The emerging service economy.* Pergamon Press, Oxford–New York 1987.
12. Hindley, B.–Smith, A.: Comparative advantage and trade in services. *World Trade,* 4. 1984.
13. Sapir, A.–Lutz, E.: Trade in services: Economic determinats and development-related issues. *World Bank Staff Papers,* No. 480. 1981.

УСЛУГИ В МИРОВОЙ ТОРГОВЛЕ

Е. ПАЛОЦ

Статья посвящена такой области мировой торговли, которой вплоть до последнего времени пренебрегали — международной торговле услугами. Интерес к теме оживился в начале 1980-х годов тогда, когда начались предварительные переговоры в ГАТТ о возможности либерализации торговли услугами. В ходе их выяснилось, как много неясных вопросов не только в связи с международным оборотом успуг, но и в связи с воздействием этого на внутреннюю экономику.

1. Поскольку особенности услуг, отличающие их от деятельности в области товарного производства, в должной степени не уяснены, то не сложилось до сих пор единой точки зрения и о том, что нужно считать торговлей услугами.

2. Вследствие быстрого технического прогресса информатики и телекоммуникации должны быть пересмотрены сформулированные ранее взгляды о воздействии услуг на экономический рост, повышение производительности и занятость. Пареллельно этому стал несостоятельным и взгляд о том, что услуги — за немногим исключением — не могут войти в международную торговлю.

3. Однако существенным является вопрос, какие услуги и при каких условиях могут стать экспортируемыми благами. Выяснение этого важно еще и потому, что без этого нельзя выяснить, какие возможности имеют страны, достигшие разных степеней развития, для включения в торговлю услугами, а также какие сравнительные преимущества могут вытекать из этого.

Acta Oeconomica, Vol. 39 (1–2), pp. 185–187 (1988)

REVIEWS

WORLD ECONOMIC ENVIRONMENT AND THE HUNGARIAN ECONOMY: A CONFERENCE

R. SALLAI–I. SCHWEITZER

The Institute of Economic and Market Research which was founded 30 years ago, held a scientific conference on October 20–21, 1987. The conference was based on the theme: "World economic environment and the Hungarian economy". The two-day session, organized in conjunction with the Hungarian Academy of Sciences, was one of the top-ranking events of Hungarian economic science in 1987.

The scientific session was opened following the words of welcome by J. *Deák*, director of the Institute, and by foreign trade minister P. *Veress.*

The first reader was B. *Csikós-Nagy,* academician and president of the Hungarian Economic Association. In his lecture he analysed the adjustment capability of the Hungarian economy from the aspect of structural policy. Touching upon several questions, he stood in favour of further opening of the Hungarian economy. He expounded that in structural policy, owing to their different systems of conditions, the socialist and the capitalist markets require different ways of approach. Stabilization and shifting of the economy onto a new path necessitated a change in the state's role in the economy and a renewal of enterprise activities. He emphasized that restructuring does not mean solely the cessation of uneconomical production; selective development and the building up of new progressive production capacities would also be necessary. Talking about foreign economic relations, he pointed out that beside relying on Hungary's own resources and the supporting bank and financial credits, in the future more stress would have to be laid on direct foreign investment. B. *Csikós-Nagy* advocated the decentralization of foreign exchange management, stressing that this is the only way of developing efficient foreign trade. He claimed that, in accordance with the 1984 resolution on economic reforms, both the wages and prices seem to have slightly moved towards a more market-type system; yet this process had been retarded by the fact that the situation of the Hungarian economy had changed in a way different from the original assumptions behind the resolution. We must ensure that after the tax reform, following the critical year of 1988, and from 1989 onwards, prices and wages begin to carry out their economic function – then structural policy would be able to rely on them.

The first, *plenary session* was followed by *section meetings.* More than 30 lectures were submitted at parallel section meetings.* Almost half of the lectures dealt with *the*

*All the papers have since been published in the periodical *Külgazdaság* and a selection of them in this issue. (Ed. note.)

situation and development of the world economy and the adjustment to the major processes going on in it. They were delivered by A. *Köves,* B. *Kádár,* É. *Ehrlich,* É. *Palócz,* D. *Somogyi,* A. *Inotai,* J. *Nyers,* Z. *Krasznai,* B. *Greskovits,* V. *Pásztori,* T. *Kardos,* K. *Botos* and S. *Nagy.* Some of the discussion at this session considered the subject matter of the lectures from the viewpoints of the Hungarian economy, and great stress was laid on considerations concerning the means and the ability of the economy to break free from the model of regional autarky. Several speakers dealt with the reasons behind the apparent backwardness in the sphere of the infrastructure.

Another group of lectures covered the issues of the *economic development and cooperation of the CMEA countries.* The lecturers were T. *Bauer,* L. *Csaba,* M. *Rácz,* S. *Richter,* J. Bársony,* Gy. *Munkácsy* and J. *Botos.* In the wake of two talks on the changes taking place in the Soviet Union, a vivid discussion developed and this included an evaluation of the reforms implemented so far, an interpretation of the resolutions and an assessment of the perspectives that may be expected. The majority of the speakers emphasized the need to be cautious, saying that the reform process could not be identified with the related documents. There were more varied opinions on questions surrounding the way in which Hungarian foreign economic strategy connected with the CMEA might be affected by the reform processes started in the USSR and several other CMEA member countries, as well as by any subsequent reform of the CMEA. There were many who emphasized that the changes hoped for should not be considered as an alternative to a wide opening towards the world economy.

In the section entitled: "Macroeconomic processes and the regulation of foreign trade in Hungary" papers were read by M. *Tardos,* A. *Nagy,* G. *Oblath,* I. *Salgó,* B. *Botos,* I. *Ábel,* Gy. *Boda* and M. *Forgon,* A. *Éliás* and T. *Ujhelyi,* S. *Mészáros,* I. *Dobozi,* Z. *Olach,* I. *Sessler,* K. *Antalóczi,* D. *Bonifert,* A. *Szegő,* and Gy. *Wiener.*

Questions of enterprise adjustment were covered by a number of lectures which examined various related themes by using different approaches. These included case studies of enterprise organization development and presentations of market condition tests. P. *Vince,* S. *Pásztor,* É. *Nádor,* G. *Lamberger,* Á. *Nagy,* K. *Lányi* and I. *Schweitzer* were among the lecturers.

The scientific sessions were followed by a platform discussion introduced by deputy foreign minister I. *Dunai.* In his short presentation he dealt with the current problems facing the management of the foreign economy in its struggle to re-establish foreign trade equilibrium. He said it was the government's present objective to turn the expected 200–300 million dollar deficit of the trade balance of 1987 into an approximately 800 million dollar surplus by 1990. This would be a very challenging task. Amongst other problems, he mentioned that enterprises exert great pressure in order to increase Rouble exports, yet they show no interest for the Rouble imports. The same intensity can be found in the pressure for increasing Western imports. In the practice of

*The lectures by M. Rácz and S. Richter were published in the previous issue of *Acta Oeconomica* (Ed. note).

restructuring the main trend is to allocate money to areas where marketable commodities can be found. This suggests a short-term attitude which will tend to maintain the deteriorating terms of trade. He stated, in a self-critical manner, that the management of foreign trade had changed the demands placed upon enterprises several times in 1987; at times the main objective had been to increase efficiency, at other times it was to raise volumes.

M. *Tardos,* (Institute of Economics, Hungarian Academy of Sciences) expressed his doubts about the foreign trade policy targets: the creation of a one thousand million dollar surplus i.e. to turn the present deficit into a surplus within the next three years. It is rather questionable if the traditional approach of "increasing production and reducing domestic consumption" is workable in the present situation. He argued that by using the above-mentioned simple formula we may get into the danger of taking a forced path which will not improve but only worsen the position of the country.

How can we avoid this pitfall? In the opinion of M. Tardos the indispensable condition for advance is liberalization; prices, imports, wages and salaries have to be liberalized. According to his views this change-over could have been made in 1984–85 when conditions were much more favourable. Then, if we had at least reckoned with the additional loans drawn later on by the government, it would have been possible to produce a significant scope of manoeuvring for the successful implementation of a policy of this kind. Three years later it is much more difficult to implement it, but it can be done. We must be, however, aware of the fact that it will entail a social shock. A calculated restriction of the living standards and the occasional export surplus resulting from it would certainly not be sufficient to solve the problems of Hungary. Great flexibility is needed on behalf of the producers and to achieve this the appropriate political and economic atmosphere has to be created. In addition beyond all this, good luck is necessary, too.

In his comment, L. *Antal,* (Ministry of Finance) stated that it was already obvious that the equilibrium of the balance of payments could not be restored in 3 years. It is also clear that the establishment of equilibrium in the external economy could not be separated from the internal processes. It is absolutely clear that the essential condition for finding a way out is radical reform. In the consolidation period of the reform process, beside very strict monetary restrictions, significant state intervention is needed. Without monetary restrictions the other economic regulators, e.g. prices, would not be able to exert their favourable effects. He also believed that in order to start the internal process of economic renewal a gradual but simultaneous liberation of wages and imports would be necessary. This in itself is, of course, not enough, for there are organizational and other conditions, too. At the same time a deregulation process also has to take place since, while there is a comprehensive redistribution by the state, liberalization cannot be imagined. Antal believes that the tax reform means, primarily, a withdrawal of the state from the operative process of income redistribution.

I. *Martos* (Medicor Works) was of the opinion that in order to achieve the planned trade surplus higher Western export volume would be necessary. Conditions for this have to be further examined.

The platform discussion and the scientific conference ended with the colosing words of deputy minister I. Dunai.

Acta Oeconomica, Vol. 39 (1–2), pp. 189–196 (1988)

BOOK REVIEWS

SZAMUELY, L. (ed.): *A magyar közgazdasági gondolat fejlődése 1954–1978* (The development of economic thought in Hungary: 1954–1978. Research of the mechanism of a socialist economy). Budapest 1986. 597 p.

The debate that flared up around the "reform bargaining" in 1984 albeit surprisingly short for such a hot subject, proved how varied the camp of supporters of the Hungarian economic reform was. It may also have indicated that, in the mid-1980s, almost everyone concerned agreed on the need for a reform and only differed with regard to the scope of justified or possible solutions. The fact that the interpretation of the reform itself is far from being uniform in Hungary today may be due, among other things, to the many directions of previous reform initiatives and to their highly varied intensity and speed – in short, to anything but the straight initial path of the latest wave of reforms.

The description of that path has now been explored more extensively and deeply than any previous attempts by a collection of studies edited by László *Szamuely*. The volume is an amalgam of three genres, even if we consider excerpts it contains as being of the same genre (although they include articles from periodicals and protocols of debates as well as manuscripts and party documents.) The introduction of the volume is in itself a theoretical and historical study which is useful for reference: it provides an analysis of the development of research into the economic mechanism, although this stands on a much wider basis of professional literature than the volume actually contains. Short introductions also precede the chapters, these having been edited in chronological order; there are a few pages giving explanatory details concerning theoretical and/or economic policy matters and, unlike the major study opening the volume, they are closely related to the given selection. All this is the work of László Szamuely and therefore it must be added at this point that, over and above selecting and editing, László Szamuely was instrumental also as an author in making this volume into a basic document of Hungarian reform economics.

The introductory study hastens to stress perhaps the most important viewpoint of the selection: the writings included in the volume focus primarily on the issues of *economic mechanism* and deal less with *economic policy target-setting and economic strategy*. Beyond understandable space limitations, this can be explained also by the intention of the editor to illustrate the logic of the development of the Hungarian reform concept as directly as possible, without making détours. However, it also has to be admitted that most of the Hungarian reform literature concentrates on the issue of the reform of the mechanism and that, as the 1969 article of Ferenc *Jánossy* aptly stresses, at that time (and let us add, even now) the *reform has been interpreted* by many as one *limited to a reform of the mechanism*. Jánossy says: "To find and enter the path of a process of economic development which promises success, we must radically break not only with the old economic mechanism *but with the old economic policy concept as well.*" (p. 498, author's italics).

However, it is not fair to blame the editor for the afore-mentioned principle of selection because such a selection was also the result of the material available to him. Yet he has not adhered strictly to it, thus several important writings have been included in the volume, such as those by József *Bognár* and Tibor *Liska* in the 5th chapter, by Rezső *Nyers* in the 6th chapter, by Ferenc Jánossy in the 8th chapter and by András *Hegedűs* in the 9th chapter. These deal with more than just the reform of the economic manage-

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

ment, and thus they provide an insight into domains of reform thought that have rarely been accessible so far.

László Szamuely has included in this volume a few documents which now appear for the first time. These documents are instrumental for the understanding of the development of the reform concept, yet for decades they have been available to researchers in manuscript form only. Such are, for instance, some highly interesting excerpts from the protocol of the 1957 spring debate of the Economic Committee, and several studies made during the preparation of the reform in 1964–65. Among the latter we can read two characteristic excerpts from Tibor Liska's "The Oeconostat", a famous but unpublished work much more influential than justified by the number of people who have actually read it.

Looking at the "first and second waves" (1954–57 and 1963–68, respectively) of the reform debate, the introductory study follows the periodicity usual in Hungarian economic literature (it is used, among other things, for the better accentuation of the special importance of the current "third reform wave"). Yet it finds novel ways to stress a few significant notions within the periods. Such is, for instance, the fact that the macroeconomic trend of reform thinking can be dated to György *Péter*'s article in December 1954; that the activity of the Economic Committee formed in the spring of 1957 remained more or less the business of a selected few insiders of the profession and that it had not got too much political support even when it started; that the initial political resistance to the second wave (in 1963) of the debate on the mechanism *later became* weaker; and that resistance reappeared again dressed as technocratic proposals giving priority to a "rationalization" of the array of instruments of the old mechanism, but not fully rejecting the reform of the mechanism.

The introductory study provides a particularly significant analysis of the results and *deficiencies* of the 1968 reform, as seen in the light of the recent debates. Many of the *deficiencies* could be traced back to the 1966 reform concept. Szamuely shows the soft points of the 1968 reform on a mainly theoretical basis and does not draw on the lessons of the nearly fifteen years which had elapsed when the study was written. Of those *deficiencies, professional* literature has already delt with the unsatisfactory decentralization of investment decisions and with the fact that, primarily due to political considerations, the reform concept *"left untouched the traditional institutional system of central economic management..."* (p. 52, italics in the original). Although several authors, (e.g. Ferenc Jánossy in his article cited above), warned the government that without a new economic policy concept, the reform would never bring the expected results, to have an unbiased look at the reform it is expedient to cite Szamuely's concise judgement: "... *the revision of economic policy and the economic development strategy did not even occur to those preparing the reform concept.*" (pp. 52–53, italics in the original). The "technocratic nature" of the reform of the mechanism obviously followed from this fact (p. 53.). Going on to consider the next link of the logical chain Szamuely states: "Since the reform concept contained virtually no proposals for the solution of foreseeable social tensions and troubles, these factors caught both the political-economic management and the wider public quite unprepared when they eventually did happen. There being no *forums* for the reconciliation of interests and for the creation of a consensus, the leadership could not react to the revival of movements in the labour market, to the growing differences in wages and incomes, and to the deteriorating situation of certain big companies etc. (we may add, to the ensuing intensification of the opposition to the reform). The leadership's only option was to introduce various restrictions and bans, that is, it stiffened the effect of the freshly introduced economic incentives (p. 54).

Szamuely does not mention another weakness of the 1968 "new economic mechanism", most probably because foreign trade analyses or reform proposals are entirely missing from the volume. The fact is that, except for the famous and pioneering 1954 article by Tibor Liska and Antal *Máriás*, the foreign economic trend had not been significant before 1968. In this field really important Hungarian scientific results were only reached in the wake of realizing the necessity of adjustment to the world economy, i.e. from the mid-1970's onwards. Yet the introductory study does not tell that the 1968 reform left virtually untouched the strictly divided and rigid system

of foreign trade, nor that the monopolistic positions of big foreign trade companies were hardly shaken by new forms of contacts between manufacturers and foreign trade and by new foreign trade licences granted to some manufacturers. On the other hand, in the mid-1960's several important reform proposals concerning the exchange rate policy were made and these formed an organic part of the reform thought at that time, even if none of them was implemented.

The reader may also miss something else from the introductory study and this is that the author does not enlarge upon his briefly mentioned but highly interesting ideas with regard to the post-1968 sociographic trend of reform thinking. As for the review of the "third reform wave", he has cut this short perhaps because, as the book reveals, another collection of studies, dealing with the reform after 1978, is in preparation. Anyhow, he raises exciting questions when investigating the extent to which the third stage of reform debates drew on earlier ones. One major message of the volume is that *the theory of the reform is far ahead of its practice;* and that quite a few questions – put fifteen or twenty years ago – concerning the function of the system of management have still not been answered. The following titles may give a good indication of what these questions are:

– The role of profits in company management (Jenő *Wilcsek*);

– Optimization and humanization. On the modernization of the management system (András *Hegedűs*);

– Fixed assets management in the new mechanism (Kálmán *Szabó* – Miklós *Mandel*);

– The problem of complex long-term evaluations of the activity of companies (Sándor *Kopátsy*);

– On reasonable forms of capital *regrouping* in our national economy (Tamás *Nagy*).

It is important to note that *these were all written between 1964 and 1970.*

Between the introductory study and the annex containing the reform document of the CC, HSWP, from April 1984, there stand nine chapters which follow each other in a chronological order. The relationship among texts included in the individual chapters concerns the role they have played in the development of reform thinking. The nature of this relationship is well demonstrated by the titles of the chapters; the table of contents itself is reform history in a nutshell. Between chapters 4 and 8, for instance, one can read publications ranging from the colosing of the first reform debate to ones evaluating the immediate aftermath of the 1968 reform of the mechanism. The "reform history" of that stage comprises such titles as:

– From attempts to rationalize the mandatory plan system to the revival of the idea of reforming the mechanism (1957–1964);

– Suggestive (manuscript) studies for the preparation of an economic reform (1964–1965);

– New considerations, different views, and debates during the elaboration of the reform concept (1965–1966);

– Concept of the reform, approved in 1966;

– Ideas and plans concerning the evolution of the reform (1968–1970).

Thanks to the logical and clear structure of the volume, the reader can thoroughly study the introduction and then, on the basis of the theoretical guidelines to be found there, the collection may be used almost as a refernce book. The book can undoubtedly be considered as the chrestomathy of the Hungarian economic reform ideas, yet it also supplies many lessons for the participants in the "third wave" of reform debates.

This volume of studies comprises a wide range of sources, a great number of which have not been available so far in book form, i.e. they could only be found with some difficulty and in may different places, *and to some extent melts* in the many, almost forgotten, *publications of economic journals.* Sceptical readers might also suspect that the volume shows Hungarian reform economics in a much more favourable light than it deserves because, even though now appearing decades after their original publication, the overwhelming majority of the writings in the selection represent obviously outstanding contributions to economic science. However, this nurtures the hope that the volume as it is will be useful and edifying for coming generations of reform economists.

Á. TÖRÖK

SETON, F.: *Cost, use and value. The evaluation of performance, structure and prices across time, space and economic systems with a special annex.* Clarendon Press, Oxford 1985.

For the young Hungarian economist, trained in mathematics and knowing the basic facts about non-negative and irreducible (and/or primitive) matrices and their eigenvalues and eigenvectors, Francis *Seton*'s new paradigm in value theory shall pose no difficulties in grasping – indeed it will go down swiftly and sweetly as a nostalgic, almost-known but forgotten tune, a melody helf remembered from somewhere, utterly familiar but bold and new.

Yet the uniniciated, lost among the mathematical abracadabra and fearing this sort of exposition as ritualistic and mystical gibberish, will be thoroughly taken back. He spent the sixties and seventies by labeling anti-marxist (that is: bad, unscientific, irrelevant) each and any mathematical exposition that went over his head, condemning all mathematical argument more complex than computing percentages and quotients.

Writing here for a periodical sharing traditions of verbal explication and seldom applying any mathematical font I must try the impossible: to translate Francis Seton's argument back into a non-mathematical verbal reasoning. Happily the text, not averse itself to occasional spells of verbal stunt-flight, is immensly helpful and lucid. Indeed one may propose the non-mathematician to skip all the maths – even the numbers – and watch only the train of thought which is clear and convincing. What will be lost is only some illustrations and proofs of existence and uniqueness. The latter cannot be furnished verbally but I hereby vouchsafe for them and also for the unavoidable direction of the argument. This is a mathematical machinery which – when set up properly – does all the thinking (and also: the actual computing) almost automatically.

The tiny little shift in the setup, that is in the questions asked from value theory (which then lead with deadly consequence to a new paradigm) warrant anyhow special attention. The breakthrough (and it cannot be judged less than the break-through triggered by Piero *Sraffa*) is not in mathematics. The tools applied, the machinery erected, is well known since *Weierstrass*, *Frobenius* and von *Neumann** created them. I believe the fundamental change in approach happens right in the first – mostly verbal – chapters, where the main questions asked are down-to-earth practical and operational instead of the usual sweeping theoretical and high-brow inquiries.

To make this focal point entirely clear: traditional value (or price) theories – both labour theory of value and marginalism – want to explain, to determine value and price relations within a given economic system at a certain historical instant. Francis Seton now asks instead a seemingly innocent and less ambitious question: how to compare practically two systems when both have their own size and technology and prices. The shift of interest seems to be modest and it also circumvents the theoretical questions: let the prices in the two systems be as they are, it is not our task to explain or judge them – we only want to compare. So let us fumble a bit with all sorts of indexes, categorize the work done by practical researchers, *Bergson*, *Kravis*, etc.

Yet this mock modesty actually covers a very strict and demanding extension of the basic question: let us look for a theory of measurement allowing *intertemporal* and *interspacial* comparison. To make sense (to be of practical use, to yield operative answers) the value system needs to be extended from a single point in time and space (as envisaged by classical theories) to adjacent points, it must be relevant to broader domains of time and space.

How to go ahead with this project? We have different, deviating even conflicting theories about pricing from the input and from the output side. They are aptly labelled as all kinds of cost-monomanias and use-monomanias (labour-theory of value and marginalism turn out to be just two of the very specific monomanias among them). They are promptly illustrated and computed by a simple 3 sector model of an economy imported, if you wish, from *Leontief*'s great statistical kingdom. Nevertheless with all

*The latter is acknowledged as demonstrating the potentialities of this kind of mathematics for economic theory as early as 1938.

those different assortments of relations, all justified but *prima facie* conflicting, the disorder and disorientation could not be greater. Actually they are yielding the extreme cases of valuation. No economist in his right mind would go to any of these extremes – but each has a right of his own.

So some reconciliation has to be worked out. The problem now looks even more formidable than before – if we reconcile these extremes, then we fit (among other things) labour theory of value to marginalism. These are two theories vying for supremacy for almost hundred years, the intellectual battle more exacerbated than and intermingled with the political confrontation of capitalism and socialism.

To pick a fine point of philosophical portent, advanced only toward the end of the first part: if cost and use, or – as *Aristotle* would have posited it – the *causa efficiens* and the *causa finalis* of values can be brought into concordance, then the result must be a system of pure numbers, dimensionless magnitudes.

It probably has been a common fault of labour theory and marginalism to look for some mysterious "substance" which would "carry" those "forces" expressed by value or price relations. Physics, too, grappled with ideas of phlogiston and ether and it is inly modern reasoning which puts away the need for such concepts. Slowly it becomes clear that it is not the exclusive field of economics where such value-systems can be encountered. Biology, the self-organization of matter, survival of the fittest, chemistry with its affinities, thermodynamics with its exchange-ratios for different kinds of energies, nay even the Lagrangeans and Hamiltonians in mechanics abound in such relations – every time nature has to compare the incomparable (because qualitatively different) it must engineer a system of values. So in this respect Aristotle has been probably right and *Marx* probably wrong.* We now possess a very strong mathematical tool for assessing the existence of such a value – or price – system, extending from mechanics (through thermodynamics, where it has been originally conceived) to the most recondite branches of non-linear and semi-infinite programming in the so-called Farkas-lemma** and I believe its skilled application could extent the validity of Francis Seton's argument to non-linear models of the economy.

The proof of the existence of such a price-system is given in our book by a convergent iteration process ,– a simple ,and easily computable algorithm: start from factor costs, assign optional weights (prices) to the factors and compute the prices of use values. Then reverse the perspective and compute the factor costs imputed by these prices and the actual allocation of commodities and again *da capo – al fine*: this process will converge to a unique system*** correcting whatever error of judgement we committed by assigning wrong values to the factors at the first round. The reviewer may have second thoughts about the particular model being chosen but most admire the simple procedure which works like magic. Whatever qualms one may have about the basic model – one is then convinced in Parts II and III that theoretical extensions and variations are possible and practical applications are abundant. Particularly the concisely elaborated interconections with the Sraffa-system, with linear programming, reciprocal marginality, von Neumann and Leontief models, Little-Mirrlees-prices and Marxian concepts produce a feeling of comfort and fertility: clearly marked pathways leading toward further possibilities of theoretical research.

In part III, which shows also the author's avowedly makeshift first computations with real arrays, the work of Albert *Steenge* has to be mentioned, who painstakingly and thoroughly compared 30 years (1948–1978) of Dutch prices to 10 years (1970–79) of Hungarian ones. If I remember well his original starting point in theory has been the mathematical fact that the powers of any non-negative and primitive matrix tend toward a unique dyad, formed by the (dyadic) multiplication of the right and left hand eigenvector, pertaining to the maximal eigenvalue

*See his remarks on this question in Chapter 1. Point 3.A.3. in Book one of The capital.

**Alfred Haar: Über lineare Ungleichungen Acta Sci. Math. 2. (1924) 1–14.

***The idea relies heavily on the fact that a surplus-producing system is mathematically equivalent with a contraction operator and thus has a fixed point.

of this matrix. They are the "eigenprices" (and "eigenquantities") of the system and their positivity and uniqueness is waranted by theorems enunciated by *Frobenius* and *Perron.*

It turns out that the actual Dutch prices were much closer to their theoretical values than the Hungarian ones – a conclusion already anticipated in all the earlier computations which invariably showed heavy price-distortions in planned economies. And here is the only point where I disagree with Francis Seton because he is too modest. On p. 101 he writes "Eigenprices optimize nothing". On the experience I had (in may own and neighboring countries, a bit in India, a bit in various parts of Africa) I Would claim more for his theoretical construct; countries with distorted price systems necessarily vaste their resources, will be underprivileged on the world market and are the losses in the long run. A correct value system – though we can only approximate it crudely by computations and somewhat better by market-automatisms – is always an expression of the true internal relations of the given economy and thus *optimizes the chances for survival.* No meaningful or favourable trading can be done when disregarding the dire necessities dictated by such a valid system of proportions. Of course: an economy can still be very inefficient even in possession of a correct system of its values, but it certainly canot become efficient by disregarding it and, indeed, cannot work efficiently without it.

A. B.

ANDREFF, W.: *Les multinationales* (The multinationals). Editions La Découverte, Paris 1987. 126 p.

The more than century-long history of multinational corporations has from the very beginning been full of controversies, but in the 1960s and the 1970s debates on their role became particularly heated. Admirers praised the multinationals as the disseminators of technical and economic culture, and even of democracy; on the other hand, critics blamed them for being the source of all economic and political troubles in the world. Aware of the distortions which have been caused by extremist approaches in the foreword of his book the author promises to present a less biassed analysis.

The very first difficulty in the evaluation of multinationals is in finding a precise definition for them, for there are numerous, and widely different ones in circulation. As a matter of fact, any small company operating in more than one country may be a multinational. Most definitions contain such or similar stipulation. Yet the best approach seems to be a definition which adopts a kind of historic attitude.

Multinationals usually emerge as the result of direct foreign capital investment. Their global value was a mere USD 14 billion in 1914, but this figure had soared to 500 billion by 1982. However, these data must be used with great caution because the dollar value of capital flow can change considerably from one period to another as the result of changes in exchange rates. Also, the distortive effect of different methods of data collection, evaluation and registration must be taken into account.

Anyhow, available data shows that before World War II, most subsidiaries founded in foreign countries were set up in colonies, i.e. today's developing countries. Meanwhile a strong reorientation seems to have taken place: today, three fouths of the most countries are industrialized ones. Another interesting trend is that during recessions the growth rate of foreign investments accelerates. The author points out that more recently the parent states of multinationals have also undergone a gradual change: of prime importance is the fact that the restructuring has reduced the relative weight of the US, while the share of direct Japanese investment has grown. However, it is remarkable that the role and attraction of the US as a host country are undiminished, irrespective of the exchange rate of the dollar. This proves the supra-economic role of the US: it functions as a sort of capital haven.

A symptomatic tendency of direct foreign investment is the growing role of manufacturing and services as against the extracting industries – although in this respect Italian and Canadian capital are exceptions. A relatively new feature is the appearance of developing countries (mostly, but not exclusively, oil exporters) among the capital exporters. The role of larger and smaller "multis" owned by socialist countries cannot be fully neglected either, although the author notes that their weight is not particularly significant. A slightly paradoxical feature involves cases in

which state companies become part of a multinational company, not infrequently due to incorporation into its structure.

A highly important part of the business strategy of multinational corporations is the method of control over foreign subsidiaries (joint venture, majority or minority share), the distribution of R+D expenditures, the formulation of a global trade strategy and, equally important, the profitable running of finances. Changes in strategy are signalled by the fact that the former strategies of moving to raw materials or to markets, and then, to rationalize production, moving to low-wage countries, have been increasingly replaced by financial considerations. Hence the scene is more and more dominated by investments in the so-called third sector (services) or by the parent company moving to some tax haven. Good examples of the former include the virtually monopolistic international news agencies, the internationalization of the advertising sector and the growing role of Japanese-type trading houses.

The multinationalization of banks is as old as, if not older than that of, industrial companies. Over the past 20 years, the process has quickened through the growing participation of banks in the activities of industrial and servicing companies. The latter, too, have penetrated the banking sector. The already rapidly growing importance of multinational banks received a new impetus from the creation of the so-called euro-markets (eurocurrencies, eurocredits, eurobonds etc.), these being intended to recycle oil capital. The market movement of huge amounts of capital, freed from state control, and then the growing debts of nation-states in this market, opened up possibilities for big international off-shore banks. Since the 1981–82 debt crisis further financial instruments have been "invented" (euronotes, euroshares, and 'swap' deals – that in fact represent trade in debts) and a more cautious credit policy has been applied.

Frightened by the debt crisis, international banks have sharply restricted credit granting to developing countries (especially to those very deeply in debt). However, as the author states, a correlation computed from UN and World Bank data shows that it is precisely those countries that took most of the direct investment in 1978–1981 that ran into the gravest debts by 1983–1985. Owing to a scarcity of local capital involvement, subsidiaries were forced to raise more foreign credits and these helped to add to the indebtedness of the country they operated in.

With regard to the influence of multinationals on the national economies, their relationships to the nation-states concerned must also be considered. The activity of transnational corporations exerts a strong influence on the trade, balance of payments, technological development, industrial production and employment of both parent and host countries. It also influences the development tendencies of society (for instance, the much-cited Americanization of taste and fashion).

Generally, "sending" countries try to protect the foreign investment of their multinationals, particularly from nationalization. In the same manner, they try to make best use of derivative advantages, by foiling financial manipulations designed to escape taxation. In the 1960s and 1970s the attitude of host countries was dominated by restrictive tendencies. In many cases, this led to instances of nationalization. From the second half of the 1970s, and even more so from the early 1980s, more ,liberal policies got the upper hand. This was due to the influence of a pragmatic trend that made itself felt even in the socialist countries: except for the GDR, Mongolia and Albania, they all aloow, and in some cases even lure, investments by multinationals.

In the fifth chapter the author tries to find short and concise answers to questions which ask how and why the multinationals exist and originate. He thinks these answers can be found by surveying various economic theories explain direct foreign capital investment by examining various factors (such as comparative advantages etc.); the neo-classical theory explains it by referring to different rates of profit (under a free capital flow). As a result of a growing multiphobia in the 1970s, the shortcomings of international markets and the world economy, the internationalization of capital were stressed in connection with the evaluation of the activity and role of multinational corporations. More recently eclectic views have prevailed and once more the advantages of multinationals are stressed.

In the fifth chapter the author tries to find short and concise answers to questions which ask how and why the multinationals exist and originate. He thinks these answers can be found by surveying various economic theories and their development, respectively. Foreign trade theories explain direct foreign capital investment by examining various factors (such as comparative advantages etc.), the neo-classical theory explains it by referring to different rates of profit (under a free capital flow). As a result of a growing multi-phobia in the 1970s, the shortcomings of international markets and the world economy, the internationalization of capital were stressed in connecdtion with the evaluation of the activity and role of multinational corporations. More recently eclectic views have prevailed and once more the advantages of multinationals are stressed.

The author certainly gives them credit for the fact that they pulled through, almost unscathed, the prolonged crisis of the world economy, at least until 1982–83 – and even then they suffered less than other (national) companies. Their profitability has been preserved even at times of economic crises and this is a clear proof of their flexibility. They play an outstanding role in developing, and even more in employing and adapting new technologies. As for the role they play in developing countries, here the views are more varied. Many claim that their operation causes an extreme differentiation of developing countries since their investments are nowadays almost exclusively concentrated in NICs. It is now recognised that the relatively low profile of multionationals in any country is a characteristic sign of underdevelopment. At the same time, the author believes there are more and more indications that in industrialized countries the state and the multinationals are reaching a "compromise". He thinks that in the "global village" of decades to come it will be just this cooperation that is going to guide the state capitalist world.

All in all, this is an enjoyable and substantial book about trade. It is written in good style on an interesting and complex question. Owing to the relatively small size of the book, we miss certain things, for instance, more detailed data could have been used to support certain statements. One feature that is highly disturbing is the overuse of abbreviations. This forces the reader to carry out the constant and cumbersome task of consulting the list of abbreviations. Despite this I can recommend the book not only to readers already interested in the subject but perhaps to the wider public as well.

A. TÓTHFALUSI

BOOKS RECEIVED*

ALTMANN, F.-L.: Wirtschaftsentwicklung und Strukturpolitik in der Tschechoslowakei nach 1968. Gegenwartsfragen der Ost-Wirtschaft, Band 13. Olzog Verlag, München 1987. 215 S.

BACH, Q. V. S.: Soviet economic assistance to the less developed countries. A statistical analysis. Clarendon Press, Oxford 1987. 175 p.

CASLEY, D. J.–LURY, D. A.: Data collection in developing countries. Oxford University Press, Oxford 1987. 2nd edition. 225 p.

CHADWICK, M.–LONG, D.–NISSANKE, M.: Soviet oil exports. Trade adjustment, refining constraints and market behaviour. Oxford University Press, Oxford 1987. 263 p.

Hungarian food economy at the start of the new five-year plan. Research Institute for Agricultural Economics, Bulletin No. 65. Budapest 1986. 87.

Ordnungstheorie: methodologische und institutionentheoretische Entwicklungstendenzen. Arbeitsberichte zum Systemvergleich, Nr. 11. Philipps-Universität, Marburg, September 1987. 168 S.

RÁBA, A.–SCHENK, K.-E. (eds): Investment system and foreign trade implications in Hungary. Gustav Fischer Verlag, Stuttgart–New York 1987. 260 p.

RIISHØJ, S.: Plen – den soerlige vej til normalisering af det politiske og økonomiske liv siden december 1981. Sydjysk Universitetsforlag, Esbjerg 1987. 163 p.

World labour report, 1–2, 3. Oxford University Press, Oxford 1987. 296 and 169 p.

*We acknowledge the receipt of the enlisted books. No obligation to review them is involved.

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

AUTHORS

dr. András KÖVES, see Vol. 37, Nos 3–4.

dr. András NAGY, see Vol. 37, Nos 3–4.

dr. András INOTAI, see Vol. 36, Nos 3–4.

dr. Márton TARDOS, b. 1928. Titular professor, Director-general of Financial Inc. Budapest. Formerly head of department at the Institute of Economics, Hung. Acad. Sci. Author of "The role of money in Hungary" (European Economic Review 31. 1987), "Enterprise ownership, monetary interest, capital market" (Külgazdaság, 3. 1987. – in Hungarian), "The structure of the Hungarian economy and the reforms" (Magyar Tudomány, 4. 1987. – in Hungarian) and several studies, published in Acta Oeconomica.

Gábor OBLATH, b. 1952. head of main department at the Institute for Economic and Market Research and Informatics (KOPINT–DATORG). Co-author of "The rate of exchange and the foreign trade price coefficient" (A. Oec. 1979), "Hungarian foreign trade in the 1970s" (A. Oec. 1983), "Trade with the Soviet Union: the Finnish case" (A. Oec. 1985) and studies in Hungarian.

dr. Béla GRESKOVITS, b. 1953. Scientific research worker at the Institute for Economic and Market Research and Informatics (KOPINT–DATORG). Author of "The Hungarian credit programme to stimulate exports" in: Investment system and foreign trade implications in Hungary (eds: Rába–Schenk, Gustav Fischer, Stuttgart–New York 1987) and several studies on development, market-oriented industrial policy in Hungarian.

dr. Iván SCHWEITZER, b. 1938. Cand. of Econ. Sci. Head of Department at the Institute for Economic and Market Research and Informatics (KOPINT–DATORG). Autor of "Size and market behaviour of the Hungarian engineering enterprises" in: Organization and interaction patterns in Hungarian industry (Gustav Fischer, 1984), "Some problems of the investment and capital allocation system in Hungarian state owned industry" in: Investment system and foreign trade implications in Hungary (Gustav Fischer, 1987) and several studies in Acta Oeconomica (1980; 1981) and a book on enterprise size in Hungarian (Közgazdasági és Jogi Könyvkiadó, 1982).

Kamilla LÁNYI, see Vol. 34, Nos 3–4.

dr. László CSABA, b. 1954. Cand. of Econ. Sci. Head of department at the Institute for Economic and Market Research and Informatics (KOPINT–DATORG), formerly research worker at the Institute for World Economics, Hung. Acad. Sci. Author of "Die Investitions- und Innovationspolitischen Befugnisse der Unternehmung in der DDR, der Sovjetunion und in Ungarn" (Konjunkturpolitik, 3. 1987), "CMEA and East-West trade" (Comparative Economic Studies, 3. 1986.), "Die dritte Etappe der ungarischen Wirtschaftsreform" (Südost-Europa, 7–8. 1987) and "Eastern Europe in the world economy" (Cambridge Univ. Press, forthcoming in 1988).

dr. Tamás BAUER, see Vol. 34, Nos 3–4.

dr. Éva PALÓCZ, b. 1952. Economist. Scientific research worker at the Institute for Economic and Market Research and Informatics (KOPINT–DATORG).

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

TO BE PUBLISHED IN OUR NEXT ISSUE

A. SIPOS–P. HALMAI: Organization System and Economic Mechanism in Hungarian Agriculture
F. FEKETE: The Performances of Hungarian Agrarian Production Systems and the Income Producing Capacity of the Partner Farms
T. LAKY: Half-Hearted Organizational Decentralization: the Small State Enterprise
K. BALÁZS: Market-Oriented Scientific Research and Development after the Economic Reform
R. ANDORKA: Economic Difficulties – Economic Reform – Social Effects and Preconditions
T. A. WOLF: The Simultaneity of the Effects of Devaluation: Implications for Modified Planned Economies
J. KOVÁCS–T. TARJÁN: Cycle and Replacement
L. SZAMUELY: The After-Life of NEP
A. KÖVES: CMEA-Cooperation and the Soviet Reform

REVIEWS

GY. SZŐKE: A Chapter of Recent Economic History – Mergers of Agricultural Cooperatives over Two Decades in Hungary
O. LUKÁCS: Hungarian Trade in Consumer Goods – Some Questions Related to Changes in Enterprise Structure

BOOK REVIEWS

BOOKS RECEIVED

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

PRINTED IN HUNGARY

Akadémiai Kiadó és Nyomda Vállalat, Budapest

Journal of Consumer Policy

Editors

Folke Ölander, *School of Business Administration & Economics, Åarhus, Denmark;* **Norbert Reich,** *University of Bremen, FRG;* **Gerhard Scherhorn,** *University of Hohenheim, Stuttgart, FRG*

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.
Journal of Consumer Policy includes a separate section devoted to consumer law. This section reports regularly on developments in legal policy with a bearing on consumer issues.

Subscription Information **ISSN** 0342–5843
1988, Volume 11 (4 issues)
Institutional rate: Dfl. 206.00/US$97.00 incl. postage/handling
Private rate: Dfl. 90.00/US$37.50 incl. postage/handling

Private subscriptions should be sent direct to the publishers

D. Reidel Publishing Company

Kluwer Academic Publishers

P.O. Box 989, 3300 AZ Dordrecht, The Netherlands
101 Philip Drive, Norwell, MA 02061, U.S.A.

OECONOMICA POLONA

Vol. XIV 1987 No. 4

ARTICLES

Edward Golachowski: Socialized Ownership in Socialism
Wojciech Maciejewski, Władysław Świtalski: Central Economic Planning in Poland. Informational Aspects
Eugeniusz Gorzelak: Incomes of Farmers' Households in Poland
Leszek Zienkowski: Incomes Redistribution in Poland. Part II
Zbigniew Ladnau: Foreign Capital in Poland (1918–1939)

NOTES ON BOOKS

Elżbieta Domańska: Kapitalizm menedżerski (Managerial Capitalism) — by Stanisław Rudolf
Ekonomia polityczna (Political Economy), ed. by Jędrzej Lewandowski and Władysław B. Sztyber — by Zbigniew Matkowski

---

Journal of the Economic Committee of the Polish Academy of Sciences and of the Polish Economic Society. Offers in English language a selection of the most interesting articles, papers and excerpts from books by Polish economists.

Is available throughout the world on a paid subscription basis at the following rate: 48 US $ (plus mailing cost) or equivalent in local currency for a one-year subscription. To enter a subscription, send check or money order to Państwowe Wydawnictwo Ekonomiczne, together with mailing address, to:

Ars Polona
ul. Krakowskie Przedmieście 7
00-068 Warszawa, Poland

All requires, requests for complimentary copies and other correspondence should be addressed to:

Marek Okólski, Editor
OECONOMICA POLONA
ul. Nowy Swiat 49
00-042 Warszawa, Poland

ACTA OECONOMICA

A Magyar Tudományos Akadémia
idegen nyelvű közgazdaságtudományi folyóirata

Szerkesztőség: 1112 Budapest, Budaörsi út 45.
1502 Budapest Pf. 262.

Megjelenik évi 2 kötetben. Megrendelhető az Akadémiai Kiadónál (1363 Bp. Pf. 24.) a külföld részére a Kultura Külkereskedelmi Vállalatnál (1389 Budapest, Postafiók 149).

ACTA OECONOMICA

Журнал Академии наук Венгрии

Публикуется в двух томах в год.
Статьи публикуются на английском, русском и немецком языках.

Адрес редакции: H-1502 Budapest P.O.B. 262

Заказы принимает предприятие по внешней торговле Kultura (H-1389 Budapest, P.O.B. 149) или его заграничные агентуры.

ACTA OECONOMICA

Zeitschrift der Ungarischen Akademie der Wissenschaften

Aufsätze erscheinen in englischer, russischer und deutscher Sprache, in zwei Bänden pro Jahr.

Redaktion: H-1502 Budapest, P.O.B. 262

Bestellbar bei Kultura Außenhandelsunternehmen (H-1389 Budapest, P.O.B. 149) oder seinen Auslandsvertretungen.

Periodicals of the Hungarian Academy of Sciences are obtainable at the following addresses:

AUSTRALIA
C.B.D. LIBRARY AND SUBSCRIPTION SERVICE
Box 4886, G.P.O., *Sydney N.S.W. 2001*
COSMOS BOOKSHOP, 145 Ackland Street
St. Kilda (Melbourne), Victoria 3182

AUSTRIA
GLOBUS, Höchstädtplatz 3, *1206 Wien XX*

BELGIUM
OFFICE INTERNATIONAL DES PERIODIQUES
Avenue Louise, 485, *1050 Bruxelles*
E. STORY-SCIENTIA P.V.B.A.
P. van Duyseplein 8, *9000 Gent*

BULGARIA
HEMUS, Bulvar Ruszki 6, *Sofia*

CANADA
PANNONIA BOOKS, P.O. Box 1017
Postal Station "B", *Toronto, Ont. M5T 2T8*

CHINA
CNPICOR, Periodical Department, P.O. Box 50
Peking

CZECHOSLOVAKIA
MAD'ARSKA KULTURA, Národni třida 22
115 66 Praha
PNS DOVOZ TISKU, Vinohradská 46, *Praha 2*
PNS DOVOZ TLAČE, *Bratislava 2*

DENMARK
EJNAR MUNKSGAARD, 35, Nørre Søgade
1370 Copenhagen K

FEDERAL REPUBLIC OF GERMANY
KUNST UND WISSEN ERICH BIEBER
Postfach 46, *7000 Stuttgart 1*

FINLAND
AKATEEMINEN KIRJAKAUPPA, P.O. Box 128
00101 Helsinki 10

FRANCE
DAWSON-FRANCE S.A., B.P. 40, *91121 Palaiseau*
OFFICE INTERNATIONAL DE DOCUMENTATION ET LIBRAIRIE, 48 rue Gay-Lussac
75240 Paris, Cedex 05

GERMAN DEMOCRATIC REPUBLIC
HAUS DER UNGARISCHEN KULTUR
Karl Liebknecht-Straße 9, *DDR-102 Berlin*

GREAT BRITAIN
BLACKWELL'S PERIODICALS DIVISION
Hythe Bridge Street, *Oxford OX1 2ET*
BUMPUS, HALDANE AND MAXWELL LTD.
Cowper Works, *Olney, Bucks MK46 4BN*
COLLET'S HOLDINGS LTD., Denington Estate,
Wellingborough, Northants NN8 2QT
WM DAWSON AND SONS LTD., Cannon House
Folkstone, Kent CT19 5EE
H. K. LEWIS AND CO., 136 Gower Street
London WC1E 6BS

GREECE
KOSTARAKIS BROTHERS INTERNATIONAL BOOKSELLERS, 2 Hippokratous Street, *Athens-143*

HOLLAND
FAXON EUROPE, P.O. Box 167
1000 AD Amsterdam
MARTINUS NIJHOFF B. V.
Lange Voorhout 9–11, *Den Haag*
SWETS SUBSCRIPTION SERVICE
P.O. Box 830, 2160 Sz Lisse

INDIA
ALLIED PUBLISHING PVT. LTD.
750 Mount Road, *Madras 600002*
CENTRAL NEWS AGENCY PVT. LTD.
Connaught Circus, *New Delhi 110001*
INTERNATIONAL BOOK HOUSE PVT. LTD.
Madame Cama Road, *Bombay 400039*

ITALY
D. E. A., Via Lima 28, *00198 Roma*
INTERSCIENTIA, Via Mazzé 28, *10149 Torino*
LIBRERIA COMMISSIONARIA SANSONI
Via Lamarmora 45, *50121 Firenze*
SANTO VANASIA, Via M. Macchi 58
20124 Milano

JAPAN
KINOKUNIYA COMPANY LTD.
Journal Department, P.O. Box 55
Chitose, *Tokyo 156*
MARUZEN COMPANY LTD., Book Department
P.O. Box 5050 Tokyo International, *Tokyo 100-31*
NAUKA LTD., Import Department
2-30-19 Minami Ikebukuro, Toshima-ku, *Tokyo 171*

KOREA
CHULPANMUL, *Phenjan*

NORWAY
TANUM-TIDSKRIFT-SENTRALEN A.S.
Karl Johansgata 43, *1000 Oslo*

POLAND
WĘGIERSKI INSTYTUT KULTURY
Marszalkowska 80, *00-517 Warszawa*
CKP I W, ul. Towarowa 28, *00-958 Warszawa*

ROUMANIA
D. E. P., *Bucuresti*
ILEXIM, Calea Grivitei 64–66, *Bucuresti*

SOVIET UNION
SOYUZPECHAT — IMPORT, *Moscow*
and the post offices in each town
MEZHDUNARODNAYA KNIGA, *Moscow G-200*

SPAIN
DIAZ DE SANTOS Lagasca 95, *Madrid 6*

SWEDEN
ESSELTE TIDSKRIFTSCENTRALEN
Box 62, *101 20 Stockholm*

SWITZERLAND
KARGER LIBRI AG, Petersgraben 31, *4011 Basel*

USA
EBSCO SUBSCRIPTION SERVICES
P.O. Box 1943, *Birmingham, Alabama 35201*
F. W. FAXON COMPANY, INC.
15 Southwest Park, *Westwood Mass. 02090*
MAJOR SCIENTIFIC SUBSCRIPTIONS
1851 Diplomat, P.O. Box 819074,
Pallas, Tx. 75381-9074
READ-MORE PUBLICATIONS, INC.
140 Cedar Street, *New York, N. Y. 10006*

YUGOSLAVIA
JUGOSLOVENSKA KNJIGA, Terazije 27, *Beograd*
FORUM, Vojvode Mišića 1, *21000 Novi Sad*

HU—ISSN 0001—6373

Index: 26.033

ACTA OECONOMICA

PERIODICAL OF THE HUNGARIAN ACADEMY OF SCIENCES

EDITORIAL BOARD

M. SIMAI (Chairman)
M. AUGUSZTINOVICS
T. BECK
A. BRÓDY
CS. CSÁKI
B. CSIKÓS-NAGY
P. ERDŐS
T. ERDŐS
F. FEKETE
J. FEKETE
I. HETÉNYI
R. HOCH
J. HOÓS
I. HUSZÁR
B. KÁDÁR
J. KORNAI
F. KOZMA
A. NAGY
V. NYITRAI
Z. ROMÁN
M. TIMÁR

EDITOR
T. FÖLDI

AKADÉMIAI KIADÓ, BUDAPEST

VOLUME 39
NUMBERS 3—4
1988

ACTA OECONOMICA

PERIODICAL OF THE
HUNGARIAN ACADEMY OF SCIENCES

Editor:

TAMÁS FÖLDI

Editorial office: H-1112 Budapest, Budaörsi út 45. Hungary
H-1502 Budapest, P.O.B. 262

Published in two volumes a year. Orders can be placed with Kultura Foreign Trade Company (H-1389 Budapest, P.O.Box 149) or Akadémiai Kiadó (H-1363 Budapest, P.O.Box 24).

CONTENTS

A. SIPOS—P. HALMAI: Organization System and Economic Mechanism in Hungarian Agriculture 199
F. FEKETE: The Performances of Hungarian Agrarian Production Systems and the Income Producing Capacity of the Partner Farms 231
T. LAKY: Half-Hearted Organizational Decentralization: the Small State Enterprise..... 247
K. BALÁZS: Market-Oriented Scientific Research and Development after the Economic Reform..... 271
R. ANDORKA: Economic Difficulties—Economic Reform—Social Effects and Preconditions..... 291
T.A. WOLF: The Simultaneity of the Effects of Devaluation: Implications for Modified Planned Economies..... 303
J. KOVÁCS—T. TARJÁN: Cycle and Replacement..... 325
L. SZAMUELY: The After-Life of NEP 341

REVIEWS

GY. SZŐKE: A Chapter of Recent Economic History—Mergers of Agricultural Cooperatives over Two Decades in Hungary 357
O. LUKÁCS: Hungarian Trade in Consumer Goods—Some Questions Related to Changes in Enterprise Structure..... 369

BOOK REVIEWS

J. KORNAI—X. RICHET (eds): La voie hongroise. Analyses et expérimentations économiques *(W. Andreff)* 385
K.A. SOÓS: Plan, Campaign, Money—Regulation and Business Cycles in Hungary and Yugoslavia *(J. Szabó)*..... 388
J. SZALAI: The Diseases of Public Health *(É. Ozsvald–A. Kiss)*..... 395
P. MARER: East-West Technology Transfer. Study of Hungary, 1968-1984 *(A. Tóthfalusi)*..... 398
Y. TOLONEN: On Macroeconomic Consequences of Trade with Centrally Planned Economies *(Á. Tōrōk)*..... 401
T.I. BEREND—GY. RÁNKI: The Economy of Europe in the 19th Century (1780-1914) *(É. Ehrlich)*..... 404

BOOKS RECEIVED

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

©Akadémiai Kiadó, Budapest

Acta Oeconomica, Vol. 39, (3-4), pp. 199–230 (1988)

ORGANIZATION SYSTEM AND ECONOMIC MECHANISM IN HUNGARIAN AGRICULTURE

A. SIPOS—P. HALMAI

The economic reform process evolving in Hungary from the mid-sixties also involved deep changes in the economic mechanism and organizational structure of agriculture. Yet, factors restricting enterprise have continued to assert themselves with a rather big weight. According to the standpoint of the authors a transgression of the factors restricting the regulated market and enterprise can only be realized in the framework of a powerful and compatible reform process, a precondition of which is that a trend aimed at improving income production should become determinant. The points of emphasis of the desirable price formation are: strengthening the regulatory role of money; institutional securing of autonomy for the firms interested in long-term profit; elimination of the administrative obstacles to the flow of resources; evolution of market relations; moderation of the price disparity and of budgetary (fiscal) redistribution; strengthening of the orienting role of prices; a more differentiated structure of establishments; a more organic relationship between small-scale production and the simpler cooperatives; a more unambiguous institutionalization of agricultural interest.

The organizations operating in agriculture fit into the organization system of the economy as a whole, yet it is justified to analyse the system of the agrarian institutions separately. First of all because the sectoral features of agriculture are very specific. The natural factors play an outstanding role, e.g. one of the most important means of production is land and the objects of labour are typically living organisms.

The socio-economic relations are also specific in the agricultural production of Hungary. Despite the centralization campaigns of certain periods, the large number of the economic units, the multi-sectoral character of the production[1] and the decisive weight of the non-state-owned sector (cooperatives, small-scale production) are characteristic features.

The control system also cannot be the same as in other sectors of the economy. The operational problems of the centralized system based on plan instructions appeared in Hungarian agriculture in an especially marked form. In the centralized mechanism of mandatory instructions agrarian production was "the patient in medical science on whom the symptoms of every disease are simultaneously demonstrated," and the reason for this was not only the income drawn away for

[1] In this study the state farms, the agricultural (farming) cooperatives and associations of these will be collectively called the "enterprise sector". The small-scale farms—which are occasionally linked in several aspects to some enterprise—will be called the "small-scale production sector".

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

the purpose of industrialization. In later development periods of the Hungarian economy certain reform measures were in general taken earlier in agriculture than they were in other sectors (e.g. introduction of the contracting system; the possibility of establishing cooperatives' associations or combined organizations of small- and large-scale production units; the abrogation of the detailed breaking down of plans to the plant level; greater liberty in selecting the sphere of activity etc.).

In our research work we made efforts to reveal the major particularities in the operation of the organizational system in agriculture. In the framework of the present study—after presenting certain basic problems of agrarian production—we are going to summarize our most important findings with regard to the autonomy of the agricultural enterprises, the integration of small-scale production, and the situation of the interest-representing system. Following this we shall indicate the main directions of the changes we recommend.

The socio-economic significance of agriculture and the dilemmas of development

The significance of agricultural development in the modernization of Hungarian society is much greater than is indicated by the share of agrarian products in gross national product and its social role is also much more important than it is normally thought to be. [1]

The factors which underline the socio-economic significance of agriculture, are the following:

— Hungary's most important natural resource is *arable land*; its other ecological endowments also provide favourable conditions for agrarian production.

— Despite its declining trend, the role of agriculture in *employment* is also important. In the last decade the share of all active earners that are employed in agriculture fluctuated around 20 percent. We need to add to this figure the quantity of work carried out in small-scale production, which equalled the annual worktime of about 600.000 workers and exceeded the quantity of live labour performed in the agricultural enterprises.

— As a result of the impressive growth of gross output the demand of the domestic market—including the rising quality requirements—can essentially be covered.

— *The growth of production has been accompanied by an improving export performance of the food economy.*[2] In the foreign-trade balance of the early 1980s the food economy was the determinant factor in developing the export surplus in the non-rouble markets.

— Agriculture takes a significant place in the performance of the Hungarian economy even beyond its gross output. Its share in the national income (net ma-

[2] In Hungary this term covers agriculture plus food processing—Ed. note.

terial product in MPS) is more than 17 percent and in the Net Domestic Product (SNA) about 20 percent.

— Agriculture is, at the same time, the supplier of raw materials for the manufacturing industry (first of all for food processing) and, as the user of industrial products and materials, provides a market for industry.

— In addition to the development (location) of industry, or together with it, the modernization of agriculture can be a factor in regional development.

The development of Hungarian agriculture, however, has been a process that has been far from consistent. While not denying its achievements, we think that, regarding the future role and development of agriculture, some questions of rather great importance can be formulated which are still waiting for an answer. In this study our aim is to formulate only the five dilemmas which are in our opinion the most important ones, and merely to add a few viewpoints to them (which may concern the possible answers). *The answers to the proposed questions will by all means affect the economic mechanism and*—sticking closely to our subject proper—*also the organization system of agriculture.*

1. *Can the dynamism of the Hungarian economy be induced by agriculture?* After the collectivization of agriculture was finished in Hungary in 1961, a conspicuous growth of its gross output took place. The material inputs, however, increased far more rapidly than gross output, so that the share of the net domestic product within the whole output came to be continuously declining. In the opinion of many people, as the volume of production grew, effectiveness permanently decreased, and some even express the view that the impressive growth was based on agrarian protectionism and coupled with the producers' lack of sensitivity to costs.

In connection with the development of the net domestic product it is worth mentioning that in the last quarter of a century—mainly up to the mid-seventies—the labour force in agriculture decreased to a great extent.This also had an impact on the net product, since it includes labour incomes, too.

On the other hand, owing to the disparity between agricultural and industrial prices, the price system also caused some distortions in the value of output.[3]

From the late 1970s on in the enterprise sector of agriculture, the material-intensity of production, and especially the consumption of primary energy resources and chemicals, markedly decreased. Capital-intensity of production also declined and the productivity of labour increased. Taking these changes into account and looking at indicators calculated at constant prices, a shift can be observed: comparing the average of 1983–84 to that of 1978–79, the gross output of agricultural enterprises grew by 12.4 percent and the net product by 33.7 percent. Taking into account the total of all activities pursued by agricultural enterprises in the same period, gross output grew by 26 percent and the net product by 37 percent. (In

[3] According to calculations aimed at eliminating these distortions, the index of net agricultural output between 1960 and 1980 was not 11 percent, but 38.5 percent. See [2]

small-scale production, in contrast, material inputs were growing more rapidly than gross output.) All in all, in the sphere of the agricultural products the growth of gross output was 10.3 percent, and that of net product was 12.4 percent. Taking into account all the activities of agriculture, gross output increased by 20.9 percent, and the net product by 22.1 percent.[4]

At the same time, *the increase of the material inputs was only lower than the growth of the production at constant prices; as a result of the price scissors, at current prices the costs increased faster.* Thus, in the enterprises the growth rate of the net product was somewhat lower than that of gross output and, regarding the total activity, the dynamism was similar only because the share of the pluriactive (multifarious) various supplementary activities has grown. At the same time, in the small-scale farms the increase of the net product at current prices remained far behind the growth of the gross product, and its real value markedly declined.

The limits to growth of agricultural production in the sphere of realization became more severe. A significant extension of the domestic market—which, in addition, could only be based on increased standards of quality—might come to pass only if real incomes would powerfully increase. This, for the time being, cannot be expected.[5] Thus, possibilities for growth are restricted to opportunities in the external market.

In principle (but merely in principle) a volume-increasing agricultural development, based on the additional involvement of industrial means of production, could also be imagined. [3, 4] Beside dynamic agrarian export, agriculture can indirectly mobilize supplementary growth resources in industrial production and foreign trade.

2. *Can the volume and the profitability of the exports grow simultaneously?* This question entails, however, a new one, namely, whether the structure of the Hungarian agrarian exports can be changed in terms of products and markets.

Or, to formulate it more generally: Is it possible to increase agricultural exports without a foundation in a protectionist domestic market?

With regard to the potential answers the following circumstances have to be taken into account:

— Among the national economies which are able to pay for food imports *endeavours at self-sufficiency*, and, linked to these, *protectionist efforts*, have strengthened during the last decade all over the world. The extent of self-sufficiency has shown an especially high increase in the West-European countries, which in earlier eras were target countries of Hungarian agricultural exports.[6]

[4] We must note that in 1985—owing mostly to unfavourable weather—the value of agricultural production decreased. [3]

[5] Whether, in the context of the current price system, an increase in demand would really improve the income realization conditions of the agrarian producers, is another question.

[6] According to certain calculations, in the case of liberalizing international trade, the world level

— The endeavours aimed at self-sufficiency are also powerful in the CMEA countries. Food imports—especially when they have to be paid for in hard currency—are practically considered a sacrifice on behalf of the national economy. *In the trade within the CMEA no regional preferences have come into being and, in the foreseeable future, no such preferences can be expected.* Agricultural trade prices are unfavourable for exporters, and the food-importing countries refuse to accept any institutional price correction for agricultural products. At the same time, the potential advantages of exchange—which can be realized through intricate systems of reciprocal deliveries—can be judged with difficulty and only on the level of the national economy.

— The extent of solvent foreign demand is uncertain, *the agricultural market is highly unstable*, fluctuations related to business cycles have increased. In the world market of agricultural products—which is in effect a set of regional markets—competition is going on not only between producers but also between national commercial policies and between state budgets. The agrarian exports and the export-oriented development of the small countries can only be (relatively) safe if they are based on diplomatic economic agreements and on enterprise cooperation.

— To assert the comparative advantages of food exports under such circumstances becomes more difficult. The speculative ideas about the price explosion of foodstuffs proved false, and what is more, in recent years a drastic fall in prices occurred in most agrarian product markets (especially in the prices of mass products). To replace shortfalls in foreign currency earnings due to price losses, economic policy has been compelled to press for an expanded quantity of exports, very often at the cost of economic efficiency.

— The specialization in agricultural mass products determines the selection of the foreign markets; a one-sided specialization results in a rigid structure, reduces the ability to adjust, i.e. increases unilateral dependency on the external market.[7]

— It is not only sales of agricultural products that meet with difficulties in the world market—other circumstances may also cause price losses. A substitution for agrarian exports is only realistic if a more profitable and marketable supply of manufactures can be offered.

3. *Can the disparity between industrial and agricultural prices, and the role of redistribution by the state budget in mitigating this disparity, be eliminated?* Furthermore: to what extent can income differences between production units or individuals be tolerated? Is it possible to implement a regulation system in agriculture which is decisively built on prices? Is it possible to develop a system of

---

of food prices would be 20–25 percent higher. See [3, p. 160.], [5] deals with the interdependence of liberalization and the price level, drawing up different alternative models. About the potential effects of liberalizing agrarian trade in the CMEA countries see [5, pp. 1423–1425].

[7] In detail see [6, pp. 9–14].

land valuation which, in taking account of the engagement of agricultural capital, would make the utilization of land measurable?[8]

4. *Should adjustment to changing market conditions and the safety of production be promoted by a central production policy defined by physical targets, or by a system of vertical connections, based on the producers' own interests?*

— In demanding markets (sensitive to quality) well-organized vertical relationships and a rapid flow of information are important and indispensable. In these markets it is especially advantageous for the producer to know, where the product that he has produced or primarily processed, will be used. Less sophisticated markets, however, do not really require the surplus knowledge and higher level of organization embodied in the product and indeed refuse to pay for it.[9]

— In the experience of countries where the most advanced food production is found agreements and associations based on the producers' own interests, which contain parallel common interests and self-constraints, can best suit the contradictory requirements of an elastic adjustment and an indispensable stability. The warding off of market disturbances is, at the same time, provided by state intervention, using tools that are in conformity with the market. [15, 25]

— If the rationality of exports to rouble markets can only be determined by the "physical exchange rate" of the foodstuff offered for exports and the raw materials received in return, the results of such calculations may easily become the objectives of the production policy. If the objectives of the production policy are developed in this way, transmission of them to the enterprises requires strong centralization in agricultural production, the greatest possible uniformity of the farms, an artificial income structure and the least possible number of market relationships. [6, p. 10]

5. Finally, with reference also to the dilemmas mentioned above, *the basic question arises whether in the following period of Hungarian agricultural development the tendency to increase volume or to make profit should be the prevailing one.*

The *volume-boosting tendency* is characterized by a strategy aimed at increasing the exports of agrarian products. It is based on further extending the utilization of external resources, first of all of industrial means of production, and on increasing the productivity of live labour.

The *strategy directed towards increasing the income producing capacity* means efforts to enhance the production of value added, to better utilize internal resources, mainly the available workforce and the soil. It means, furthermore, to diversify the activities, and finally, to improve the efficiency of the means of production which had been supplied by industry. Instead of quantity, the increase of profitability comes to the foreground. Development is more selective, and only the production

[8] Certain questions of price disparity will be dealt with in the next point.

[9] For details on this problem see [7, pp. 13–14] and [6, p. 10].

of the really effective sectors is extended for export purposes. The increasing use of the manufactured means of production in agriculture declines. What is more, attempts are made at restoring in part the agrarian production that is based on natural resources.

In case the strategy enhancing the volume becomes dominant:

— the increment of output comes from the "pulling" sectors which turn out large volumes (cereals, oil seeds, meat-poultry, slaughter pig);

— the income of the agricultural producers is primarily obtained from agrarian production, and the various complementary activities have secondary significance;

— the export share of articles safely sold in large volumes on the basis of inter-state agreements, increases; the export level is stable, the risks are taken by the state;

— the domestic needs of staple foodstuffs are covered from central stocks, on the basis of central decisions;

— the relative stability of production and distribution, and safe fulfilment of the export targets can be assured by central measures; the national economic plan is mandatory, sets concrete targets, and the regulators serve to ensure fulfilment of the plan;

— the state subsidies granted to agriculture remain lasting and show an increasing trend in the long run; the financial links with the state budget radically rearrange agricultural incomes.

If the profit-making tendency plays the decisive role:

— production grows at a slower rate, prompted increasingly to produce products which contain more value added: to turn out food products that are better processed; and to improve quality;

— the complementary (non-agricultural) activities are some of the tools for reducing the cost of agricultural production, therefore agricultural policy lays great stress on maintaining their stability and profitability;

— in the wake of orientation towards diversification and meeting the various demands, the autonomy of the smaller production units within the enterprises gains ground; occasionally simpler forms of cooperation are developed and even the possibilities of independent small-scale production are extended;

— exports become more varied. Their magnitude fluctuates depending on market opportunities, and the relationship between the producers and the foreign market grows more direct;

— the importance of the domestic market increases; food marketing becomes more differentiated; the processing and marketing activities of the agricultural enterprises and/or their ventures shortens the route of commodities from the producer to the customer;

— the regulation of production becomes more decentralized; the role of the trading companies that are in direct contact with the market, and of the producers' own commercial organizations, grows; the state's role in organizing the economy diminishes; the prognostic character of the plans strengthens;

— the levelling effect of the subsidies and of the state budget on enterprise incomes decreases and the role of land tax grows.

Some combinations of the two markedly different models can be discovered in the agriculture of several countries. Yet, it is not at all insignificant, how this combination has been formed, and which tendency finally comes to be dominant. As to our own view, in the present situation of Hungarian agriculture, and within the foreseeable future, the prevalence of the profit-making tendency may be qualified as the only reasonable one.

Venturing, and the autonomy of the agricultural enterprises

The basic principles of the Hungarian economic reform in 1966 declared the autonomy of enterprises in general. Therefore, following the proclamation of the reform, with regard to our subject in a narrower sense, most decisive is the question as to what *extent the autonomy of the agricultural enterprises can assert itself* and to what degree a *venturing character* can be detected in their operation.

a) The venturing character (entrepreneurship)

Venturing can essentially be interpreted as a behaviour in economic management. The conceptual criteria of the venturing character—concentrating on agricultural enterprises—can be summarized in the following:

1. The agricultural enterprise freely chooses and/or modifies its activities, its product pattern in terms of quantity and quality, the employed means of production, its technology and the applied production processes. The basis of the decisions is adjustment to the development of the market demand for agrarian products and foodstuffs, and for other types of products and services.

2. Production is motivated and driven by the objective of increasing the enterprise's (gross or net) income.

3. The enterprise enjoys independence and freedom of decision needed for successful operation, as a right granted to it, in respect to production and sales, purchasing production equipment, in the choice of technologies, in the employment of the workforce, and in utilizing the enterprise income. Furthermore, it cannot be compelled, by administrative measures, to carry out a set of activities determined from outside.

4. Survival or growth of the enterprise, obtaining the loans needed for development, depreciation of the fixed assets, return of the costs, are defined and/or made possible by the effects of the market, and limited by market prices.

5. The risks of the given production strategy are carried by the enterprise itself, whether they be due to internal management factors, or to causes beyond the control of the enterprise. At the same time it has the freedom of decision-making that is necessary in order to avoid such risks. The failure of the operations is a threat, but the enterprise possesses a wide range of options for protecting itself even without the support of state control.

6. The agricultural enterprise is allowed to give up any activity which becomes a burden to it, by autonomous decision. It may change the branch of cultivation in a given land area in accordance with the opportunity cost. In certain land areas it can abandon agricultural cultivation either temporarily or entirely. It can also put up for sale its surplus land capacity—based as well on entrepreneurial decisions—either by selling the land, or by transferring the right of utilization. Using the land, or withdrawal of cultivation depends on assumptions regarding the income producing capacity. Land, as a factor of production that can be monopolized and as a capital asset can, at the same time, create the opportunity of income-reservation. Land is a market factor for the enterprise, together with its price and with the inherent potential to produce income. Consequently, it is a cost, a fixed asset requiring replacement and development, the cost of which is returned in the market price of the products. Or—in a case where venturing turned out to be unsuccessful—return in the market is not, or is only partially assured.

The characteristics of managerial behaviour are also formed for the agricultural enterprise through the concurrence or conflict between the given production organization and its economic environment. (The adjustment of the enterprise to its environment is, of course, regulated by—among other influences—legal rules and by the agreement of producers of equal rights and obligations.)

With regard to the emergence of entrepreneurial characteristics it is a basic question as to how far the constraint of adjustment to market impulses asserts itself in the agricultural enterprises. If they are forced to compete for winning the opportunities of marketing and for the return of their costs in prices, and if,—in this context—for the sake of creating the conditions of growth, they have to adapt themselves to the market relations by organizing production and marketing, entrepreneurial behaviour will markedly appear in their management. If, in contrast, the driving force and the constraint of market relations are missing, a venturing character may come into being, but its features will be faint and will mainly—and mostly only formally—show up in certain categories of accounting and recording.

The potential and opportunity of the agricultural enterprise for venturing can be built up to the extent it has been from the outset inherent in the regulation system of agriculture and as far as its other institutional conditions are given. Deficiencies in entrepreneurial ability are also linked primarily to environmental conditions,

first of all to the regulation and the institutional system. In the last few years the differences in this respect between farming cooperatives and state farms have ceased to exist, for the economic environment, especially the mechanism of economic management is now the same in both sectors.

b) Economic environment and the limits to venturing

The economic environment of the agricultural enterprise is mostly manifested in its commercial relations of purchasing and selling commodities, in credit transactions and in connections with the state budget. In addition, specific attention has to be paid to the impact of income (earnings) regulation on the enterprises.

1. *The market relations of purchasing and selling*[10] can be characterized—among other things—by the following:

— *The monopoly and/or oligopoly structure* of the connected organizations has been maintained in both the input and output sides. Significant changes in this field have only shown up since the early 1980s but no radical change has occurred in the quality of the relationships.

— In the past period marketing of the means of production was in effect only allocation. *The market of the means of production, has only rudimentarily, if at all, come into being.* [11, 12, 13, 14] The supply of means of production has not adjusted to the differentiated demand, and has often compelled enterprises to make decisions under the pressure of necessity. They were frequently forced to adopt standard processes and technology which were either unsuitable to the relations of their productive land or, which owing to their endowments, were too costly to utilize properly.

While the agricultural enterprises are not in general threatened by a sales crisis, some difficulties of selling do, however, occur almost regularly. Practically no efficient system of interventions has been developed to avoid these in the commodity market. Interventions have not so far been part of a deliberate production policy for eliminating the cycles, but were implemented as barely predictable responses to unforeseen situations, determined not by the actual market conditions, but by the level of supply in the preceding year.

— The majority of the selling prices of agricultural products are fixed by the authorities, and are disconnected from consumer prices. For a long time prices were one-sidedly adjusted to production costs—interpreted in an autarkic manner—and this was assured by repeated price rises. The requirement of cost returns and competitiveness were not and are not even today unambiguously asserted in prices.

[10] For details on the system of enterprise relationships see [10] and [15].

At the same time, prices of agrarian products contain much less net income than do industrial producer prices.[11] Following the declaration of the economic reform the disparity between prices had been reduced but still remained quite significant. In the meantime goods of industrial origin have been increasingly used in production, and, from 1976 on, the gap between industrial and agricultural prices has again grown wider.

The conditions of self-financing have been only partially created in the price system of agriculture if at all. Under such conditions,—even assuming rational management of the enterprises—a complex system of *state subsidies* is necessary. This impedes transparency, makes it difficult to evaluate inputs and yields, efficiency and exportability. The system of subsidies, at the same time, entails the constraint of permanent bargaining of the enterprises with the supervisory authorities. When the resources for development (replacement) are independent of market returns, the requirement of efficiency in selecting and utilizing the fixed assets is reduced. Under such conditions it is even possible that certain types of growth may be accompanied by the deterioration of efficiency.

Another effect of the price disparity is that *in the regulation of production the price mechanism plays a much smaller part than is possible and desirable.*

— The lower income-content of agricultural prices confines the differentiation of prices by quality of the products within narrow bounds.

— A rearrangement of prices can be implemented only to a small extent. A majority of prices are fixed by the authorities and a great number of those based on agreements appear in practice in procurement as fixed prices.

— In the restructuring of the product pattern changes in the system of subsidies come at times to the foreground.

— Wastefulness in the treatment of the soil is characteristic because land has no price.

In our opinion, the existence of price disparity (the agrarian price scissors), and especially its extent has been, for a long time, a flagrant contradiction of the Hungarian price system. The demand for income of an increasingly industrialized agriculture by far exceeds that of traditional agrarian production. Beside accumulation, which is the "cost of the future", the demand for parity of the earnings also plays a part in this. It seems that *the agricultural price* system which was prevailing in the last two decades was—despite its becoming more favourable for agriculture compared to earlier periods—*essentially not in conformity with the industrialization of agriculture*. Through a wide system of state supports the coverage for income parity and industrialization can be assured even under such conditions. *This system of resource-allocation* is, in reality, part of the concept of industrialization from above, since from the income drawn away (or from a part of it) resources can be allocated for centrally defined purposes and technologies. In such

[11] For details on price disparity see [15].

a mechanism the agricultural enterprises' ability to accumulate, as a condition for the operation of industrialized agriculture, can be provided not by adjustment to the market, but by the hierarchy of allocation.

The price scissors force the improvement of efficiency but also involve some by-effects,—even under the circumstances of the market economies. It is and experience overall that it punishes those enterprises who made a lot of investments and undertook large debt-services, but not those whose use of inputs is most ineffective. In Hungarian agriculture, however, *opening the price scissors has entailed boosting of the presently existing disparity to such an extent that may result in an inability to accumulate in a growing number of agricultural enterprises and, concomitantly, in an inability to venture.*

The non-market relationships continue to represent a large weight. [16, 17] The state bodies and various social organizations permanently interfere in enterprise management to accomplish a variety of aims. On the other hand, the producing organizations strive to assert their economic interests informally, through their leaders' contacts which are either linked to their position, or are merely personal.

Informal relationships, of course, exist in market economies too. The role and functions of such relationships in the Hungarian economy are—to put it in a somewhat simplified form—different. *In the market economies the enterprise managers use their non-official relationships for stabilizing the contacts between sellers and buyers, while under Hungarian circumstances they are occasionally used for the substitution of business transactions in the market.*

2. Up to the late 1970s the Hungarian financial system had made attempts to provide a source of accumulation for increasing production, an objective which was then held to be the primary one. However, owing to the unfavourable marginal efficiency of the additional inputs needed for the growth of production, this was not realized in enterprise incomes, even though the volume of production increased. [18], [21, pp. 13–23] Accumulation was not realized as a result of market effects, but was in practice determined in line with the trends of development. Guarantees for additional accumulation were extended exclusively to the sphere of the large-scale farming units,—large-scale production was preferred to small producers, right up to the late 1970s.

Central economic management—contrary to the original ideas—drew into the orbit of central decisions not only the most important investment projects aimed at increasing and restructuring production, but also refused to give up the right to decide on enterprise investments. *Economic management intended*—in close connection with the method of industrializing agriculture—*to stimulate enterprises to implement the development projects deemed desirable from the viewpoints of macroeconomy, by means of subsidies, loans, and credit preferences.*

The credits, as well as the subsidies were closely linked to the production policy outlined in the central plans. For this purpose the sectoral credit quotas were broken down into partial ones allocated to particular objectives of the production

policy. The result was that loans were only granted to enterprises for preferential objectives, from partial quotas attached to them.[12]

The conditions and the appraisal of credit were not influenced by the expected circumstances of return and the creditworthiness of the enterprises applying for it, but by the centrally defined allocation possibilities. Loans were also received by several non-efficient and loss-making enterprises and it is not by chance that the problem of indebtedness shows up most frequently in precisely these cases.

The banks very often performed official authority functions (e.g. immediately drawing away any surplus purchasing power for investments, compelling the enterprises to use their excess income achieved by successful operations for paying out-of-turn credit instalments; at the same time, granting compulsory loans to low-efficiency companies etc.). Banking activities maintained their coercive character—business aspects, such as the undertaking of common risks were missing from their armory [20, pp. 14–15].

Preferential credit targets were also connected with subsidies which prompted enterprises in making their development decisions to consider the possibilities of obtaining subsidies or other preferences, instead of observing market conditions and the profitability of the sector to be developed. Under such conditions,—which characterized mainly the period ending with the late seventies—the acquisition of external resources became the prime mover of any investment project embodying some development. *The goal and the means were mixed up,* for the enterprises, in order to gain greater possibilities for development, were ready to develop almost anything. In ranking proposals regarding investments, ones for which subsidies or loans could be obtained received priority. Seemingly, this tendency promoted the use of resources in conformity with the objectives of the national economy. Actually, in reality, the application for external resources could only be justified by rather dubious economic efficiency calculations, and success at obtaining the resource could not in itself assure long-term profitability for the enterprise. This is proved by the examples of several investment projects to which high priority was given (e.g. that of the animal breeding plants). What is more, often the increasing depreciation costs—arising in the wake of investments which were ill-considered, but which were given high preference—caused losses or decreased profits.

At the same time—according to the typical practice of the central development programmes—if the parameters of process and technology were not in conformity with the centrally prescribed ones, the agricultural enterprises could count on neither the support of the investment, nor on obtaining credit. This meant that they were in practice unable to develop. Based on the foregoing, one may state that *with regard to the selection of production process and technology, the agricultural*

[12] Credit preference meant not favourable credit conditions but that the state granted loans first of all to development projects connected with the preferential objectives.

enterprises were almost completely deprived of the possibility of making autonomous decisions on venturing.

After the cessation of the granting of supports, in a large number of agricultural enterprises the bases of production became exhausted, and a part of the capacities which had been built up with significant support turned out to be inappropriate for efficient production. It can be clearly seen that recently the weight of the cost-reducing investments has been growing, as a result of the increasingly severe economic conditions and the strengthening sensitivity to costs of the enterprises.

3. It is a common characteristic of the income (earnings) regulation of the agricultural enterprises that among operating costs wages are specifically brought under excessively strict control. While the savings achieved by live labour can fully be used for other expenses, the benefits of economizing on assets influence personal incomes only indirectly and to a degree that is very restricted and is usually almost imperceptible. The prohibitive type of taxation built into the system as a brake on labour remuneration elicits behaviour in the enterprises which results in a complete lack of interest in the saving of total costs. For a long time one of the primary aims in labour management of the agricultural enterprises has been to evade the steeply progressive wage tax and not to employ the optimum labour required for production. The extremely variable types of income (earnings) regulation and the particular elements of the given regulation system deserve special attention. All of the several—and repeatedly modified—regulations exercised, in some way, an effect adverse to the desired goals.

The income regulation system permanently and very strictly protected the potential for accumulation inherent in the realized gross income of the enterprises. At the same time, in the most important matter, i.e. in dividing the income between accumulation and personal income, it delimited the enterprises' freedom of decision to a very narrow range. This means that, in the final analysis, this decision had also been taken into the hands of the state.

The experimental methods of income regulation in the 1980s were formed with the aim of getting rid of the "fetters of the average wages". They have undeniably granted greater freedom for personal interests to assert themselves within the enterprise. However, even in this context, some problems can already be formulated. On the one hand, to maintain setting aside a continuously increasing ratio of income for development purposes is not always sound and not even possible in the long run. Hence, with this form of regulation every enterprise will, sooner or later, fall into the danger of paying penalizing taxes. The tax payable on personal earnings by the large-scale enterprises will, in turn, still prompt them to employ workers with low wages and poor performance.

c) Transformation of cooperative membership relations

The proprietary interests postulate that a considerable part of the gross income stemming from savings of assets should regularly increase the shares of the members. Such an interest should also let the members bring their influence to bear on purchasing the assets, on innovations of processes and technology, and on replacement of the assets. This interest can only become typical if the risk of utilizing the assets also prevails in a realistic form. In the share of the members of the gross income of the enterprise the results of both utilizing the assets which are in common ownership, and of the live labour performed by them, ought to manifest themselves. Common ownership cannot be expressed, strengthened, and maintained in the farming cooperatives, if the interest of the members in the utilization of the means of production does not provide a lively driving force.[13]

The member of the agricultural cooperative is not a partial owner, but, in principle, a member of the owners' community. Common use and joint disposal of the property are deliberately undertaken and integrated objectives in the model of the agricultural cooperatives. Theoretically, the bonds of personal ownership ought to be replaced by the bonds of group ownership. Collective disposal of the cooperative property ought to be assured by the system of forums created by cooperative democracy. In the majority of cases the activity of the corporate bodies responsible for self-government is only formal; at the same time, the process of alienation from the membership is also rather advanced.[14] The growing size of the cooperatives greatly contributed to the acceleration of this process.

Under present circumstances the position of the members and that of the employees became rather similar to one another. The cooperatives must permanently compete in the labour market with other potential employers in order to maintain and restore their workforce—including also their members. At the same time, no property consequence is linked to either the establishment, or the termination of membership.

The employee-like position is also promoted by the decisive weight of the indivisible cooperative property in the possessions of the cooperative. The most important problems raised by the fact that the indivisible common property is becoming almost exclusive, are the following:

— it is difficult to draw in the personal savings of the members for the purpose of financing the development of the common undertaking. The proposed solutions of the problem do not fit organically into the model (the transactions in question are practically loans for limited periods and occur relatively rarely).

— the creating of personal interests in increasing the common property is not adequately solved; neither is the recording of the personal contribution to the

[13] About the position of the state farms and the special cooperatives see [22], and [24, pp. 64–81].
[14] About the West-European practice see [24].

increment of the property, nor the allocation of the share in the property in the case of resigning membership, retirement, or even for the period of continuous membership;

— under such conditions an active participation in property, undertaking of the risks, as well as interests proportional to these on the part of the collective farm members could not actually unfold.

The development of the institution of the cooperative farm as an enterprise, the however limited but still extending market relations, the huge volume of commodity production and the growing size of the cooperatives required the increasing importance of professional skills and experience of the management. *The professional staff of leaders increased not only in numbers, but its role in the guidance of the cooperatives also went through a decisive change.* Its original function was to assist the elected management in making the best possible decisions and to assure appropriate business administration. In opposition to this, for a long time now the most important decisions have been made by the professional leaders.

The collective, which is *de jure* a group of owners, seems to become more and more a collective of employees, the members of which content themselves mainly with improving their own performance and income situation.

d) Tendencies and counter-tendencies—A few further conclusions

A specific feature of the agricultural enterprises is the pursuit of supplementary activities. The profitability of these far exceeds that of the basic activity, so that they reduce the risks inherent in agrarian production.

Supplementary activities evolved in agricultural enterprises following the economic reform. The large upswing that started in the late 1960s, was, however, not smooth. From the early 1970s the number of restrictions again increased. Then, after 1978, owing to the changing economic conditions, which came to be increasingly severe, the opportunities of venturing grew broader once more.

From supplementary activities essentially the following advantages are expected:

— increase of the enterprise income, i.e. "pumping over" the produced income into the area of basic activity;

— more intensive utilization of certain technological capacities of the enterprise (buildings, vehicles etc.);

— for the sake of fully utilizing labour capacity, levelling out the "valleys of workload" (which are typical because of the seasonal cycles of agricultural production) with the aid of non-agricultural activities.

The first two functions are realized by an increasing number of activities in ever more agricultural enterprises. It was also hoped that first of all the farming cooperatives, which are working under unfavourable conditions, would compensate

for their low income with supplementary activities, but this failed to come true. The majority of such activities unfolded in the enterprises situated in the neighbourhood of towns, which were provided with a better supply of infrastructure, and which had dynamic management.

In the wake of the changing economic environment, the income situation of agricultural production grew continuously worse. *An increasing part of the agricultural branches, instead of being income producers, become income consumers and, consequently, are devalued even within the enterprise.* The income disparity between the basic and the supplementary activities causes devaluation of the agricultural sectors—and not only in terms of their prestige. The tendency to use the income from supplementary activities not for the development of agriculture, but for that of the sectors most capable of producing and increasing income, is also gaining ground, opposing, at the same time, the system of "pumping over". (Along with the evolution of economic accounting of the branches and the production units, this approach is spreading widely.)

The auxiliary activities of the West-European farmers (Nebenerwerbsbetrieb) and part-time farming are obviously analogous to supplementary activities in Hungary. [28] But there is a decisive difference in quality between the two types of supplementary activities. The Hungarian agricultural enterprise organizes these activities itself as a business operation (i.e. on a scale suitable for group operation), and what is more, as a kind of venture. The family farm, in contrast, offers its non-utilized labour capacity individually, and the large-scale enterprise might set up at most a business-like organization for the outworkers. The farmer uses supplementary activities for increasing his income, but not for the compensation of the losses occurring in his basic occupation. Of course, this cannot be completely excluded, as in the case of some years of adverse weather, but if agricultural production were to become permanently non-profitable, he would give it up. There are no administrative constraints to prevent him from doing so. In contrast, *the Hungarian agricultural enterprise is often forced to support its basic activities by its highly profitable supplementary operations for some longer time.*

2. It has already been shown in the foregoing that so far the effect of the agricultural price system was to limit, to a large extent, the venturing possibilities of the agricultural enterprises. At the same time it is a strange paradox that the prices fixed by the authorities also mean an external condition for the agricultural enterprises which they are compelled to reckon with in their operations. [25]

Apart from the sales in the free market, the prices of the agricultural products are easy to handle, they are typically dictated from outside (exogeneous) for the agricultural enterprises, hence, the enterprises accept, and do not set the prices. No hidden price rise is possible for the agricultural enterprise (with regard to the agrarian products), as is the case with manufacturing enterprises. *An increasing*

"pressure" caused by the costs does not automatically lead to a price rise. The agricultural enterprise is unable to shift this effect onto the user.

The agricultural enterprises also obtain some returns from sales which are not considered to be agricultural ones. A significant part of these is represented by reselling agricultural products bought up from small producers. In such cases the prices are governed by the aforementioned conditions. Another decisive part of the non-agricultural sales returns stems from industrial, construction and commercial activities. Such returns come from the sales of products and services where the success of the business is not automatically guaranteed and where—and this is the most important rule—the agricultural enterprises are not in a monopoly position. Their potential to set the prices—if it can be asserted, e.g. on regional level,—is limited, and can only move within narrow boundaries.

The prices realized from the supplementary activities of agricultural enterprises cannot in themselves justify their high profitability.[15] The experience—gained especially in the agglomeration of Budapest—underlines this by showing that, along with the slowdown in growth, with the growing number of supplementary industrial and services workshops, and with the emergence of various forms of small undertakings, with respect to certain activities, the market has become saturated.

The conditions of the agricultural price system—aside from some unfavourable effects—meant a powerful constraint which *resulted in a relatively stronger sensitivity of the agricultural enterprises to costs and prices.* (This tendency grew especially strong after 1978.) The only possible response of the agricultural enterprises—at least in their basic activities—was a series of *real actions*, e.g. better utilization of the available resources, a reduction of imports, and a modification of the input-output combinations. Manipulation of financial variables, raising prices, or receiving some gift from the state—though it was not excluded—could not be typical to the extent it was in a large sphere of industry.

A particular agricultural enterprise (even if it is a large one) only represents a small weight in relation to the whole sector; the centrally set objectives can be achieved without its participation, and its weight in the total supply is not a decisive one. The regulation of the survival and growth of the enterprises is adjusted to these conditions. Enterprises in agriculture (and especially farming cooperatives) have to face relatively more threats than those working in other fields of the national economy. Despite the successfulness of the sector as a whole, great numbers of enterprises in agriculture regularly meet with serious financial troubles, and some cooperative farms were even liquidated.[16]

---

[15] The high profitability of the supplementary activities can be explained not by the particularities of the price relations, or regulation, but by the low costs. See [26]. Otherwise, from 1983 on, the growth of the supplementary activities came to a stop and in certain fields (e.g. in construction) a setback could be observed. The average profitability of the activities also declined.

[16] Reorganization has, however, so far been practically an administrative process. The latest

3. Although the Hungarian reform process brought about some progress in the evolution of certain enterprise factors, in the last two decades elements which restrict venturing activities were also heavily present. Beside those we have mentioned earlier, these include the following:

— The hierarchical dependence of agricultural enterprises on the state administration has not ceased even following the declaration of the economic reform, but merely the extent of it has been reduced. Even in the present situation the—usually coordinated—intervention of the external, typically local and regional bodies in the daily matters of management is still strong and the abolition of the earlier system of districts[17] brought about no radical change either. A characteristic means of paternalism is to influence the appointment of the enterprise managers and to evaluate their activity. The supervisory bodies also powerfully influence the management of the cooperatives, which are independent from the state, by applying widespread state preferences and discriminations.

Informal interventions in the management of the enterprises cannot be excluded. At the same time, the controlling organs are, on the one hand, able to get the enterprises to carry out activities which would otherwise bring no benefit to them, and, on the other hand, they interfere with the utilization of the enterprise's gross income, or with the disposal of monetary assets. *The proprietary functions are actually divided between the agricultural enterprise and the state, regardless of the form of ownership.*

— *The institutional potentialities of adjustment are limited.* The industrialization carried out with the aid of central programmes—beside decisive technological modernization—restrained the enterprises in selecting technological processes suitable for their endowments. *The hierarchy of allocation granted certain means to the enterprise, but fundamentally restricted their autonomy in selecting and utilizing them.* This way of industrialization was, up to the late 1970s, accompanied by a deteriorating efficiency of the tied up assets and, in the meantime, the agricultural enterprises failed to bring about conditions sufficient for improving their efficiency.[18]

On the other hand, an optimum structure of agriculture in a process of modernization can only be developed by an economically rational combination of the means of production available in particular enterprises,—land, labour and capital. This may also include the partial withdrawal of one or another factor from agricultural production, if it is favourable for the enterprise. However, the objectives proclaimed in the period of the economic reform did not include the creation of a

regulation aimed at arranging the situation of insolvent enterprises cannot as yet be unequivocally evaluated.

[17] Districts were administrative units within counties.—Ed. note.

[18] See [11, 18] on mutual interdependence of agrarian modernization and the political system of institutions in selecting the technologies to be introduced, and for some examples from the third world, see [27].

capital- and a land-market. Though some measures were taken with regard to the flow of capital, the lack of turnover of land, and administrative measures forcing the utilization of land restricted producers' possibilities for adjustment.

In the last few years even enterprises in a good financial position were allowed to resort to their reserve fund only if it was aimed at financing actual losses. Compensation for unrealized profits was rendered possible neither by the rules for using the reserves, nor by borrowing. As a result of this situation developments already commenced were often partly stopped, or postponed. Investments promising high profitability were cut, and many times the consumption of materials and means of production had to be restricted—without reasonable consideration. The maintenance of even simple reproduction became difficult in a significant sphere of agricultural enterprises. These enterprises sometimes even use up some part of their available means, but are unable to provide for their renewal and replacement; further adjustment is out of their reach. [18, p. 32] *The wide variety of options that should be available to a proprietor to act in order to change the current situation is missing*, and such change can only be brought about with state support.

The product structure of agricultural enterprises is still developed very much in the direction expected by the supervisory authorities. These authorities are striving in practice to provide physically defined product quantities (or forecasts of sowing areas, livestock etc.), which are not profitable, or are insufficiently profitable for the enterprise. By observing these expectations enterprises are normally able to produce the volumes of use value determined in the central plans, but such external pressures have at least two further effects. On the one hand, the enterprises cannot shape their product-mix according to their own interests. This implies that they are deprived of some income, i.e. that certain business transactions with higher risks, even though promising greater income, and being outstandingly efficient (but not included in the plan) cannot be realized. On the other hand, fulfilling these demands raised by the authorities means that enterprises are entitled to claim at least partial compensation. It follows that central economic management cannot deal forcefully with an enterprise if its financial problems are partly due to activities forced on it from above.

This specific situation of the agricultural enterprise is called the *responsibility for production*, since—in contrast to most manufacturing enterprises—in agriculture it is not the individual enterprise which decisively covers the domestic demand for a product (or product group). The prevailing production responsibility (i.e. the obligation to utilize the potential elements of agrarian production) is often accompanied by a certain non-explicit expectation, i.e. responsibility for employment, too, especially in the regions where surplus labour is available.

Under present conditions the economic context of agricultural production imposes especially strict constraints on enterprise management. State supervision expects the enterprises to respond profitably to this challenge. At the same time abandoning production that is permanently operating at a loss, has been, even

quite recently, considered a harmful measure, a violation of "national economic interests."[19]

Transferring production risks to the enterprise while simultaneously determining the production structure from above – by regions and enterprises – may cause a state of split personality in the enterprise sphere and, at the same time, it may hinder the spreading of the germs of venturing.

— The requirements imposed on agricultural enterprises are formulated for the most part on the basis of *regional development goals*. Certain regional organizations treat the enterprises—especially cooperatives — as organizations responsible for communal public services. [11, pp. 33–36] *In addition to price disparity, redistribution also afflicts agricultural organizations in terms of the development of settlements*, i.e. it afflicts the typical settlement form of agrarian production, the *village*.

4. About the autonomy and venturing characteristics of agricultural enterprises a complex picture unfolds on the basis of our examination. On the one hand, it can be seen that the financial position of the agricultural enterprise depends, at least to a certain extent, on its success in the market, and, that its survival is not automatically guaranteed. *The interest of an average agricultural enterprise in profitability is more intensive, and its budget constraint is harder than those of a typical industrial enterprise.* Its relatively greater necessity to rely on itself permanently forces it to exploit its reserves and potentials, to operate its production capacity more flexibly, and to rapidly adjust to demand. In the short-term enterprise regulation of the potentially rather price-sensitive output structure (though this sensitivity is often neutralized by intervention of the supervisory authorities) the price-sensitiveness of decisions on investments has recently also increased. It can also unequivocally be seen that the mechanism following the declaration of the economic reform was not quite favourable for venturing, though certain elements that favoured venturing had already evolved in the 1968–1971 period and later, after 1978. *However, even today, Hungarian agricultural enterprises can barely, or, at best, partly be characterized as real ventures.*

[19] Whereas it is easy to admit that first of all the capacities producing with the highest marginal costs ought to be closed down, or converted to product lines which are profitable and presumably also boost the national income.

Small-scale production in the organizational system of agriculture

a) Development and differentiation

In the performance of Hungarian agriculture—especially when comparing it to other sectors—small-scale production is very significant; with respect to several products such production even plays a determinant part. The value of production turned out by the approximately 1.4 million small farms steadily exceeds one-third of the gross output in agriculture, 40 percent of the output in animal breeding, and half of the Net National Product of agriculture.

Hungarian small-scale farming is the product of the creation and development of socialist agriculture. Though in certain particularities it is similar to the family farms, in the Hungarian economy small-scale farming is typically and generally an auxiliary activity (with the exception of some part of the members' farms in the specialized cooperatives). [29]

The small-scale farms have survived, or have developed further, with modified functions. The significance of traditional self-sufficiency has decreased, commodity production came to be determinant, and, simultaneously, also specialization, which is closely connected with the latter, is gaining ground. This functional modification came to pass parallel with a process of differentiation and polarization. The commodity production of the auxiliary farms and household plots is on the increase, in spite of the fact that a growing number of cooperative members and state farm employees are not engaged in agricultural production pursued in a family framework. At the same time, there still exists a (decreasing) number of the traditional type of household plots which are variegated, mainly self-sufficient, and in which only the superfluous products are brought to the market.

In our experience, there are still some traditional-type small-scale farms, run mainly by families of a low educational level. (This is the reason for the low income characteristic of agricultural small-scale production, which, on the average, remained at a far lower level than did the income level of the socialist sector.) At the same time, a venturing stratum has begun to separate itself from the specialized commodity producing farms in which the ratio of better educated families is significant. The role of inertia and the power of tradition, of the pressure to make profit at any rate, and of constraints deriving from the deficiencies of supply, *is replaced by the endeavours of the workers (families) to utilize their working power in rational ways.*

b) Small-scale production in the medium of the commodity-producing economy

The state is able to influence small-scale production as an indispensable sphere of agrarian production almost exclusively by the use of economic tools. This, however, affects the enterprise sector, too. The small-scale farms have made it possible for the supervisory authorities to avoid compelling large-scale production of those products which can be more profitably produced on a small scale.

The costs of small-scale production are, at the same time, rather specific. [30, pp. 1059–1062] Namely, only those inputs which also exist in the form of commodities and are marketable can be taken into account as costs in the strict sense of the word. Those for which there is no market are converted into money only through the return from sales, and their remuneration usually constitutes the more variable part of income. The possibilities of cost reduction are different in particular groups of small farms; the additional costs of an increased quantity of commodity production can be offset by the growing amount of the income.

The groups of farms belonging to the small-scale producers' sector include farms whose situations vary, and who are differentially affected by changes in the market (as well as by the modifications of the regulation system).[20] Generally, commodity producers who are specialized and belong to auxiliary farms without a large-scale farming background, are most sensitive to these changes. These producers are dependent on the market to a much greater extent than the other small-scale farms. Their market position is less protected and their cost background more unfavourable.

The small-scale producers respond to market changes in a specific but not in a uniform manner. [30, pp. 1061–1062] There are two major reasons for this:

1. Since they pursue production in the framework of supplementary activities, their existential safety does not depend on the market. The domestic small-scale producer, who is oriented to commodity production and to maximizing income, is freer in being able to decide whether to continue or stop the production of commodities—i.e. responds to market relations more sensitively and rapidly—than the individual private farmer, or than the large-scale farm.

2. Their reaction is also modified by their perspective of self-sufficiency and production destined for the local market. If the price in the market falls, they reduce commodity production, but maintain their production capacity and utilize it by supplying themselves. Under favourable market conditions the available reserve capacity can result in a rocketing commodity production.

These features of small-scale production are indispensable in the Hungarian economy.

[20] Owing to the lack of space we do not touch upon the effects of taxation, and upon the situation of the purchasing and selling relations of small-scale production. About these issues see [29].

The enterprises—if only because of their relatively high capital-intensity—cannot develop large reserve capacities, thus, for them the possibility to suddenly reduce or increase production is much more limited.

c) The limits to combining the resources

An important factor which limits agricultural small-scale production is the land area that can be obtained by the small producer. The maximum area equals the allowable area of the household plots (0.6 hectare) and strongly restricts potential output. The possibility of renting can substitute for the land market, but this restricts, for two reasons, the investments of the small-scale producers that can be made in land-intensive branches. On the one hand, the current turnover rules of land in private ownership and use are aimed at incorporating the land sooner or later into state or cooperative ownership. On the other hand, in the case of land rented from large-scale enterprises, there is no sufficient guarantee for the pay-off of investment. Hence, small-scale production came to be oriented first of all towards labour-intensive activities adaptable to smaller land areas.

In such settlements as villages, farmsteads and garden-cities, small-scale production is suitable for utilizing otherwise unemployed working capacities. Small-scale production can provide—though at the cost of much work—significant additional income. *At the same time, without appropriate mechanization and modernization, small-scale agricultural production can hardly continue to increase.* According to the current situation, mechanization in small-scale farming is possible only to a very limited extent, and capital has to be replaced by so much work that its economic rationality is already questionable. The country is not prepared to mechanize small-scale production. At present the demand of small-scale farming for machines can be covered neither from domestic production, nor from socialist imports, while capitalist imports are impeded both by their high prices and by the lack of foreign exchange.

In a significant part of the small-scale activities little capital is invested in agricultural production, since the land-, and capital-intensive branches and technologies can only develop in the large enterprises. This has two consequences. Firstly, to enter into small production and become a producer, or to cease to do so, does not entail, in most cases, a great risk. That about two-thirds of agricultural small producers are, by (full-time) occupation, not agriculturalists has to do with this factor. This means that the farming profession is open at the bottom, and even those with neither land nor capital can enter into this sphere. Secondly, above this base level the farming profession is rigidly and strongly limited, for even the owners of small pieces of land have no possibility to accumulate either land or some means of production, since this is, from the outset, impeded by agrarian policy. Under

such conditions even the successful small producer can respond to an increasing market demand by extending his production only between very narrow boundaries.

d) The small-scale farm and the agricultural enterprise

Gradual development has brought, in its wake, a typical division of labour—which is to some extent, a complementary one—between the collective (or state) farms and the household plots.

The relationship between the agricultural enterprise and the household plot is to a great part extrinsic. It is partially based on the fact that the fodder and services needed for field production, which are necessary for the small producers, can only be provided by the large-scale farms.

At present the collective farm provides (increasingly expensive) services for the cultivation of household plots, which are situated mainly in external areas, and can influence them by the integration of purchasing and selling. From this point of view the collective farm has an advantage over any other potential integrator.

Several variant of the relationship between the large-scale agricultural enterprises and the commodity producing small farms are known; tighter and looser types can be found among them. The variant when the agrarian enterprise provides the small producer with the most important conditions of production (sowing seed, fodder, animals for breeding and fattening, services etc.) and, together with that, prescribes certain conditions regarding type and quality of the commodities and the time of selling them, is a closer relationship than that of merely selling and buying. But even so, in most cases the risk of production lies with the small-scale producer.

In the organization of certain dynamic agricultural enterprises another quality of relationship, much more organic than the foregoing ones, was established with the small producers, who *in some cases became subcontractors.* Another system is when the enterprise, beyond providing for the conditions of production and marketing, determines the materials to be used, together with the other parameters of production. In this type of relationship some preconditions of production (such as materials, animals, etc.) are often owned by the enterprise, while the small producer offers his labour power and certain means (buildings etc.). The value of the inputs made by the small producer is usually calculated on the basis of predetermined norms, and the risk of production is divided between the small producer and the integrating enterprise. This method of integration is only one step away from the form of relationship where the employee of the large-scale farm undertakes to perform some activity within the agricultural enterprise on the basis of a contract concluded with the enterprise management. [31]

Organizing the small-scale producers' activities involves significant inputs in

terms of money. The payments received for the services and products sold to the small-scale producer, the commercial trade margin, and trade surcharge of large farms divided between the parties cover such exenditures of the enterprise. For some cooperatives this has resulted in a certain amount of profit, but there are some enterprises where the payments for services performed at direct costs and for certain products having no trading price (e.g. grass fodder) do not completely cover the inputs of the collective farm. It seems, however, that lately the relationship between the small producers and the large-scale enterprises has been changing towards the increasing dominance of commodity and money relations.

The basic problems of the system of interest representation in agriculture

The structure of the interest representation of cooperatives [32, 33]—notwithstanding the undeniable achievements of the representative organs—can be characterized by at least two contradictions:

1. These organizations are not only destined to represent the interest of the member cooperatives in the current system, but also serve to exercise state influence on the cooperatives. *This Janus-faced nature makes it difficult to unambiguously represent the interests of the enterprises* and result in compromises which can unfavourably affect the producers' interests.

2. The organs representing interests ought to simultaneously represent and assert the most varied and often mutually contradictory interests (various interests of enterprises, members, small-scale producers etc.). The undifferentiated combined representation of the interests of various strata makes it difficult for the representative organs to act unambiguously. In addition, certain partial interests may be less intensively represented than other (contradictory) ones which are given priority by the organs in question. It is a hard question whether safeguarding and representing the interests of the cooperative as an economic organization and those of the collective and also personal interests of the cooperative members is inseparable or not. Another question is whether the current state of affairs (i.e. declaration of the formal unity regarding the interests of the cooperative enterprises and their members) means as obvious an advantage in fact as is usually attributed to it.

With regard to the activities of the organs representing the interests of the agricultural cooperatives—based on the experience of the preceding years—we emphasize the following:

1. The representative organs (especially the National Council of Agricultural Cooperatives, under the Hungarian acronym TOT) participate in planning and in developing the economic regulatory system. In such decision-making they strive to represent the interests of their founders but, at the same time, they also under-

take the transmission of central objectives. Owing to their transmission role, these organs—especially the regional associations—came to be powerfully integrated with the hierarchy of state control and sometimes try to influence the production structure of the enterprises (e.g. prompt the cooperatives not to give up certain loss-making agricultural activities etc.).

2. The tensions in management which developed and became palpable most recently and the low profitability of certain sectors of agrarian production forced the representative organs to face new situations. These conditions made it clear that specific sectoral and professional interests are not institutionalized in the present system of interest representations.[21]

3. The significance of the representation of production interests which were developed in the commodity relationships of the cooperative farms and in purchasing and sales, is on the increase.

4. The representative organs also perform certain tasks of the authorities, often those which the state administration is reluctant to carry out. The transferred administrative functions strengthen the assimilation of the representative organs to the state bodies. The fact that legal supervision of the regional representative bodies is exercised in practice by specialized organizations of the county councils, also acts in this direction.

Up to the present period the situation of the *state farms* has been characterized by the lack of any institutionalized representation of their interests. In the absence of a representative body, the National Centre of the State Farms, as their supervisory authority, represented their interests.[22]

The current possibilities for the protection and assertion of small-scale producers' interests are extremely limited; these functions are divided among different organizations of little competency. [29] Such activities of the specialized groups and the home-plot committees only extend to the partnership relations, whereas the roots of the problems are far deeper. In addition, usually the enterprise (farming cooperative, state farm, general consumers' cooperative), on which the small-scale producing organization depends in several respects, is the direct partner. Thus, *the assertion of the small producers' interests is only successful to the extent they coincide, if they coincide at all, with those of the enterprise.*

[21] After the proclamation of the reform—according to the original ideas—within the system of organizations for the representation of interest some branch representations should also have been built up. But such initiatives soon died out and currently in practice only the fishery cooperatives have their own representation within the TOT (National Council of the Agricultural Cooperatives).

[22] The association established as the successor of the AGOK (National Centre of the State Farms), which has been established—beside pursuing certain coordinatory tasks—for the representation of the interests of these enterprises, offers new opportunities and more unequivocal ones than earlier for an institutional interest representation. For evaluating its operation to date however, our available experience is insufficient.

With respect to the representation of the small-scale producers' interests, their coordination in large areas, regions, or in the whole country, is missing. Also missing are the autonomous organizations of small producers, which would be necessary for this purpose. Hence, both the chance to influence decision-making on higher levels, as well as the related information channels, are limited.

At present the protection of the small producers' interests falls within the competency of those organizations which are primarily responsible for representing the interests of the agricultural enterprises and the general consumers' cooperatives. Within the work of these, the behaviour towards the small-scale producers is determined rather by political expectations. Currently, regarding the contacts between large-scale enterprises and small-scale production, the state agencies and social bodies have a broad function of coordinating these interests. At the same time, the structure of the representation of the small producers' interests is built upon indirect and mostly informal means, and can hardly be reconciled with the basic principles of a regulated market mechanism.

The general conditions and main directions of the recommended changes

The objective of overcoming the contradictions in the economic mechanism of agriculture, and the overall development of the system of agricultural organizations postulates a deep-going transformation of the economic mechanism as a whole. It is true also about agriculture that increasing the economic regulatory role of the market would improve the performance potential of society and adjustment capacity of the economy.

We think that the troubles that we have pointed out cannot be solved without comprehensive changes. [34, 35, 23] This does not mean that smaller steps of correction are not acceptable. But we claim with complete certainty that an elastic system of agricultural production oriented toward increasing income producing capacity (and an economic mechanism of this kind) can only unfold through a consistently continued reform process.

For a consistent unfolding of a regulated market, not free from the element of risk, but promising significant improvement of performance, in our opinion, the following changes of the system of institutions, centred on agriculture, are necessary. We have grouped them around seven focal points:

1. *Strengthening the regulatory role of money, monetizing the economy, and institutionalizing the general regulation of demand.*

2. *Institutionally assuring the autonomy of enterprises that are interested in long-term profitability.*

3. *Elimination of the administrative hindrances to resource allocation, institutionalizing the capital and labour markets, and – following appropriate preparation – the land-market.*

4. *Developing conditions of economic competition, bringing out market relationships in the agroindustrial sphere.* [10, 15, 25] A strong line, using economic and legislatory means, has to be taken in order to terminate monopolies and the supply responsibility of the enterprises.

5. *Reduction of the disparity between industrial and agricultural prices and, in general, restricting the role of budgetary redistribution, and finally, connected with this, strengthening the orienting function of prices.*

6. *A more differentiated system of agricultural enterprise structure.* It is necessary to move forward—from the current, extremely polarized enterprise structure—towards the development of elastic small organizations, supplied with capital and land. (Beside the newly established enterprise organizations, also including the autonomy, or the increasing weakening of dependency of certain divisions in some existing enterprises.)

7. *More unambiguous institutional representation of the interests of producers than it is currently the case.* In order to achieve this:

— the quasi-authority functions of the present interest-representing organs ought to be eliminated;

— based on the possible options, an alternative representation of interests has to be created, because a single institutional channel from the outset involves the danger of merely transmitting state intentions;

— for institutionalizing the many-sided representation of interests, it would be desirable to establish a Chamber of Agriculture.

References

1. Kulcsár, K.: A mezőgazdaság helye a magyar társadalomban (The place of agriculture in the Hungarian society). *Gazdálkodás,* 11. 1985.
2. Drechsler, L.—Szűcs, A. Mrs.: *A mezőgazdasági nettó termelési érték rejtélye* (The secret of agricultural net production value). OT Tervgazdasági Intézet, Budapest 1983.
3. Pálovics, B. Mrs.: A mezőgazdaság távlati fejlesztésének gazdaságpolitikai alternatívái (The economic-political alternatives of long-term development in agriculture). Manuscript, Budapest 1986.
4. Pálovics, B. Mrs.: Az élelmiszergazdaság távlati fejlesztése (Long-term development of the food economy). *Gazdaság,* 1. 1983. pp. 45–46.
5. Csáki, Cs.—Rabár, F.: A liberalizálás lehetőségei és következményei az élelmiszer-világkereskedelemben (The possibilities and consequences of liberalization in the world-trade of foodstuffs). *Közgazdasági Szemle,* 12. 1986.
6. Lányi, K.: Magyar mezőgazdaság: export-fölösleg, vagy fölös növekedés? (Hungarian agriculture: export surplus, or superfluous growth?) *Külgazdaság,* 2. 1985.
7. Lányi, K.: A gazdaságos növekedés és export korlátai a magyar mezőgazdaságban (The limits to efficient growth and exports in Hungarian agriculture). *Külgazdaság,* 8. 1984.

8. Halmai, P.: Vállalati kapcsolatok a mezőgazdaságban (Enterprise relationships in agriculture). Manuscript, MTA Közgazdaságtudományi Intézet, Budapest 1985.
9. Halmai, P.: *Társulások a piaci mezőgazdaságban* (Associations in market-agriculture). Közgazdasági és Jogi Könyvkiadó, Budapest 1986.
10. Sipos, A.: Az agrár-ipari szféra vállalati kapcsolatainak rendszere (The enterprise relationship system of the agro-industrial sphere). *Közgazdasági Szemle,* 7–8. 1983.
11. Gönczi, I.: Összefoglaló a mezőgazdasági vállalatok technikai-gazdasági viszonyai c. témáról (Summary on the subject entitled "The techno-economic relations of the agricultural enterprises"). Manuscript, MTA Közgazdaságtudományi Intézet, Budapest 1984.
12. Husti, I.: Összefoglaló a mezőgazdasági vállalatok technikai-gazdasági viszonyai c. kutatásról (Summary of the research project entitled "Techno-economic relations of the agricultural enterprises). Manuscript, Gödöllő 1985.
13. Mózes, L. Mrs.: Lehet-e rugalmasabb és dinamikusabb mezőgazdaságunk gépellátása? (Elasticity and dynamism in the supply of machinery to agriculture). *Közgazdasági Szemle,* 7–8. 1982.
14. Mózes, L. Mrs.: A mezőgazdaság beszerzési szférája (The purchasing sphere of agriculture). Manuscript, MTA Közgazdaságtudományi Intézet, Budapest 1984.
15. Halmai, P.: Az árdiszparitás és az árukapcsolatok fejlesztése (Price disparity and the development of commodity relations). *Gazdálkodás,* 8. 1986.
16. Czakó, Á.: Érdekérvényesítő eszközök és kapcsolatok a vállalati gazdálkodásban (Means and relationships for asserting interests in enterprise management). Agrárgazdasági Kutató Intézet, Budapest 1982.
17. Sik, E.—Czakó, Á.: Összefoglaló jelentés a "Mezőgazdaság beszerzési szférája" c. kutatáshoz kapcsolódó adatfelvételről (Summarizing report on the data collection linked to the research project entitled "The purchasing sphere of agriculture"). MTA Közgazdaságtudományi Intézet, Budapest 1984.
18. Vági, F.: A mezőgazdasági nagyüzemek vállalatisága a gazdaságirányitásban (Enterprise character of the agricultural large-scale farms in economic control). MTA Közgazdaságtudományi Intézet, Budapest 1984.
19. Vági, F.: Növekedés a mezőgazdaságban és gazdasági szervezeteiben In: *Hatékonyság és növekedés szocialista mezőgazdaságunkban* (Growth in agriculture and its economic organizations. In: Efficiency and growth in Hungarian socialist agriculture). Mezőgazdasági Kiadó, Budapest 1986.
20. Potoczky, J.: Tőke és pénzpiac a nagyüzemi mezőgazdaságban (Capital- and money-market in the large-scale agriculture). Manuscript, MTA Közgazdaságtudományi Intézet, Budapest 1985.
21. Vági, F.: A szervezeti megújulás szükségessége a mezőgazdasági szövetkezetekben (The need for renewing the organization in the agricultural cooperatives). *Közgazdasági Szemle,* 7–8. 1985.
22. Menényi, M.: Az állami gazdaságok társadalmi–gazdasági szerepe és jellege (The socio-economic role and characteristics of state farms). Manuscript, MTA Közgadaságtudományi Intézet, Budapest 1984.

23. Sipos, A.—Halmai, P.: A mezőgazdaság szervezeti rendszere a gazdasági reformfolyamatban (The organization system of agriculture in the economic reform process). Manuscript, MTA Közgazdaságtudományi Intézet, Budapest 1986.
24. Graeme, T.: In praise of pluriactivity. *CERES 96* FAO, Rome 1983.
25. Halmai, P.: A mezőgazdasági mechanizmus egyes működési sajátosságai (Some specific operational features of the agricultural mechanism). Manuscript, MTA Közgadaságtudományi Intézet, Budapest 1983.
26. Papp, S.: A mezőgazdasági termelőszövetkezetek ipari tevékenységének eredményei és problémái (The results and problems of industrial activities in the agricultural cooperatives). *Ipargazdasági Füzetek,* I. 1983.
27. Stockhausen, J.V.: Staat und Landwirtschaftliche Entwicklung in den Landern der Dritten Welt. *Berichte Über Landwirtschaft*, 3. 1985.
28. Vági, F.: Az új gazdasági feltételek és az agrárpolitika (The new economic conditions and agrarian policy). *Gazdálkodás,* 11. 1985.
29. Tóth, A.E.: Kistermelés szocialista mezőgazdaságunkban (Small-scale production in Hungarian socialist agriculture). Manuscript, MTA Közgazdaságtudományi Intézet, Budapest 1986.
30. Tóth, A.E.: A mezőgazdasági kistermelés árutermelési tendenciái, jövedelme és annak szabályozása (The commodity production trends of small-scale agricultural production, its income, and regulation of the income). *Közgazdasági Szemle,* 9. 1982.
31. Németi, L. Mrs.: A kisvállakozás lehetőségei, esélyei a mezőgazdaság kistermelésben (The possibilities and chances of small-scale venturing in the small-scale production of agriculture). *Közgazdasági Szemle,* 10. 1982.
32. Zsarnóczai, S.: A mezőgazdaság érdekvédelmi rendszere (The system of protecting interests of agriculture). Manuscript. MTA Közgazdaságtudományi Intézet, Budapest 1985.
33. Zsarnóczai, S.: A szövetkezetek gazdálkodásának külső feltételrendszere (The external system of conditions of the cooperatives' economic management). *Szövetkezés,* 2. 1986.
34. Tardos, M.: Program a gazdaságirányítás és a szervezeti rendszer fejlesztésére (Programme for the development of the economic control and the organization system). *Közgazdasági Szemle,* 6. 1982.
35. Tardos, M.: A szabályozott piac kialakításának feltételei (The conditions of developing a regulated market). *Közgazdasági Szemle,* 11. 1985.
36. Sipos, A.—Tardos, M.: *Beszámoló az OKKFT-B/1 jelű program végrehajtásáról (1981–1985)* (Report on the accomplishment of the national research programme marked OKKFT-B/1 /1981–1985/). Budapest 1986.

ОРГАНИЗАЦИОННАЯ СИСТЕМА И ХОЗЯЙСТВЕННЫЙ МЕХАНИЗМ В ВЕНГЕРСКОМ СЕЛЬСКОМ ХОЗЯЙСТВЕ

А. ШИПОШ – П. ХАЛМАИ

Развернувшийся в Венгрии с середины 1960-х годов процесс экономической реформы сопровождался глубокими изменениями в хозяйственном механизме аграрного производства и в организационной системе. Цель реформы состояла в создании регулируемого государством рынка и — что является условием этого — хозяйственной самостоятельности. Процесс реформы способствовал шагу вперед в создании отдельных элементов предпринимательства. Однако в действительности, как это показывается в статье, постоянно и с большой силой действовали факторы, ограничивающие предпринимательство. Так, сохранились диспропорции сельскохозяйственных цен, модернизация сельского хозяйства шла не эволюционным путем, а с помощью проводимых в порядке кампаний программ по инициативе вышестоящих органов, что подкреплялось иерархической системой распределения ресурсов, ограничивались институциональные предпосылки приспособления, возможности выбора вариантов затрат и выпуска, отсутствовала предпринимательская автономия, производственные единицы де факто находилисъ в иерархическом подчинении, между предприятиями и сегодня в значительной части действуют не рыночные связи.

В статье подробно рассматривается процесс обезличивания кооперативной собственности, положение с дифференцированным развитием мелкого сельскохозяйственного производства, представлением интересов.

Согласно точке зрения авторов, регулируемый рынок и ликвидация ограничивающих предпринимательство факторов могут быть достигнуты только в рамках всеобъемлющего и комплексного процесса реформы, предпосылкой которого является также и то, что вместо односторонне ориентированной на количество производственной политики решающее значение приобретет направление, ставящее цель повышения доходности. Основные моменты желательного ценообразования — усиление регулирующей роли денег, институциональное обеспечение автономии заинтересованных в долгосрочной прибыли предприятий, ликвидация административных препон перетоку ресурсов, развертывание рыночных связей, снижение ценовых диспропорций и бюджетного перераспределения, усиление ориентирующей функции денег, более дифференцированная система структуры предприятий, более органичное включение в нее мелкого производства и более простых форм кооперации, налаживание более определенного представления интересов сельского хозяйства.

Acta Oeconomica, Vol. 39, (3-4), pp. 231-245 (1988)

THE PERFORMANCES OF HUNGARIAN AGRARIAN PRODUCTION SYSTEMS AND THE INCOME PRODUCING CAPACITY OF THE PARTNER FARMS

F. FEKETE

The author seeks an answer to the question how performances and the income producing ability can be increased in modern agricultural production systems. He examines the share of the production systems in the Hungarian economy. Comparing them to the farms outside the system, he analyses in detail the position of the four biggest plant production systems, the indicators of output, income and profitability in the branches of cultivation of the farms which belong to the systems.

Nowadays, in the Hungarian economy and in public life, it is a key question, as to how performance and income-producing capacity can be enhanced (and let us add: realistically measured). We have to search for a quantified analytical answer which is based on a sound methodology and adaptable to the possibilities of recording and accounting. It should also take into account the experience and observations gained by the up-to-date agrarian production systems.[1]

The study outlines the position and share, in Hungarian agriculture, achieved by the production systems which have gained great significance from both quantitative and qualitative viewpoints. The following characterizes the performance of those production branches of the member farms which are connected with the systems, mainly on the basis of output indicators and average yield (i.e. efficiency of land utilization, or, employing the "traditional" Hungarian terminology of agrarian economics, 'intensity'). The results will then be compared with the performance of farms outside the systems and with the average performance of branches not involved in the modern production systems.

[1] The study is based on a part of some ongoing research work, in partnership with Katalin *Sebestyén*. We have also made use of the information and lessons we learned from work on the corporate organs of the most widespread production systems and other inter-enterprise organizations and through personal consultations with the leaders of the system centres and the member farms. The contribution of Iván *Benet*, Katalin *Daubner* and Éva *Palcsó-Zám* should also be acknowledged in connection with this work. We wish to express our thanks for the help given by the above mentioned persons. Of course, for any errors in this paper the author alone is responsible.

The production systems as enterprising organizations aimed at cooperative surplus performance

In our earlier paper [1] we were dealing with industry-like production systems as cooperative associations of enterprises—namely, an undertakings consisting of a system centre and member farms. The members are typically agricultural organizations, i.e. large-scale agrarian enterprises which are linked to the system not through their whole operation but only through a part of their activities (through certain branches). They keep their enterprise autonomy even after having joined the system. The *system centre* can be found on the other side of the cooperation within the system. The enterprise-character and economic separation of the system centre depends on the organizational and legal form in which the production system operates. The major forms are: bilateral agreement (enterprise contract), economic association and joint venture.

In 1987, 62 production systems were operating in Hungarian agriculture. From this figure 20 were engaged in plant growing, 24 in animal husbandry and 18 in horticultural branches. 28 production systems (45.2 percent) were economic associations. A smaller number 22 = 35.4 percent), were formed by bilateral agreements and only 12, i.e. about one fifth, were joint ventures.

In the name of several systems working in the form of joint ventures, the expression "agrarian development" can be found. This term would practically suit any of the production systems, since, based on the division of labour between the system centres and member farms, research and development as advanced and ramifying activities are concentrated in the system centres.[2]

The 50 production systems which do not operate in the form of joint ventures, are managed by farms or other enterprises responsible for the system. They are mostly agricultural enterprises, but industrial and other types of economic units have also undertaken the organization of systems. In 1987 the majority of the responsible units were state farms. Of the 50 production systems almost half (23) are managed by state farms; 20 are managed by agricultural cooperatives; and in 5 cases industrial companies are responsible for management. Furthermore, a commercial enterprise and even a production system itself, TAURINA,[3] are also responsible leaders of a production system. Of the five industrial firms, two belong to the food industry, and two to the textile industry; they organized the system in order to cover their raw material requirements. The fifth one is the chemical factory

[2]The use of the term "agrarian development" is due to the fact that, from 1982 on, financial regulation favoured the so-called "development companies". Later on this preference was discontinued and the current regulation of the development companies does not differ from that of any other enterprise.

[3]The BOVINA production system for beef cattle and sheep breeding has been organized by the TAURINA joint venture for agrarian development.

ALKALOIDA which also organizes the production of poppies for the purpose of its own raw material supply.

Within the production systems two spheres of modern agrarian activities i.e. research and development ($R + D$) on the one hand and mass commodity production on the other, are structurally separated from one another—yet linked in a specific way. Large-scale commodity production is pursued in the member farms which produce the same products "in parallel" and through horizontal cooperation, i.e. without a division of labour. $R + D$ and, furthermore, the advisory and training activities closely linked to them are —beyond management and control— centralized in the system headquarters. Advice and training—together with the material services—connect the $R + D$ activities of the centre with the commodity production in the member farms. In many respects the latter is a routine operation.

The enterprises (enterprising organizations) participating in the production systems have established and maintain the systems because in this way they are able to achieve some additional result (a cooperative surplus performance), in comparison to what they could perform without joining the systems. Cooperation can contribute to greater performance in three ways:

1. Identical inputs can be more efficiently utilized, i.e. they bring about larger outputs, since the division of labour and specialization allow the economical assertion of special knowledge (skills) and capabilities or faculties (quality). (This is one of the typical ways of intensive growth—also suitable for the better exploitation of material production factors that cannot be augmented.)

2. Through the aid gained by cooperation larger quantities of inputs can be used which, under the conditions of sound management, result in greater outputs. (Such a phenomenon shows up in "pure" form when, on a given land area, the level of intensity in the conventional sense of the word is raised.

3. More up-to-date means serve as sources determining the cooperative surplus (which is a factor of growth and extended reproduction stemming from scientific and technical development). The cooperative surplus is expressed both in the income and the performance indicators (it also appears in other factors).

We are going to analyse the cooperative surplus and other achievements and development opportunities of a production system on the basis of the field crop production systems. This will rely heavily on the data and experience of four big systems.[4]

Thus it will be possible to study more or less separately the specific position, achievements, difficulties and sources of growth of the agrarian production systems.

[4] The four big systems are: the Bábolna Industrial Corn Production system (IKR), the Corn- and Industrial Plant Producing Association of the "Vörös Csillag" Agricultural Cooperative of Nádudvar (KITE), the Socialist Corn Production Collaboration of Szekszárd (KSZE) and the Corn Production System of Baja (BKR). Owing to the lack of necessary data and information we were compelled to omit the study of another very large enterprise—the Production system of Cereals and Industrial Plants of Szolnok-Rákóczifalva (GITR).

The characteristics of the horticultural and animal-breeding systems in Hungary are, at present, primarily and most directly determined by their particular economic conditions, first of all by the high living-labour-intensity of production. The producer price level, the prices of the inputs of industrial origin and central financial regulation (the system of subsidies also, and taxation) are linked with the techno-economic characteristics of these two activity groups (e.g. with their live labour requirement and the presonal income aspects of it) in such a way that in these areas, the performances and development opportunities of the modern production systems cannot be explored by an economically well-founded analysis within the framework of a short study.

The absolute and relative dimensions of the production systems

The vast majority of the Hungarian large-scale farms (agricultural enterprises) are members of some production system. This situation has not changed since 1985, when only 35 of the 1399 large-scale farms did not belong to any of the production systems involving some of their production branches. Most of the systems' participants are agricultural enterprises, i.e. state farms or agricultural cooperatives. Even some industrial and commercial enterprises take part, mainly in the larger production systems. In addition to this, certain organizations of a non-enterprise character (research and educational institutes) also join the production systems as members. In 1985 the ratio of the various types of members was as follows (in percent):

State farms, combines	8.6
Cooperative farms	82.3
Special agricultural cooperatives	1.3
Other organizations	7.8
Total	100.0

The cooperatives participate in the production systems in a greater proportion than their share in the land area of large-scale farming and in the total output of products.

The land area covered by the systems had increased from 2599 thousand hectares in 1981 to 3039 thousand by 1985, i.e. by more than one-seventh (16.9 percent). Thus the share of the production systems in the arable land under large-scale operations grew from 60.1 to 68 percent and from 10.1 to 18.4 percent in the areas of pasture.

In respect of the field crops, the area of cereals and lucerne grew at the highest rate. The area of a few important crops (corn, sugar beet, potato) decreased.

Table 1

Land area of the major field crops in the production systems in 1981 and 1985

Products	Area (thousand ha)		The 1985 area as a percentage of that in 1985	Percentage of the systems' share in the total area of large scale farms
	1981	1985		
Wheat	984.5	1174.3	119.27	89.01
Winter barley	26.8	88.6	330.42	49.87
Spring barley	36.9	34.6	93.80	44.47
Corn	809.2	758.0	93.67	92.40
Rye	12.9	10.9	85.30	100.00
Sunflower	241.6	258.9	107.18	76.88
Sugar beet	104.4	99.7	95.44	97.28
Potato	9.2	6.7	72.11	50.31
Lucerne	68.3	97.8	143.30	31.49

Source: A termelési rendszerek főbb ágazatainak költség- és jövedelemviszonyai a VI. ötéves tervidőszakban (Cost and income relations of the major branches of the production systems in the 6th five year plan period). MÉM STAGEK, Budapest, 1986.

Between 1981-1985 the average yields of field crops were higher in the production systems than they were in the farms outside the systems. Therefore their proportion in the quantity of output was also greater than it was in the land area.

In view of the changes in their output, the examined crops can be divided into three groups. In the production of wheat and winter barley, as well as in that of lucerne there was a significant growth. The output of spring barley, corn and sunflower did not change singificantly. The production of sugar beet and potato was considerably lower. The member farms of the systems responded to the changing income position of the branches in question, by modifying the sown area, this having been the primary factor in the changes of the quantities produced. The reduction in corn production, or the substantial extension of the area of wheat and winter barley, bear witness to this fact.

The member farms further increased their share in the output of the most important crops between 1981 and 1985 (with the exception of corn). In 1985 they produced 90.5 percent of the wheat, 93.6 of the corn, 78.1 of the sunflower and 97.4 percent of the sugar beet of all large-scale farms (see *Table 2*). The shares, calculated on the basis of the total five-year production, are characteristically between those of 1981 and 1985; they were 89.1 percent in wheat, 92.7 in corn, 82.2 in sunflower and 94.0 percent in sugar beet. Only in the case of sunflower was the 1985 share of the production systems less than the five-year average, in conformity with the declining trend of the output.

In 1986 the *four big field crop systems* included 1137 member farms. The overwhelming majority of them (95.8 percent) were large-scale agricultural enterprises

which accounted for 78.2 percent of the total number of large-scale agricultural economic organizations. At the same time, out of all the partner farms which joined the production systems, 83.4 percent are concentrated in the four big systems. (In 1981 these proportions were 68.6 and 71.4 percent, respectively.)

Table 2

Production volumes of the field crops in the production systems in 1981 and 1985

Products	Production volume		production as a percentage of that in 1981	in the total of large-scale production (%)	
	1981	1985		1981	1985
Wheat	4011	5746	143.3	89.3	90.5
Winter barley	93	355	381.7	21.7	50.2
Spring barley	1115	120	104.3	29.0	45.3
Corn	5251	5230	99.6	92.3	93.6
Sugar beet	4115	3817	92.8	88.0	97.4
Sunflower	512	516	100.8	82.4	78.1
Potato	243	173	71.2	46.3	56.2
Lucerne	425	600	141.2	22.7	31.9

Source: A termelési rendszerek főbb ágazatainak költség- és jövedelemviszonyai a VI. ötéves tervidőszakban (Cost and income relations of the major branches of the production systems in the 6th five-year plan period). MÉM STAGEK, Budapest 1986.

Concerning the number of member farms attached to these production systems at present, the greatest one of these is KITE with 412, and smallest is BLR with 171 member farms. Between 1981 and 1986 the total number of the members of the "big four" increased by 14.3 percent.

In all four systems non-agricultural enterprises also participate. Most of them, 22 in number, are members of BKR. The smallest group comprises the non-agricultural organizations in KITE, amounting to not more than 1.5 percent of all of its member enterprises. Between 1981 and 1985 the total area of the "big four" increased by 14 percent. Within that, KITE extended its area by 33, KSZE by 21, IKR by only 4 percent while BKR reduced its area by 29 percent.

The "big four" increased their output of wheat, corn and sunflower.

With the exception of sugar beet output, the production of the most important crops was larger in 1986 than in 1981. The increases were greatest in wheat (45.5 percent), followed by sunflower (19.9 percent) and by corn (11.6 percent).

From among the four big systems the production of wheat and corn increased at an above-average rate in KITE. In the KSZE the growth rate of every product was higher than average, but the increase was greatest in sunflower production. In the IKR the growth rate in the output of wheat and sunflower exceeded the average level. In contrast to the above the output of all the examined products declined in the BKR.

Table 3

Changes in the production volumes of four crops in all, and in the examined four, big production systems

Products	Total 1985 production of the production systems as a percentage of 1981	Production of the four big production systems as a percentage of that in 1981	
		1985	1986
Wheat	143.3	154.8	145.5
Corn	99.6	96.3	111.6
Sunflower	100.8	95.8	119.9
Sugar beet	92.8	93.4	91.3

In 1985 more than two-thirds of the output of the four major crops—93.9 percent of corn, 82.5 of wheat, 68.7 of sunflower and 79.4 percent of sugar beet—came from the four big field production systems. In 1985 the share of the "big four"—except in sunflower—was higher than it had been 4 years earlier.

During the period under analysis—as we have already mentioned—the number of the member farms grew most rapidly in the KSZE. Therefore its share in the *number of members* increased while that of the other systems declined. With regard to *land area* drawn into the systems the KITE increased its share from 33.6 to 39.5 percent. The share of the KSZE also grew, and at the same time there was a slight decrease in the share of IKR and a significant one in that of BKR.

KITE extended the system to other crops (beets, soybeans, french beans etc.) and increased the land for fodder production. It could thus increase its land area faster than the number of the member farms and in this way the area per member farms grew also larger.

The different growth rates changed the ratios of outputs between the systems (in the combined output of the "big four"). KITE enhanced its production ratio in wheat and corn, but its share in sunflower and sugar beet grew less. In 1986 the members of KSZE represented a higher proportion in all four crops than they did five years earlier.

IKR's share in wheat and sunflower increased, while it declined in the other two crops. The proportion of BKR's member farms declined in the output of each type of produce.

Table 4 gives information about the activity groups linked to the crops of the "big four" both about the relative proportions and about the "weights" (the shares in the total large-scale farming area) of the systems we have studied in detail.

In all four systems the production of field crops is dominant, standing at a level of approximately 95 percent. Relatively small are the areas of pastures and meadows, especially in KSZE. Based on area relations, cereals and corn are

Table 4

Distribution of the joint area of the four field crop systems and its share in the total area of large-scale farming in 1986 (percent)

Products	KITE	KSZE	IKR	BKR	Total	Percentage of share of the four systems in total area of large-scale farms
Cereals	45.2	42.8	47.3	44.9	45.0	62.4
Corn	28.6	31.5	37.0	27.3	31.4	79.4
Silage corn	2.7	6.0	1.5	4.7	3.5	–
Sugar beet	4.1	2.4	2.5	–	2.9	67.6
Oil plants	8.0	13.4	6.6	10.0	9.4	–
Soybean	0.4	0.1	0.2	0.6	0.3	–
Lucerne	1.8	2.7	1.2	4.9	22.2	17.0
Other plants	5.1	–	0.2	1.5	2.2	–
Total field crops	95.9	98.9	95.5	93.9	96.9	51.8
Grass (meadow+pasture)	4.1	1.1	3.5	6.1	3.1	6.8
Grand total	100.0	100.0	100.0	100.0	100.0	–

Source: The internal materials of the production systems.

determinant, their joint proportion exceeding 70 percent in all four systems, and being especially high in IKR, at 84 percent.

The systems' physical performances in the member farms

We shall investigate the performances of the production systems in three sections—in the member farms, in the system headquarters and in a framework including both.[5] The performance analysis will cover inputs, outputs and efficiency and profitability indicators which are quotients of the former two. The latter ones also reflect the internal sources of economic development.

It is expedient to begin the study of relevant performances of the member farms with gross and net output of the systems branches. Gross output can be expressed by the quantity of products or the value of output produced by the branches belonging to the systems. For characterizing the net output regarding the crops involved in the systems our database allows—from the spheres of the gross income (net output value), enterprise net income (profit), and centralized social

[5] The study of the two latter spheres and a description of the development trends are contained in [2].

net income (taxes and similar payments for central purposes)—us to use the net income of the branch. This is practically the difference between the gross output value of the crops of the systems (at average selling price), and the total cost of production.

Comparison of the outputs within and without the systems renders it possible to exhibit a special form of cooperative surplus—the so-called "negative cooperative surplus". This is the quantity of products that has failed to come about because the farms outside the systems have achieved a lower specific yield than that of the production systems.

We calculated the negative cooperative surplus using two variants. First we reckoned with the average output of the production systems, i.e. we examined how much greater the output (in the most important crops turned out by the large farms) would have been if the yield achieved by the production systems had also been achieved by the farms not belonging to production systems. In this case 1.7 percent more wheat, 1.9 percent more corn, 1.5 percent more sunflower and 0.5 percent more sugar beet could have been used for increasing domestic consumption and/or exports. In the course of the given five-year period this would have amounted to several tens or hundreds of thousand tons.

Table 5

Potential surplus production calculated on the basis of the systems' average yields in the total period of 1981-1985, in two variants

Product	Quantity of surplus production (thousand tons)		Ratio of the surplus production (in percent)	
	Variant 1*	Variant 2**	Variant 1*	Variant 2**
Wheat	489.3	1224.0	1.7	4.2
Winter barley	63.3	344.7	2.2	11.8
Spring barley	79.7	361.7	4.5	20.5
Corn	542.8	1083.6	1.9	3.8
Sugar beet	113.7	640.4	0.5	2.9
Sunflower	44.3	105.0	1.5	3.5
Potato	228.4	371.9	11.8	19.2
Lucerne	426.4	932.6	4.6	10.0

Note:
*Variant 1: Calculated with the average yields of the production systems.
**Variant 2: Calculated with the average yields of the "four big" production systems.
Source: Own calculations based on the data of MÉM STAGEK.

In the second variant our calculations were based on surplus of the average yield of only the four big systems.

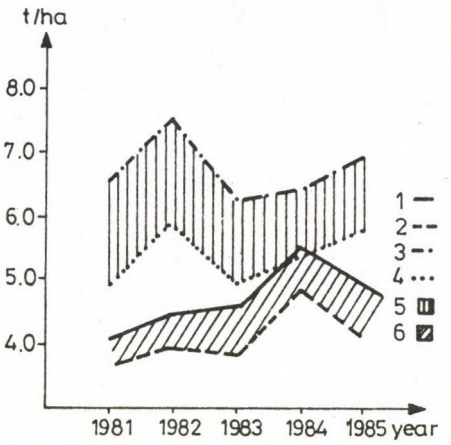
In this way the surplus which failed to be produced seemed to be even more significant: in wheat it was 4.2 percent, in corn 3.8 percent, in sunflower 3.5 percent and in sugar beet 2.9 percent.

For assessing the performance of the production systems the return from sales and the calculated value of output can be used. Information available allows calculation of the value of production. Calculation based on the data of the "big four" can be made in two ways. One of them is to express the quantity of the products in the form of money (value) by using the procurement prices. The average selling price, however, is higher than the procurement price. Therefore—and this is the other way—a more realistic output value can be calculated by applying the selling prices. The indicator of the "output value" obtained in this way is closer to the actual sales receipt. (This would have been, namely, the sales returns of the member farms, had they sold all their products in procurement and other markets. This assumption is realistic in the case of the "industrial" crops, e.g. sunflower or sugar beet. But a significant portion of wheat and corn is used by the member farms for feeding their own livestock.)

According to calculations made at the average prices of 1985, in comparison with 1981 the value of the combined output of the four big systems in the four crops increased by 37.1 percent. Within the 1985 production figures the share of KITE was 38.6 percent, that of KSZE 28.8 percent, of IKR 26.1 percent and that of BKR was 6.3 percent. Compared to 1981—conforming to what we said above about the number of the member farms and the changes of the system areas—the share of KSZE within the total output value increased (by around 3 percent), the proportion of KITE remained unchanged, and those of IKR and BKR declined (the former by 0.3 percent and the latter by 3.3 percent). It may be mentioned that in relation to the preceding year, the proportions of 1986 did not change in IKR and BKR, increased in KSZE and somewhat declined in KITE.

The average production index relates to the above characterized gross output to a unit of land area. Considering its nature, this is a partial efficiency indicator; it reflects the utilization level of agriculture's most important resource, i.e. that of land. It is at the same time an important indicator of intensity which, from the trinity of relationships: land-output-yield, emphasizes the relationship between land and yield, i.e. it characterizes intensity regardless of output. In static form it represents the level of intensity and the dynamic changes in intensity, i.e. the deviations towards either intensive or extensive extended reproduction and economic management.

The graph in *Figure 1* shows that in the production of the two major crops of the systems, i.e. in wheat and corn, the systems reached higher averages than the farms which did not join any system. In the figure the area between the two corresponding lines can be understood as a kind of physical cooperative surplus. The annual changes of the averages reflect the impact of the weather conditions, too. The lines, which demonstrate the changes of average production in the analysed



1. Average yield of wheat in the production systems
2. Average yield of wheat in the farms outside the production systems
3. Average yield of corn in the production systems
4. Average yield of corn in the farms outside the production systems
5. Cooperative surplus in the production of corn
6. Cooperative surplus in the production of wheat

Fig. 1 The average yield of wheat and corn in the production systems and in the farms outside the systems

branches of the farms within and without the systems, proceed almost in parallel.

Between 1981 and 1985 the production systems maintained their advantage of average yield in the analysed areas, although they were able to enhance it only in wheat and winter barley. The average yield incrased more rapidly in the farms not belonging to any system, owing to the fact that, starting from a lower level, the opportunities to raise the yield were usually greater.

In order to eliminate the fluctuations caused by the weather conditions, we have calculated the five-year averages of the yields *(Table 6)*. According to this, the averages of the production systems exceeded those of the farms outside the systems in respect of every examined crop, albeit to different degrees. The greatest difference representing the cooperative surplus was found in the yields of corn, where the average of the farms belonging to the systems was 25.3 percent higher. The difference in the yields of potato is almost the same.

The 1986 average yields of all the production systems are as yet unknown. From reports and the internal data of the four big plant cultivation systems, however, the conclusion can be drawn that the average yield of the production systems

Table 6

Average yields of the years 1981-1985 in plant production (tons/ha)

Products	Averages of the years 1981-1985 (t/ha)		Cooperative surplus (in percent)
	In the production systems	In the farms outside the production systems	
Wheat	4.7	4.1	16.0
Winter barley	4.0	3.8	3.3
Spring barley	3.6	3.3	9.6
Corn	6.7	5.4	25.3
Sugar beet	39.2	37.0	5.9
Sunflower	2.0	1.9	8.6
Potato	26.1	21.0	24.7
Lucerne	6.2	5.8	6.5

Source: The same as in *Tables 1* and *2.*

Table 7

Average yields of the four big production systems in 1986 (t/ha)

Products	KITE	KSZE	IKR	BKR	Average of the four systems	Cooperative surplus in percent
Wheat	4.5	4.8	4.7	4.5	4.6	5.7
Winter barley	3.6	3.8	4.2	2.4	3.6	7.8
Rye	2.5	–	2.3	1.7	2.2	11.8
Spring barley	3.6	4.3	3.7	4.2	3.9	12.6
Corn	7.3	7.0	7.1	6.9	7.1	5.1
Silage corn	20.2	24.4	35.6	–	24.3	16.7
Sugar beet	39.4	37.1	36.8	–	38.3	5.6
Sunflower	2.3	2.3	2.5	2.1	2.3	6.1
Rape	2.0	2.3	2.0	1.8	2.2	–
Soybeans	2.0	–	2.4	2.4	2.2	–

Source: Internal materials of the production systems.

surpassed the averages of all the large-scale farms, even in 1986 (see *Table 7*). The differences varied by crops but in the yields of wheat, corn, sugar beet and sunflower (which were determinant with regard to the shares of land area) there were increases of around five percent.

The average yields of the "big four" show the following results: e.g. in the case of KITE, rye, potato and lucerne rose above the average level, by surplus yields of 23.4 percent, 13.0 percent, and 15.5 percent, respectively. In KSZE significant surpluses appeared in winter barley (12.7 percent) and spring barley (26.2 percent);

in IKR the production of winter barley, rye and sunflower significantly exceeded the averages of the large-scale farms.

Characteristics of the cost and income relations

The aggregate performance of the production systems, as well as that of the selected "big four", can be measured in monetary terms by *indicators of cost and income*—in our case primarily by the direct costs and net income of the branch. We have already defined the latter; the former means the sum of the direct costs accounted to the product or the product group (i.e. to the so-called branch), and the general overhead costs of the main branch. This means that it does not contain the indirect costs spent on management at the corporate level, (of the so-called central guidance) nor the land tax.

The product cost depends on two factors; these are the cost per hectare and the average yield. The cost per hectare of current agricultural production increased between 1981 and 1985, both in the member farms of the systems and in the large-scale farms operating independently of the systems.

In the systems the *direct costs* are higher, which means that the member farms reached the higher production with greater inputs, i.e. at more costs. All the typical cost items—fertilizers, plant protection, auxiliary operations—are higher in the production systems. In cereals and lucerne the additional costs amount to 6–8 percent, while in the branches of sunflower and sugar beet growing only minimum extra costs appear.

Despite the higher cost per unit of land area the costs per unit of product are still more favourable in the member farms of the systems.

According to the average of the years 1981–1985, the unit costs of products were 7.8 percent lower in wheat and 13.5 percent lower in corn in the production systems than in the farms outside the systems. In the system-controlled production of the other field crops the level of the direct costs was also somewhat lower.

The decisive direct cost data, calculated by using slightly different procedures, are somewhat higher in the four big systems than the averages of the production systems. The differences in the structure of activities, especially the preponderant practice of renting machines (for example, introduced over almost the whole area of IKR) make the comparison very difficult.

The indicators of total product cost, including the overheads, are also more favourable in the production systems, e.g. in the five-year average of corn the figure is 12 percent, and for wheat it is 6.4 percent.

The comparison of the *net branch incomes* of the systems, with those incomes of the farms outside the systems (already analysed above) allow us to determine the cooperative surplus in the form of income.

Owing to the advantage of the production systems that appear in the average yields, the cooperative surplus—expressed in the form of net income per unit of land area—reached 141 percent in the case of corn and 25.6 percent in that of wheat.

The fact that the net branch income per unit of product and per unit of area is usually lower in the big systems—except in KSZE—than the average of all the field crop producing systems, is due to the varying critical spheres of the production costs—as we have already pointed out above—and to the very different methods of accounting. This phenomenon would need a further and more detailed analysis.

Table 8

Branch net income per product unit as an average over the years 1981-1985

Products	Average of 1981-1985 (Ft/t)		Cooperative surplus (percent)
	in the systems	in the farms outside the systems	
Wheat	958	885	8.2
Winter barley	812	717	13.3
Spring barley	1199	1497	-19.9
Corn	660	343	92.4
Sugar beet	242	226	7.1
Sunflower	2949	3150	-6.4
Potato	7786	553	42.1
Lucerne	550	336	63.7

Source: The same as in *Tables 1* and *2*.

By comparing production costs and incomes we arrive at profitability indicators (rates). The rate of net income of the branch, per unit of costs (indicating the cooperative surplus reached), was considerably higher in the average of the production systems—by 118.7 percent in corn and 15.6 percent in wheat—than it was in the farms outside the systems. (As regards the incomes stated and the profitability rates, the position and differences of the four big systems are the same.)

The data processed above, which relate to the partner farms which joined the agricultural production systems, according to current experience, bear witness to successful operations. In the establishment of the systems the relatively low-level supply of agriculture with the means of production has played a significant part.[6] However, overcoming relatively rapidly the initial difficulties, the operation

[6] In the expert opinion of Csaba *Csáki* the Hungarian agricultural production systems are typical results of the shortage economy and if there had been a broader range of choice of the means of production and competition by agricultural machine imports, it is very likely that different situation would have developed in Hungary.

of the systems has greatly contributed to the general rise of the production level in Hungarian agriculture.

References

1. Fekete, F.-Sebestyén, K.: Az iparszerű termelési rendszerek közgazdasági tartalma és távlatai (The economic content and perspective of industry-like production systems). *Közgazdasági Szemle,* 5.1986.
2. Sebestyén, K.: Agrártermelési rendszereink teljesítményei és fejlesztési lehetőségei (Performance and development possibilities of the agrarian production systems of Hungary). *Közgazdasági Szemle,* 10.1987.

ПРОИЗВОДИТЕЛЬНОСТЬ ВЕНГЕРСКИХ АГРОПРОМЫШЛЕННЫХ СИСТЕМ И ДОХОДНОСТЬ ВХОДЯЩИХ В НИХ ХОЗЯЙСТВ

Ф. ФЕКЕТЕ

Автор ищет ответа на вопрос, как можно повысить производительность и доходность современных агропромышленных производственных систем. Рассмотрев долю производственных систем в венгерском сельском хозяйстве и сравнив их с хозяйствами, не являющимися членами систем, он более подробно касается положения четырех крупнейших растениеводческих систем и анализирует показатели производительности, доходности и прибыльности хозяйств-членов отраслевых систем. Входящие в системы земельные территории возросли с 2599 тыс.га в 1981 г. до 3039 тыс.га в 1985 г., т.е. более чем на 1/7 частъ (на 16,9%). Тем самым на пахотных землях крупных хозяйств доля производственных систем возросла с 60,1% до 68%, а на пастбищных территориях – с 10,1% до 18,4%. Можно подсчитать, насколько более высоких урожаев могли бы получить крупные хозяйства за пять лет, с 1981 по 1985 г., если бы и не входящие в системы хозяйства достигли бы средних показателей урожайности производственных систем. В этом случае мы могли бы получить пшеницы на 1,7%, кукурузы – на 1,9%, подсолнечника – на 1,5%, сахарной свеклы – на 0,5% больше для нужд внутреннего потребления или же экспорта. Если же в основу расчетов взять среднюю дополнительную урожайность четырех крупнейших производственных систем, то разница была бы еще больше: в случае пшеницы – 4,2%, кукурузы 3,8%, подсолнечника 3,5% и сахарной свеклы – 2,9%.

Acta Oeconomica, Vol. 39, (3-4), pp. 247–270 (1988)

HALF-HEARTED ORGANIZATIONAL DECENTRALIZATION: THE SMALL STATE ENTERPRISE

T. LAKY

As part of the decentralization process in Hungarian economy a new organizational form: the small state firm, was established in 1982. The idea was that such organizations, much smaller than traditional firms, with simplified accounting, preferential taxation, autonomous in their dealings, will be more efficient and will have a positive effect on domestic competition.

In 1985 some 196 small state firms were active, most of them in services but the hopes attached to them were not fulfilled: the quality of services did not improve. Instead of competing, the employees of small state firms try to create their own clientele and to work in official hours with the state's tools and material on their own, thus obtaining unfair advantages against both independent craftsmen (who assume all the burdens of independence) and employees in large-scale industry. The paper analyzes some causes of this unsatisfactory state of affairs.

The organizational decentralization and breaking up of large-scale, monopolistic enterprises (which were mostly artificially established with state resolutions and fusions) and the establishment of smaller, independent organizations is an essential condition of the reform process. This process, started a few years ago, has come to a standstill after insignificant results—as the studies analyzing the circumstances of the reorganization conclude unanimously. [1, 2, 3, 4]

It is true that 350 new enterprises were established. However, the reorganization—contrary to all expectations—was in practice limited to the food-processing industry and certain services: other areas of the economy were left virtually untouched. "The reorganizations have not basically changed the onesided structure of the large state enterprises"—this is how Éva *Voszka* sums up the facts [2]. The mentioned studies explain the quick exhaustion of the process of reorganization, due to the counter-interests of the directing administration and their insistence on maintaining their previous functions. Because of this, the studies rightly judge the other steps of the reform—aimed at economic revival—as having an uncertain outcome.

The doubts are strengthened by the experiences of the small state enterprises, established during the process of decentralization and representating new organizational forms. Where decentralization has been successful—at least in the case of the numerical majority of small enterprises—it has become evident, in no more than a few years, that the organizational change has only brought about a 'half' solution. Although small-scale organizations have been established through the dissolution of a few large trusts and enterprises, it is only the sizes that have

decreased. The administrative organs directing the reorganization did not want to confront the real causes of the decade-long functional disorders, and they did not make the necessary changes to the framework of activity of state enterprises which had, even at an earlier date, proved to be unsuitable.

This paper attempts to point out these critical points, by analyzing the problems of small enterprises, and showing where we have not succeeded in going beyond the old principles and methods which sometimes stick to the old direct central management of economy. After all, these are the main reasons why the form of small state enterprise has not been able to function as a successful way of decentralization.[1]

The intention of reorganizing the economic organizational system has called into being the small state enterprise, as a new form. In the private sector the partnership forms (economic workteams, business partnerships); in the cooperative sphere the small cooperatives and cooperative specialized groups; in the state sector mainly the small enterprises. The main expectations of the affiliated firms (and the enterprise economic workteams as joint undertakings of enterprises and their associated employees) were centred on the hope that the organizational pyramid of the Hungarian economy—now "inverted"—would return to its normal position.[2] In compliance with this, the Enterprise Law was modified in 1981; the Minister of Finance and the Minister of Industry gave joint directives about the economic criterion of small enterprises.[3]

The prospective small enterprise have received different advantages to facilitate their existence and activity and to promote their versatile adaptation. (A part of these—such as the right to expand spheres of activity without restrictions on lines of production—was later extended to the whole enterprise sphere.) The most important concessions have been:

---

[1] This article is based on a more comprehensive study, written in the Labour Research Institute [5]. This study analyzes in detail the partial market of the servicing areas touched upon, and the circumstances of the establishment of small enterprises on the basis of the yearly data concerning their activities. I have used here the small enterprises' balance-sheet data, the reports of the Central Statistical Office,—the analyses made continuously at different authorities about the whole servicing sphere and its different areas. I have also used the evaluations regularly made by the Servicing Research Institute. In addition to this—elaborating special questions—Ágnes *Oszoli* has written an independent study about the situation of car repairs, Klára *Czenki* on the servicing of household and telecommunication appliances, Lajos *Hegedüs* about hairdressing and Judit *Lakatos* on the main characteristics of the industrial small enterprises. In this article, I use numerous conclusions and thoughts emerging from these documents and analyses—sometimes, albeit involuntarily, without referring to the source.

[2] The witty figure of the "inverted pyramid" comes from Iván *Schweitzer* [6].

[3] Law-decree No. 20 1981 as well as the Decree of the Council of Ministers 42/1981. /IX.28./ which modified the implementation of the act, as well as the joint directives 347/1981. /PK.25/ of the Minister of Finance and the Minister of Industry on the economic criterion of small enterprise.

— The economic regulation, accounting, and statistical data-supply functions were reorganized into a simplified system (imposing less responsibilities than the bigger firms had).[4]

— The taxation of small enterprises became simpler and more favourable than that of the bigger ones and over recent years it has become even more favourable. As distinct from traditional enterprises, which are linked to the budget through a complicated system, the small enterprises only make two kinds of payment into the budget: 18 percent of their gross income (the sum of profit and wages) and 40 percent of their depreciation allowance are withdrawn from them. "In the case of small enterprises, in this way the ratio of budgetary payments to the monetary means staying at the enterprise has been modified to 1:3."—sums up a report[7].

— The economic regulation makes special concessions to those small enterprises where at least 51 percent of their activities are made up of (personal and communal) services. The small enterprises functioning in the industry have become, with only a few exceptions, so-called "consumption servicing" small enterprises.[5]

— The servicing enterprises—among them also the small enterprises—receive, in additon, a refund from the 40 percent social insurance contribution. This is paid after wages, in proportion to the services rendered to the population.

— While the tax burdens of the big enterprises have increased, the small enterprises and the small cooperatives have receive further allowances: the tax on their gross income has decreased to 15 percent and the total sum of the depreciation allowance remains at the enterprise. Although the refunding of a part of the social insurance contribution has stopped, enterprises performing services for the population are granted a 10 percent tax benefit from the sales returns from the services performed (deducting invoiced material and part values).

— Finally, according to the regulations, the founding organ cannot deprive the small enterprise of its assets. On the other hand, financial rehabilitation proceedings cannot be taken for the enterprise either. If the enterprise's balance-sheet shows a deficit or, because of its management, there is a shortage of funds and it is not able to stop this on its own, the founding organ can liquidate the enterprise.

The legislators have helped small enterprises with many kinds of favours. The idea was that they would complement the activities of the large factories, carry out "background" industrial activities, be the prime producers (in smaller batches) of special final products, and meet the demands of the population—above all, the demand of the population for services. The directives of the Minister of Finance and the Minister of Industry especially emphasize that "the establishment

[4] This principle was extended by the regulations to the establishment of affiliated firms from the 1st of January 1982, and then to small cooperatives also.

[5] The small cooperatives and affiliated firms functioning in the form of small enterprises, could choose this form.

of small enterprise can be justified in every branch of the economy" and they list many dozens of activities in the manufacturing industry, the building industry, and home trade and transport which would be deemed especially suitable for this organizational form.

Only three small enterprises were established in 1982, but in 1983 132, in 1984 148 and by 1985 196 were functioning—of which 160 were in specialized branches of the repair-servicing industry. In the rest of the branches of the national economy their number is insignificant: 13 in the building industry, in transport and telecommunications only two, in commerce one, and in other "material" branches, 18 (of this 10 in hairdressing); there are two in the health, welfare and cultural services. In 1985 21,300 people worked in the small enterprises, out of which about 17,000 people were in the industrial services, 1800 in the building industry, 2400 in other branches of "material" activities (within this 1700 in hairdressing) and about 100 people in the rest of the branches of the national economy (health, commerce, intellectual services).[6] Out of the 196 enterprises functioning in 1985, only one was established for productive activity (a paper processing enterprise employing handicapped people). The rest—instead of the many kinds of suggested production activities—were established in different areas of the service sector.

Each of the established small enterprises existed at an earlier date, although under a different name and in a subordinate relationship. The majority of them were established by granting independence to the local units of two trusts which had a nation-wide network (AFIT, dealing with car repairs, and GELKA, dealing with the repair of electronic household and telecommunication appliances).

At the end of the 1970's, AFIT was made up of 13 enterprises, having several sites which operated 68 service-shops in every part of the country, and employing about 10-12 thousand workers. However, of the service shops only one dealt exclusively with passenger car repair and servicing. The rest, beside the repair of trucks, also repaired passenger cars—in smaller or bigger proportions. (In 20 service shops more than 80 percent of the workers, in 5 services less than 20 percent carried out passenger car repair.) The service shops which became small state enterprises were those in which the share of passenger car repair was determinant.

The state enterprises had a share of about 50 percent in the total yearly value of car repair and servicing—performed for the population—until 1974 (within this AFIT accounted for 4 percent); the cooperatives employing about 6-7000 people accounted for nearly 20 percent of this figure, and private small-scale industry, employing 3-4000 people, accounted for nearly 30 percent.

By the end of the 1970's—with roughly the same number of people—the share of the state industry in the increasing demand slackened to about 40 percent; the

[6] At the time of writing this article, I did not have access to the data of 1986. The source of the data mentioned in the article is the publication of the Financial Research Institute. [8]

share of the cooperatives decreased a little; that of the private small-scale industry increased to 43 percent.

At the end of the 1970's GELKA maintained about 320 service workshops—usually employing less than 15 people and scattered around the country—for the servicing of telecommunication and electric household appliances. In the service workshops of GELKA, in 1979 altogether about 4900 people were working; (in the cooperatives about 1700, in the service workshops of the manufacturing firms, 350). In these two repair trades about 1600 artisans were working in 1980: 50 percent of them full-time, 40 percent of them part-time and 10 percent as retired people but still active.

The determinant part of the value of repairs (expressed in terms of sales returns) made for the population was performed by the state enterprises until the middle of the 1970's (telecommunication 67 percent, household appliance services 40 percent; the share of the cooperatives was 16 and 20-24 percent; the rest was performed by private small-scale industry /artisans/). By the end of the decade the share of the private small-scale industry in the increasing demand had gradually increased (telecommunication equipment 25 percent, household appliances about 50 percent).

This is also how 10 individual small enterprises were established out of the Budapest State Hairdressing Saloon. The Budapest State Hairdressing Saloon operated with 111 shops and 1800 workers. The proportion of the state sector in hairdressing and cosmetic services was never high: over the decades it gave about one-tenth of the total of the value performed. The dominant form was the cooperative, with two-thirds of the value performed. The private sector operated mainly in the countryside. In 1982, 4900 (in Budapest 760) barbers and hairdressers, cosmeticians, manicure-pedicure artisans and employees, and helping family members were registered in this trade. In this servicing branch the performance ratios by sectors, on the basis of ownership, did not change considerably until 1981.

One of the reasons for the administrative decisions on the breaking up of these large servicing organizations—made after troublesome delays—was the constant poor economic results of these organizations: comparing the main indicators showing the efficiency of management they fell well behind cooperatives and artisans. It was hoped that the possibility of greater independence and flexible functioning would improve results. In the bargaining between the central authorities affected by the decentralizations envisaged in the central programme for the modernization of organization it was also suggested that sooner or later it "would be better to take a few organizational decentralization measures, and to show willingness to accept a reorganization qualified as well-founded by them, in order that they could act more efficiently in preserving the organizational framework in other cases". [4] In the case of a few of the former local enterprises (repair mechanics, building industry designers), a change of form simply proved more favourable (although with the independence of the units of the provincial Laundry Enterprise they expected

the easing of their problems, as in the case of the state-run repair services). The predecessor of most small enterprises performing intellectual—designer, organizing, advisory—services, was the sectoral organizing isntitute or educational centre. With the abolition of the 3 industrial ministries, only one possible form was given for maintaining their activities: transformation into small enterprises. Therefore, the past of most two-year old small enterprises generally reaches back, in general, ten to twenty years. The transformation did not bring great improvements in their economic results. In fact, their efficiency indicators lag behind those of other small organizations (affiliated firms, small cooperatives, and affiliated cooperative firms) using similar simplified accounting.[7]

— The share of the small enterprises in the sales returns is smaller in every branch of the national economy than their importance measured by employment. In other words, the staff-proportionate sales returns are the lowest in the small enterprises (321 thousand Forints, as opposed to the affiliated firms' 767 thousand Forints). In the small enterprises the wage cost per 100 Forint sales return is the highest (21 Forints). It is 15 Forints on average; in the affiliated firms 11 Forints. The input per 100 Forint sales return is also the highest (86) at these enterprises. (The appropriate data of the small cooperatives is 65 Forints.)

— According to the calculated profitability indexes (results compared to assets, sales returns, income and resources), the management of the small enterprises proved to be the least profitable, that of the small cooperatives the most profitable.

— One third of the small economic organizations showing a deficit were small enterprises. (Another one third came from the small cooperatives, but it is true that one third of the total loss of 243 million Forints occurred in three affiliated firms of the building industry.)

— The poor results have come into being in spite of the fact that, out of the small organizations, the small enterprises (and the affiliated firms) make the smallest payments to the state budget: 11 (the affiliated firms 10) Forints out of 100 Forint returns from sales, as against the average 17 Forints of the small cooperatives and 13 Forints of the affiliated cooperative firms. In addition, the taxes per unit of sales returns have decreased exclusively in the small enterprises (by 19 percent); with the rest, they have increased (with the affiliated firms by 4 percent and the small cooperatives by 6 percent).

The Hungarian public rarely reads about these figures, but they every day experience the poor supply of most small servicing enterprises, the increase of prices, the non-improvement of services offered to individuals and households, and the long waiting periods. The discontent and the complaints are permanent topics in the press, television and broadcasting. It is well-known, but gets less publicity, that in the organizations offering industrial and personal services—comprising the majority of small enterprises—many people work on their own with the machinery

[7] Source of data [8] pp. 29-37.

and materials of the enterprise. This creates unfair competition for the enterprise itself, and also for the artisans who bear a major share of the taxes and operating expenses.

The obvious economic and social problems related to the operation of small enterprises are rooted in several determining circumstances. In my opinion, and in the first place, they are rooted in the fact that the administration only wanted to establish small enterprises by routing, by simply breaking up the big organizations. It did not undertake the truly complicated task of looking for the appropriate form of the numerous service activities. This was principally prevented by the mentality which insists on the superiority of state property. On the other hand, the government—in spite of its intentions—could not find a way to handle the small-scale enterprises in any different manner from the big ones. The necessary standardization of central management and the pursuit of a generally valid regulation have quickly integrated the small firms into the existing order of state enterprises. In addition, the obvious contradictions between the given organizational frameworks and the activities have made numerous small enterprises operate at an economically low efficiency; at the same time, they became state-privileged organizations for unfair individual profitmaking.

Activity, organizational form, property

As regards size and *organization*, the legal rules concerning the establishment of small enterprises only state that "the small enterprises have a much smaller staff and less fixed assets than the other enterprises functioning in the given sphere of activity". The staff—especially as compared to the usual size of enterprises—is really small (see *Table 1*) and this perfectly coincides with the structural modernization conceptions. Yet the question arises: is there really a need for such small-scale state enterprises, and if the answer is yes, are they needed where they have actually been established?

The measures related to structural modernization have, in recent years, just like the relevant national literature, only kept in view the necessity of modifying the size-structure of enterprises. They have not examined which form of ownership and organization would be the most appropriate framework for the given activity. The approach which concentrates only on size has remained; this is in spite of the fact that in numerous servicing branches affected by the measures of structural modernization—car repair, hairdressing, servicing of household appliances and telecommunication equipment, textile cleaning— many years of experience have shown, that the (mostly diversified) cooperatives and artisans have produced far better results than the specialized state enterprises.

Table 1

Distribution by size of enterprises (according to number of employees) in 1985

Number of employees	Number of small enterprises	Manufacturing	Building industry branches	Other material classified	Other branches (not elsewhere)
2–10	10	7	–	2	1
11–30	45	43	–	1	1
31–50	8	7	–	–	1
51–100	43	38	3	1	1
101–150	48	34	6	8	–
151–300	39	28	4	6	1
301–	3	3	–	–	–
Total	196	160	13	18	5

Source: [8]

The organizational form in which a given activity can be carried out most successfully depends primarily—according to experience—on the following characteristics of the activity:

— The need for division of labour: this depends on whether we are talking about one competent person or a work organization made up of several people, such as the cooperation of helping family members; also occasional or regular labour is sufficient for carrying out the work; perhaps there is also a need for the cooperation of people having different professions.

— Technological equipment: are hand tools sufficient or is there a need for more complex equipment, machinery, and factory-like circumstances?

— The scene of performing work: is the work done at the customer's home or at the servicing firm?

The fact that numerous services—mainly the less capital-intensive ones—have remained everywhere in the world in great part in individual or family establishments, and that big industry has not invaded the many areas of services (even at the time of its rapid expansion) can be traced back to these factors. In contrast to this, the big servicing organizations have become dominant in Hungary. Added to the above mentioned complexes, the textile cleaning "factories" were founded to serve big districts, the staff of the big building and designing enterprises could be about 100-200 etc. At the time of their establishment the obvious principles of organizational rationality were not taken into account. They were replaced—said or unsaid—by the demand for the existence of big state-owned organizations and their easy manageability. At the time of decentralization of the big organizations, the "protection of the already invested state property" and "its keeping together" had become more important than the organizational forms adequate for the particular professional characteristics or the real capital intensity of the different activities.

It is, therefore, worth examining more closely what property the small enter-

prises have inherited; furthermore, it is necessary to see what chances there are for the realization of state property by mechanically giving independence to the units.

Since, in the course of reorganization, the procedure usually followed was that the building and equipment used until that time came to constitute the property of independent small enterprises, the established small enterprises did, in some cases, not even dispose of the necessary means. In other cases, just the contrary happened: they inherited a much too large manufacturing capacity, which they had not been able to utilize satisfactorily even at an earlier date. This is the situation, for example, in textile cleaning, where the constant problem of the small "Patyolat" enterprises is the unutilized capacities established for the centralized supply of the wide districts.[8]

Many enterprises originating from the division of AFIT have also inherited large unutilized servicing capacities. "A big car repair enterprise has been established, for example, in the capital. It has been advertised as being the biggest service workshop in Central Europe. Not one word was said about what types of cars would be repaired here and how they would try to win customers" [10]. The result was that, even in 1985, there were many complaints about the unutilized capacities [11]. In addition, the technical instruments—bought mainly from state development subsidies—piled up at the big service stations. These provided evidence of the whimsical nature of the earlier acquisition of these instruments [23]. In the case of hairdressing, a relatively less instrument-intensive activity, the immovable property of the small enterprises was also causing trouble. Some of the shops were established between 1980 and 1982, in the framework of a 128 million Forint development project (half received as state grant), and renewals implemented earlier and paid for by state subsidy. The new oversized shops—especially designed for the expected residents in the servicing houses of the new housing estates—(just like the entertainment units, established in the same mentality) did not win many customers. With time, almost all of these shops have suffered financial losses. (The losses were covered—as with GELKA and AFIT—by the predecessor of the enterprises, that is, from the "common hat".)

The majority of the assets of the successor enterprises of GELKA are immovables. The value of their machinery and equipment does not even make up half

[8] Two years ago one of our daily papers reported: " ... the network has been established for thousands of million of Ft, it cannot be changed. It is certain, that more small-scale shops are needed instead of the monstrous ones ..." [9] The manager of the first established small "Patyolat" enterprise said in a broadcast last year: "The different needs and constraints forced the enterprises to take up different actions." Grasping the opportunity which enables small enterprises to autonomously widen their sphere of activity, with the steam generated during washing they are growing asparagus in foil tents on 400 m of the factory hall. They have made Ft 100.000 in one year. Another Ft 400.000 was earned by their undertaking to burn environmentally harmful materials. Their greatest profit, Ft 1 million came from commercial activity; they sold shoes, dresses and left-over textiles. This way they could stand on their own feet, but the central establishment has little work. (Radio Petőfi, January 1986)

the value of their immovables—i.e. their workshops and the buildings including the workshops. According to a survey conducted by the Ministry of Industry in 1985 (in which they received processable answers from 63 enterprises of GELKA) operational conditions were satisfactory in only 14 enterprises. The rest complained about settlement, the conditions of the premises, and— 62 percent—about the inappropriate technological equipment and the supply of instruments.

The out-dated technological equipment and the lack of needed equipment are old and constantly reappearing problems. The former shops of GELKA received equipment more or less depending on whether they functioned in small or large settlements. However, they could not utilize the capacities—in spite of the general discontent— even before the reorganization.

The assets of other small enterprises not mentioned here are insignificant—they do not even make up 10 percent of the small enterprises' total assets. A significant part of them are also in the form of buildings, offices and premises. The inherited immovables are in part really necessary, but they would like to get rid of some of them if they could (incorrectly built buildings which are very large and consume big heating, lighting and maintenance costs).

Protection of assets at the majority of the small enterprises means primarily the protection of the state property. Yet there are other possibilities for this. For instance the buildings might be handed over to the local councils and the small enterprises could rent them. This solution would ease the liquidation of the units which continuously show deficits; only the tenant would change, so the state property would not suffer any damage.

A more moderate proportion of the property of the small enterprises is tied up in machinery and equipment. (In the small enterprises repairing telecommunications and household appliances this value was only 50.000 Forints per employee, and much less in hairdressing.) There is relatively less capital engaged in the means of production in the activity of workers in small enterprises— probably less than each artisan would invest in this profession.

The decentralization, introduced with the slogan of protecting state property, actually disregarded the protection and utilization of productive property. As a matter of fact, even the analysis of the degree and composition of the productive property itself makes it questionable whether "keeping together the state property" is necessary and correct in all services.[9] If it has to be kept together—as it is believed—(because the high-value, built-in equipment is localized), is the enterprise form the exclusive framework, or can other utilization possiblities be brought up (lease, franchising, inner venture, etc.)?

Naturally, a contributory fact to the neglect of these questions was that the

[9] It is obvious that "The scissors, the razor and the hair-drier will not really be public property in hairdressing saloons employing one or two people, no matter how big the state-owned hairdressing saloons we organize actually are"— wrote Balázs *Hámori* and Katalin *Szabó* in an article [13].

central management urged the quickest possible termination of the rather clumsy decentralization process.

I for one, find the main cause in the fact that, in the course of decentralization, the government did not intend to face either the contradictions of development conceptions already involving determining circumstances, or the possibly uncomfortable consequences of progress.

Every concept which prepared for the modernization of organization and offered various possible solutions, started from the fact that existing state organizations and national networks are, under the present circumstances, not flexible and efficient enough. That is why they should be divided into small units, which are able to adapt to the requirements or the buyers. The idea that the establishment of the inflexible structure of big, state service enterprises is the product of an economic policy endeavour which may be qualified as mistaken from the outset, has not come up. In fact, just the opposite has occurred: instead of a critical review, insistence upon the correctness of earlier decisions has been a characteristic feature. "We have to recognize that the network could only be established by the concentration of forces. It would be a pity to deny in retrospect those things which were correct." [11] Every centralized development programme has also been justified: "In the period of extensive development until 1980 a modern, well-equipped service-network was built. Thus, laundries and services were built all over the country. The opening of these businesses was needed, because the growing demands of the population could only be satisfied in this way."[14]

Is our service network really so good, that "it would be a pity do deny the way of its establishment, the conception of its development in restrospect"? The constant shortage of services, the lasting dissatisfaction of the population, the poor efficiency of the servicing units in monopolistic situations which are indifferent to the customers' demands, and the spreading of illegal activities have shown, for a long time now, the radical error of this development conception. The mentioned opinions—which exist in a wide circle—protect the very practice which prevented natural organic development in the servicing sphere for decades. Instead, organic development was replaced by artificial expansion.

The conceptions developed in the 60's were really organic continuations of those of the 50's: instead of letting the characteristics of the servicing activity determine the organizational form, the fundamental principle of state property and the tight central manageability of the organizations and processes remained dominant. Yet organizational form like the individual enterprise, the family work organization or a workshop employing a couple of people did not conform to this.[10]

[10]Katalin *Szabó* writes about the fetishism of state property: "We treated state property as a form in which the other property solutions could finally be resolved, which could then be suitable for "homogenizing" the property system ... We gave preference to state property in every aspect, against other property forms. We discriminated against the cooperative and individual enterprises

For example, the natural product of the demand for this type of management was the decision that the state had to organize the servicing network for the quickly expanding durable consumer goods. The decision (and what goes with it: restriction of the vital conditions of the small-scale servicing industry, and the decay of the servicing network of small-scale industry) has delayed the natural and organic development of numerous servicing branches for a long time.

The further development of the sphere of servicing continued according to the old principles in the 1970's. Furthermore, in the years of recentralization the old preferences cropped up again and this sphere was naturally included in the demand for wide-ranging central management. The existence of the big state servicing enterprises provided possibilities for this. Allocation of the central development funds to a few big firms and keeping track of their managements are routine administrative tasks. In this way, the investments could not be qualified as rational according to the real, differing needs of various spheres or the weighing of the profitability differences; rather, it appeared rational to the central developmental intentions which conformed to the interests of the large enterprises: that is, services should be expanded by the location of big units and capacities ("planned network development") in the areas considered as being unprovided for.

It was, of course, rational for the state to take over the establishment of units which satisfied actual needs and which required greater capital investment. For others —beside cooperations—there was no possibility to do that. However, the development conceptions focused exclusively on centrally manageable big expansions and disregarded the small servicing units. Yet the majority of the population's needs was actually satisfied by these units. The servicing-development conceptions thus did not serve the general expansions of these services, but the unilateral development of the socialist sector.

This was supported by many ideological arguments, starting with an insistence on the principle of responsibility for supply (taken as a state responsibility), all the way to that thesis according to which the concentrated utilization of the central sources is the main pledge of rationality. Moreover, the principle of the central development and management of the servicing sphere necessarily strengthened one side of the arguments concerning an issue which is still handled today in an ambivalent manner: the unsolved question of the place and role of the private sector.

This is why the question of why thousands of millions intended for the development of services were not utilized in another way, never came up: for example, should the people working in services receive it as tax relief or in other forms of advantages or, parallel to the establishment of units with greater capital investment,

---

in taxation, as well as in the distribution of social resources. This kind of favouritism does not cause the greatest damage with the social tensions it provokes, but with the fact that it does not leave enough room for the "natural selection" of the forms. [15]

should the competent state organizations work out stimulating programmes for the development of small-scale industry workshops?

It is mainly the "traditional socialist" values of a significant part of the managing administration that explain why the earlier years' organizational development conceptions were not revised on their merits, thus such values affected the practice even in the 1980's. They stressed the superiority of state property, against the "class-alien" nature of the small private property of the means of production; there was verbal acknowledgement of the economic necessity of the private sector, but it was judged carefully and with distrust.

The organizational development programmes of the 1980's did not openly break away from the old principles and this is why the course for future development was characterised in an ambiguous way. Instead of a radical revision of the whole system of services—within this the role of the state enterprises—only the small enterprise model was established. This compromise proved to be feasible in practice.

The previous experiences with the functioning of small enterprises did not generate the need for a revision of the organizational forms in the mentioned servicing branches. In the eyes of the government administration the small enterprise is the product of, on the one hand, a successfully executed administrative action (of organizational modernization) and its mere existence is qualified as an achievement: small organizations have replaced large organizations. On the other hand, the organizational development conceptions have chartered the course for further development; thus the administrative organs consider the execution of such conceptions as their task—not the revision of the actual situation and functioning of small enterprises. According to the conceptions, there should be even smaller, independent units established under the auspices of the small enterprises. This should be in such a way that the smallest, separately located units and shops would operate under contract across a wider range. (The cooperatives also strive for this, with the establishment of the 'lump-sum' accounting units.) Yet this contractual operation has not gained ground in the past few years. At the same time, the proposal—which still appeared in the original conception of organizational development—that the smallest workshops should be leased to artisans or to work collectives of artisans has been removed from the agenda. The proposal has been unpopular from the beginning since, in the eyes of many, small-scale industry is invariably the real rival threatening the "truly socialist" state sector. This is why many people in the economic management and political bodies are afraid of the expansion of private property (although many analysts have pointed out that the flexibility of small-scale industry results from its organizational characteristics and from the fact that the artisan usually works alone, in a self-governing organization with little administration). The guard of the old principles wants to ignore the advantages inherent in the work organizations of small-scale industry.

For the time being, the organizational development conceptions do not even plan to introduce other modes of utilization of state property. (One way would be,

for example, the utilization of a part of the high-value equipment in a technical station. This could be leased to cooperatives or to individuals—or even sold to them.)

The central management of small enterprises—intentions and reality

Regulation of the functioning of small enterprises

In the beginning it seemed that the small enterprises, which functioned in the simplified system of economic regulation, accounts, accounting and statistical data supply, would have the benefit of greater independence. However, it soon became evident that the small enterprises were not going to receive any greater autonomy than the big ones. This was partly because—as mentioned earlier—many kinds of conditions of independent operation were missing from the small enterprises. (And this was caused by the mechanical way of their foundation.) They inevitably needed the help of their new manager, the local council; the difficulties which occurred later made these relations even tighter. On the other hand, it also became evident that although the economic management strived to take into consideration the characteristics resulting from the small proportions and the form of small enterprises, later on they could not handle the small ones in a manner different from the big ones.

The most important of the few remaining distinctions is the taxation of the gross income. This undoubtedly simplified the generally valid, multi-channel withdrawal system of the state enterprises. With this, the regulation made the financial accounting of small enterprises easier and, together with other financial advantages, made a significant increase possible in the results, even in the case of organizations working with a high wage cost ratio. [7] After the payment of taxes, the small enterprises can freely use their profit, decide what proportion to keep in reserve, or they can use the money for development or the increase of wages. Yet the small enterprises—just like the big ones—put wage increases in the first place.

The free widening of the sphere of activities—which at the beginning was an advantage only offered to the small enterprises—was also a great help. The profit resulting from the widening of the scope of activities, from the utilization of the premises and from commercial business enabled them to function and provided the possiblity of good results.

However, the facilitating measures were accompanied by more and more detailed, all-embracing regulations and, in the end, "as a consequence of the combined effect of the different regulations, instead of the expected improvement, the profitablity of the small service enterprises in fact decreased."
[16] Yet in the system of the regulations, as usual, the "gaps", and conflicting reg-

ulations have appeared. The managing organs conscientiously worked hard on the modification and regulation. With this they tried to indicate that they do in fact pay attention to every problem of the small enterprises and are ready to take even newer measures. (Within the regulation of wages, for example, they regulated with meticulous care—and with several modifications—the premium of the managers and their deputies, the so-called "higher executives"; they encouraged the training of apprentices, reduced the tax on wages paid for economizing materials and granted credit with favourable terms for development, etc.)

The very detailed regulations extended to small firms and the solicitude of the central directing bodies have made the relations of dependence unequivocal for the small enterprises. Thus, instead of the expected market behaviour (competition for the buyers), they adjusted their operations more and more to the requirements of regulation. In fact, they did not have a genuinely different choice: prices and wages depend on regulations and not on the market situation. Instead of the price-forming effect of demand and supply, the price authority regulated their price and first the successor companies of GELKA and AFIT; then small hairdressing enterprises applied for the possibility of raising their prices,—and they did.

In such a regulative environment, the intended simplification of the administration of small enterprises could not succeed either. Immediately after their establishment, and by the time their rules of operation had been elaborated, serious administrative burdens began to fall on these organization and their small staff: "the authorities set the same requirements for them as for traditional enterprises. They are controlled by the fire department, labour safety authorities, social security authorities, the state prosecution and—for tax, price, personnel and other reasons—by various offices. Their rules of organization and operation have been elaborated according to the viewpoints of these organizations. One of these rules actually runs into more than 500 pages, and its implementation requires considerable expense and time". [17] "Small enterprises have to prepare more than 23 rules (according to certain opinions, even more)".[18]

The burdens of small state enterprises have continued to grow because the regulations of the directing bodies—concerning economy—put ever newer administrative obligations on them—as is the case with the big companies.

The supervision of small enterprises

The direct supervision of the functioning of small state enterprises—and thus the responsibility—was delegated to the local councils. (Sectorial direction has remained the task of the competent ministry.) In the beginning, the councils were a little bit hesitant about what should be the substance, methods and means of

supervisory activity, especially if the declared independence of small enterprises was to be respected.

According to the law, they could practice a legal supervision. Yet it was evident from the beginning that most small enterprises required concrete help. The supervising bodies could not and did not want to deny help. This was formulated for them by the Council Office of the Council of Ministers: "local councils should not interfere with the functioning of the enterprise, but should help where they find problems; if bankruptcy threatens, the councils should help them to avoid it—within the possibilities of their manoeuvring."[19]

Thus, in times of need, the supervisory organ of the council—sometimes at the request of the small enterprise, sometimes on its own initiative—had recourse to the usually applied means: if needed, it gave financial support (in the form of transferred or repayable circulating-capital provisions, supplementation of development funds, elimination of liquidity problems, granting of sites, cession of assets etc.), took part in the changing of managers, in the solution of staff problems, and "not least they helped the development of enterprises by paying continuous attention to their activity, by making the managers report, and through different resolutions". [20] The councils are ready for this because the general principle is that they are responsible for the quality of services in their own area. The responsibility for supply in itself justifies the fact that elimination of the economic problems of small enterprises should be helped by all means at the disposal of the councils. This is all the more in their interest because, in cases of bankruptcy among the bigger units, the sale of assets seems to be an insoluble task for the time being.

Under the present circumstances it is also understandable that small enterprises do not demand greater independence. Employees were thoroughly discontented in certain enterprises when some councils appointed their "own" people to the higher posts of the enterprise, instead of selecting the adequate leaders from among the employees of the small enterprise. In the course of the election of the director, in certain places this led to a situation where the director appointed by the council was not re-elected.

In fact, the small enterprises do not want to become independent of the councils which comprehensively help them in their operations. The practice of the councils so far has been reaffirmed by the position of the Council Office of the Council of Ministers: "It is a just requirement that—even after the introduction of new enterprise management forms—the presidents of the Budapest and county councils should pay closer attention to, and help the activity and increase the supplying ability of, small enterprises."[19]

Thus, instead of developing the conditions of autonomous management, the unequivocal dependency relations, the all-comprehensive regulations and the ever widening data supply obligation (which all give an opportunity for intervention) made small enterprises an integral part of the hierarchy of economic organizations. The adaptation was helped by the unchanged automatisms of central management

practice and the invariably prevailing ideas about the superiority of state property and the necessity of its being held together.

The stability of ideological values has an interest-asserting function in this case, too: these can justify the necessity of existence of central managing organs; they are indispensable even in this small sphere, since they manage, guard, develop, and supervise the property of the state.

Yet in the meantime, it is precisely the state administration which has left unsolved numerous problems which basically determine the existence of small enterprises. The most serious failure, affecting almost every industrial service, is that in the course of establishing small state enterprises the earlier central provision of spare parts was eliminated without reorganizing the nature of its trade. In its absence, the spare part market disintegrated, supply became disorganized, and shortages became overwhelming. In the interest of preventing disturbances, only those steps were taken which cooperating smaller or bigger organizations could solve on their own; in fact, a really comprehensive, resolute state conception, and a general settlement was what were really needed.

Illegal services

The 160 small enterprises functioning in 1985 are mainly the successors of AFIT and GELKA. In the circle of their mechanics it became a general endeavour—exceptions are worthy of respect—to try to increase (illegal) income with a greater part of the countervalue of their services—instead of the sales returns of the enterprise. In consequence of their working conditions, some of the employees are able to influence considerably the scale and proportions between legal enterprise and illegal personal incomes. This aggravates the problems of the functioning of small enterprises within them, adding to the problems that stem from without—from the circumstances related to the establishment and conditions of their activities.

Since 1983 an increasing number of analyses have reported on the expansion of illegal services and the increase of illegally tax-free incomes in the field of car repairs and telecommunication and household appliances repair. (Apart from this, illegal work is estimated to be considerable in the sphere of apartment maintenance.)[11]

According to estimates, the proportion of illegal services is high and has been continuously on the increase since 1983.

At the time of the establishment of small enterprises many hoped that if they succeeded in making mechanics interested in increasing the results of the small enterprises—mainly by raising wages—illegal services would be forced back,

[11] On the basis of a many-sided analysis, a comprehensive estimate was made by *Drexler—Belyó* [21], on the customs prevailing in the field of car repair by *Polgár* [22] and Oszoli [23, 24]; on the telecommunication and household appliance repair by Czenki [25].

at least in this circle. After the establishment of small enterprises, wages really began to grow (the officially announced average monthly income in industrial small enterprises was Ft 5515—somewhat lower than the industrial average: Ft 6674).

Beyond the continuous raising of wages, the earlier system of task-wage has been modified. It now strives to increase the share of manual workers in the payments received after their own work. This was aimed at suppressing illegal activities. "By certain incentive elements mechanics are stimulated to do a bigger part of their work within the framework of small enterprises." [26]—in other words, not illegally. The introduction of a more incentive wage system and the increase of payments due to the employees no doubt also made legal work for the enterprise more advantageous—at least in certain professions and within certain limits. In the small enterprises repairing telecommunications and household appliances average earnings have increased, but at the successor firms of AFIT even the more incentive wage system proved to be insufficiently attractive to increase enterprise performance—and thus legal earnings.

Illegal work is not a socio-economic problem affecting only small enterprises, but it directly threatens their viability. I would like to stress just one reason for the spreading of illegal activities: the role of the organizational form which does not suitably adjust to the activity. At the same time it places firm managers in a position of impotence, for they cannot force back illegal incomes attained to the detriment of the enterprise.

Probably the key problem is that in the case of many different activities the buyer and the worker inevitably get into personal contact. An enterprise, no matter how small, cannot handle this relationship. In this contact the buyer can ask for, and the mechanic can offer certain additional services (for example, a deadline shorter than the official one, in general, quicker service and "shortage" parts). In extreme cases, the enterprise can be left out of the whole business. That is why servicing enterprises were always at the mercy of their employees, on whom the fulfillment of the plan and the returns from sales depended.

In the case of small enterprises it is the *labour force* that makes up the real capacity. The volume of performances depends rather on the quantity of living labour than, for example, on the volume of the engaged capital—in some cases materialized in real estate. In other words, incomes are "brought" by skilled workers. The elementary interest of small enterprises is to keep their specialists. (According to one deterrent example from an analysis: after the loss of a television mechanic one small enterprise lost 300 clients.)

The managers of small enterprises try to solve the dilemma of the interest of the enterprise (namely that if they do not take a stand against illegal work, they lose their clients; if they do, they might lose their workers) with a reasonable compromise: they increase the legal framework, introduce supplementary activities—and put up with illegal work. Even so, it is up to the workers in what proportion they want to share the incomes with the enterprise.

In this situation, every kind of demand which is aimed at stimulating managers to take a firmer stand and to "force back the illegal activity of their employees by taking more resolute measures" is *irresponsible.*

Instead, both the managers of small enterprises, and those searching for solutions bring up the most diversified ideas in order to increase the legal performance—and thus the legal income—of the employees of the small state enterprises.

According to one of the characteristic conceptions, for example: "the internal structure of a small organization should be reconstructed as if it were a private one. Mechanics would organize their own work themselves and would appear as entrepreneurs." [18] According to this, the small state servicing enterprise—although it has not proved to be an economically advantageous form—should be further maintained. The ideological background of the conception is invariably the rather non-substantial slogan concerning the "protection of state property". Yet the proposal itself is so pragmatic that it builds the future of small enterprises upon illegal work permitted by the state, during working hours, and performed with state-owned tools and materials. This then legalizes the privileged situation which the employees of small enterprises (and other servicing units) enjoy over the employees of both large factories and artisans.

Interests related to the maintenance of the small enterprise form

Strong interests are related today to the maintenance of this form. The proof shows that the viability of the small enterprise is an unambigous interest for both the state administrative agencies which establish this form, and the managers[12] integrated in the hierarchy of management of state-owned enterprise, and also of the people working there.

I would only like to analyse here the least obvious phenomenon: why do manual workers cling to the small state enterprises?

In the beginning, the small enterprises were afraid of losing experts and skilled workers, but their number quickly became constant. In the mentioned professions very few small independent ventures were established at the beginning of the 1980's. From 1985 on—especially because of the high social security contribution—not only did the process of becoming independent come to a sudden stop, but many people went back to the socialist sector because it offered greater security. (According to the data of the National Association of Artisans, the fluctuation among artisans is 25–30 percent annually, while the number of full-time artisans has stagnated.)

[12] The managers and the deputies who head small enterprises were put into the same 'B' category enterprises rank, as are the managers of state industry.

According to the data of surveys, the people leaving the small ventures prefer the socialist sector because it offers greater security than the private enterprises.[13]

This shows that in the present situation—for many reasons—neither the traditional small-scale industry (artisans) nor the company forms can offer attractive perspectives. The changeover from the state sector to the private sector can only be realized by the taking on of serious financial burdens. The value of the absolutely necessary initial capital differs by trades, but its finding requires financial efforts in any case. The self-managing entrepreneur has to cope with the everyday problems of continuous operation, (for example, the difficulties of purchasing materials). To these are added the tax burdens and extremely high social security expenses which, moreover, entitle the entrepreneur to less services than in the socialist sector. When considering the possibilities of becoming self-employed, this is a very important factor.

However, the employee of a small state enterprise involved in repairing or assembling (at times building or hairdressing) can use every piece of equipment that the firm has, due to his rights as an employee. Thus he can form his illegal activity and clientele (albeit linked to the legal one), and also work on his own. Through the company, he might have access to otherwise constantly lacking service parts or materials, which he utilizes to favour his "own clientele". In this way—if he wishes—his income can come from 2–3 sources: the "official work" for the firm, illegal activities on his own account and tips. (According to the estimates of experts, managers of small enterprises and employees, the income of certain mechanics in car repair services—stemming from tips and from working on their own account—can reach 1000 Ft and that of their assistants 500 Ft *per day.* Among the mechanics of the successor-companies of GELKA, a good telecommunication technician can increase his monthly income by 4000-5000 Ft, and a qualified household appliance mechanic by 3000–4000 Ft just by working on his own account. According to a more modest estimate, mechanics can earn an amount—by working like this and with tips—which, even at its minimum, is equal to their official salary in the small enterprise. Although in the circle of hairdressers illegal activity is not unknown, the principal source of supplementary income is traditionally tips, which amount approximately to 4–5000 Ft per month—according to estimates—of hairdressers with good clientele.

The interests of people working in small enterprises are unambiguously in favour of the preservation of this form of operation. It ensures these unique advantages, and there is the reasonable compromise that a lot of people apply for an artisan's licence beside their official job, which implies modest tax liability.[14]

[13] The labour-turnover was surveyed in 1984 at the small and affiliated successor enterprises of the AFIT and GELKA. About 5500 employees entered or left. In the same year, about 250 became independent in the mentioned occupations; the change of jobs took place within the socialist sector in such a way that employment increased in the small and affiliated firms.

[14] According to the data of the Central Statistical Office, in the above mentioned repairing-

For this reason,—between "reasonable" limits—they are interested in the moderate growth of the small enterprises' results; thus they can maintain the already existing state of affairs and can have untroubled access to their income stemming from other sources, too. This "interest" is not enough for the efficient functioning of an economic organization. In the present state of affairs one can expect the "mechanist to become ever richer while the servicing firm becomes ever poorer,"[27] and in the field of services, the small state enterprise is thus proven to be *the least* successful form.

Small-state enterprises, as organizational forms, are already existing realities. The evident deficiencies of this form in several fields of services lead to consequences beyond the questions surrounding small enterprises: i.e. they lead to the essential questions of organizational modernization. We have known for a long time that the restructuring of the economy's organizational set-up, and the establishment of smaller, self-managing economic organizations is an inevitable, necessary process. We already know that new forms and solutions can only be successful if we do not try to build new things on old and shaky bases. If a critical review of the basis is missing and if central managing organizations evade more complicated, non-routine tasks, endeavours at modernization can only lead to half-hearted solutions and thus reproduce the problems.

References

1. Voszka, É.: Reform és átszervezés a nyolcvanas években (Reform and reorganization in the 80's). Institute for Financial Research, Budapest 1986.
2. Voszka, É.: Átszervezés, kampány, reform (Reorganization, campaign, reform). *Gazdaság,* 4.1986.
3. Vincze, P.: Szervezeti decentralizálások a magyar iparban a nyolcvanas években (Organizational decentralizations in the Hungarian industry in the 80's). Institute for Economic and Market Research, Budapest 1986.
4. Vincze, P.: Transformation of industrial organization—without genuine changes. *Acta Oeconomica,* Vol.38, Nos 1-2 (1987), pp. 117–131.
5. Laky, T.: Az elhibázott szervezet; az állami kisvállalat (The mistaken organization: the small-state enterprise). Labour Research Institute, Budapest 1986.
6. Schweitzer, I.: *A vállalatnagyság* (The size of the enterprise). Közgazdasági és Jogi Könyvkiadó, Budapest 1982.

assembling trades a mere 36 percent of the employees were engaged full-time in 1986. In car-repair services 1960 employees were full-time and 3300 part-time; in household appliance repair the corresponding figures were 367 and 138; in the telecommunication repair services the figures were 758 and 514. When considering part-timers, naturally not only the employees of small enterprises but people disposing of adequate professional expertise, employed elsewhere, were also taken into account.

7. A vállalati (szövetkezeti) gazdálkodás alakulása a szervezeti forma és a szabályozó változások függvényében (The management of enterprise —cooperatives—, depending on organizational forms and changes in regulations). Summary for the Central People's Control Committee, Budapest June, 1985.
8. Gálik, L.—Hallgató, F.—Kamarás, G.—Urbán: A gazdálkodók szervezeti struktúrája és annak változása (The organizational structure of economic units and its changes). Institute for Financial Research, Budapest December, 1986.
9. Fehér, Gy.: A Patyolat-hattyú dala (Swansong of the Patyolat swan). *Népszabadság,* 3 August, 1985.
10. Krémer, D.: Helyzetkép és problémák a szolgáltató kisszervezetek alakulásánál (General survey and problems of establishing small service enterprises). Research Institute for Central Service Development, Budapest 1982.
11. Fejér, Gy.: Szervizre vár az autójavítás (Car-repairs are waiting for services). *Népszabadság,* 30-31 January, 1986.
12. Oszoli, Á.: A személygépkocsi-javítás fejlődése, jelenlegi helyzete, s az átszervezés hatása a szolgáltatókra (The development, and actual situation of car repair services and the effect of the reorganization on the service providers). Research Institute for Services, Budapest, 1986.
13. Hámori, B.—Szabó, K.: Az egyén "társadalmi tulajdonsága" és a társadalmi tulajdon személyessége (The "social ownership" and the individual and the personal nature of social property). *Közgazdasági Szemle,* 6. 1985.
14. Kerekasztal a szolgáltatásokról (Round-table discussion on services). *Népszabadság,* 31.Dec.1985.
15. Szabó, K.: Kisvállalkozások és szocializmuskép (Small enterprises and the image of socialism). *Egyetemi Szemle,* 3.1985.
16. Drexler, B.: A szolgáltatások szervezet-fejlesztésének 1985. évi helyzete (Situation of the organizational development of services in 1985). Research Institute for Services, Budapest November, 1985.
17. Abonyi, G.: Szolgáltató kisszervezetek. Bács-Kiskun megyei tapasztalatok (Small service enterprises. Experiences in Bács-Kiskun County). *Figyelő,* 7. Nov. 1985.
18. Célvizsgálati jelentés az AFIT, GELKA szervezeti korszerűsítés tapasztalatainak értékeléséről (Report on the evaluation of the experiences of organizational modernization of AFIT and GELKA). Council Office of the Council of Ministers, Budapest May, 1985.
19. Halfár, A.: A fogyasztási szolgáltatások 1984. évi alakulása, 1985. évi fejlődési tendenciái (Consumption services in 1984, tendencies in 1985). Research Institute for Services, Budapest 1985.
20. A tanácsi felügyelet alá került volt GELKA, AFIT egységek gazdálkodásának áttekintése (Review of the management of ex-GELKA and AFIT units put under the supervision of local councils). Állami Bér- és Munkaügyi Hivatal, Budapest 1984.
21. Drexler, B.—Belyó, P.: Nem szervezett, első sorban illegális keretek között végzett szolgáltatások (Tervezet) (Non-organized services mainly done in an illegal framework [Draft]). 1985.

22. Polgár, M.: A borravaló egy autójavítóban (Tips in a car repair service-shop). In: Fazekas, K.—Kalász, I.—Köllő, J. Polgár, M.—Révész, G.—Sziráczki, Gy.: Kereseti és bérviszonyaink (Conditions in the field of wages and earnings). *Publications of the Institute of Economics of the Hungarian Academy of Sciences,* No.28. Budapest 1983.
23. Oszoli, Á.: A személygépkocsi javítás alakulása 1983-ban, a VII. ötéves terv koncepciója (Car-repair services in 1983, the conception of the 7th five-year-plan). Research Institute for Services, Budapest 1984.
24. Oszoli, Á.: A személygépkocsi javítás fejlődése, s az átszervezés hatása a szolgáltatásokra (The development of car-repair services and the effect of reorganization on services). (Manuscript) Labour Research Institute, Budapest 1985.
25. Czenki, K.: A híradástechnikai készülék- és háztartási gépjavító ágazat vizsgálata (Examination of telecommunication equipment and household appliances repairing branch). (Manuscript) Labour Research Institute, Budapest 1985.
26. Lonti, Zs.: A kisvállalatok és a kisszövetkezetek 1983. évi teljesítményei és keresetalakulásuk (The performance and earnings of small enterprises and cooperatives). *Munkaügyi Szemle,* 1. 1985.
27. Demcsák, M.: Szegény szervizek (Poor service firms). *Figyelő,* 15 January, 1987.

МЕЛКОЕ ГОСУДАРСТВЕННОЕ ПРЕДПРИЯТИЕ—ПАЛЛИАТИВ ДЕЦЕНТРАЛИЗАЦИИ ОРГАНИЗАЦИОННОЙ СТРУКТУРЫ

Т. ЛАКИ

В ходе попытки децентрализации чрезмерно концент-рированной организационной системы экономики с 1982 г. возникла новая организационная форма, мелкое государственное предприятие. Предполагалось, что эти гораздо меньше традиционных предприятий организации, с более простым делопроизводством, с льготным налогообложением, самостоятельно работающие, будут способны рентабельно функционировать и оживить конкуренцию.

В 1985 г. работало уже 196 таких мелких предприятий, подавляющее большинство—в сфере услуг (ремонт легковых автомобилей, ремонт бытовых электро-приборов и радиоаппаратуры, парикмахерские, химчистки и т.д.). Однако они не оправдали возлагавшихся на них надежд: качество обслуживания не улучшилось. Вместо конкуренции работники государственных мелких предприятий создали собственную клиентуру и работают в свою пользу, используя государственное оборудование, материал, в рабочее время, пользуясь тем самым нечестными привилегиями как по отношению с рабочими крупных промышленных предприятий, так и самостоятельными мелкими ремесленниками, легально занимающимися таким трудом и платящими соответствующие налоги.

В статье рассматривается несколько причин неудовлетворительного функционирования мелких предприятий. Не удалось создать соответствующую организационную форму: большинство видов подобной деятельности требует не предприятия как организационной формы, а специфическое мастерское с одним или несколькими работниками. Однако и на этот раз не отказались от неоднократно объявленного ошибочным принципа, провозглашавшего превошодство государственной собственности и определявшего на протяжении десятилетий и соответствующую практику. Все это усугубило то, что государственное управление не способно дать даже мелким предприятиям более полную самостоятельность, чем крупным. Пример мелких предприятий—это урок для всех наших попыток реформ: новые формы и решения не могут быть успешными, если базируются на старых, прогнивших основах, успешные мероприятия требуют более глубоких изменений.

Acta Oeconomica, Vol. 39, (3-4), pp. 271–290 (1988)

MARKET-ORIENTED SCIENTIFIC RESEARCH AND DEVELOPMENT AFTER THE ECONOMIC REFORM

K. BALÁZS

The economic reform of 1968 was followed by new Science Policy Guidelines issued a year later. The success of the Guidelines made Hungarian science market oriented, however, the market on which it emerged is no competitive but sellers' market. The reaction exerted by market relations confused the roles of and the division of labour between the institutes. It transformed the researchers' activity structure and tied the standards of research to the low technological level of Hungary's national economy. Science and the sphere of $R+D$ have adjusted themselves to the opportunities offered by relations within the economy. Basic research has gradually been relegated to the background while applied research and development have come to the fore because they brought income. It also involved intensive atomization of the $R+D$ sphere.

In recent decades the economic roles of technical development and scientific research, respectively, have not received much attention from Hungarian economic theoreticians. Aside from, mostly technocratic, writings formulating expectations toward technical-technological development, the issue has been dealt with at random and almost incidentally in professional literature. [1, 2] Empirical research into the economic mechanism and into the reform has passed over a systematic survey of technical development.

The question has failed to arouse the interest of both companies and researchers and this indicates the *peripheral* role of the problem within enterprise management and, up until recently, in central economic management as well.

It is a proven fact of economic history that, simultaneously with the establishment of mandatory planning, functions necessary for the market operation of a firm were separated and removed from the enterprises, while bureaucratic sections serving a vertical dependency were extended. [3] Researchers trying to explore company attitudes and their internal operation mechanisms simply wrote about what they found at companies. [4]

They could not describe non-relevant company functions. This would have resulted if the question had been posed differently.

In (central) economic management and in the major trends of system regulators and industrial policy, numerous other expectations and guidelines have dominated the requirements of technical development in recent decades. The role of investments and that of the technical development cannot be fully separated within the centrally initiated and implemented development programmes. The examination of the economic role of technical-technological development, seen as an eco-

nomic question, was overshadowed by restructuring, by the allocation and distribution problems of investment quotas, by the debates on selective industrial policy and by other related issues.

Beside stressing the importance of the market in general and analyzing the role of market factors in particular (price, exchange rates, credit, shares, capital and labour market, banking system etc.), the literature on reform economics has tended to neglect the *technical development*—that is, with regard to its economic content—a *competition-related category* and not a market category. It is an activity necessary for the market competitiveness of firms and for the world market competitiveness of the economy as a whole. Thus its role is closely related to the role of the market, and to the importance of success in the market.

If, to put it simply, we identify the economic reform mainly with market processes, the economic analysis of technical development is left to offer only indirect clues about the reform process. As it is, the attitude to the new technology (techniques) of companies and economic management (the relevant interests and ways of behaviour) provide information about the actual role of market coordination.

Looking into the question from such viewpoints means analysis in at least three directions: the survey of companies, of central management organs and of institutions engaged in $R + D$; such analysis should concentrate on their interest in techn(olog)ical development, their relationship to the market and to each other.

In this article I will not give all three directions equal attention. In this study the focus is upon scientific and $R + D$ institutions and what I try to establish is how the $R + D$ sphere has adjusted to the post-reform economic environment. The research looks to see if changes and trends in $R + D$ institutions can qualify the state of the domestic market as established in the 1970s and 1980s.

Since the company, (central) management and $R + D$ spheres are closely interrelated with supply and demand and with the hierarchy, I have deemed it necessary to support the reality of facts, beside stating them, with some theoretical reasoning and statistical data. However, I appreciate that a part of the correlations require further research.

Scientific policy implications of the reform

The 1968 economic reform was followed by new Scientific Policy Guidelines in 1969. In the spirit of the economic reform, the scientific policy formulated new expectations towards, and set new goals for Hungarian science. The essence of this was that $R + D$ institutions should contribute to improving the Hungarian economy's efficiency and that scientific research should be practice-oriented. The means of implementing the guidelines were, as with the economy, to create financial interest and to turn toward the scientific market. When studying the reform

process, one cannot shun the question whether the Hungarian science policy was successful in implementing the concept as it was understood in 1969 and, if it was, can this now be considered as having been a success for the Hungarian economy and science?

By analyzing the processes of the past 20 years I want to prove my hypothesis:

The successful implementation of the Science Policy Guidelines, while making Hungarian science market-oriented, included certain *destructive* elements as well. Hungarian $R + D$ has actually become market-oriented, but the market in which it has become an actor is not a competitive market but one of a resource-constrain economy. The repercussion of market relationships muddled up roles within the science as well as the division of labour among institutions, it changed the structure of activity of research workers and tied the level of scientific research to the low techn(olog)ical standards of the Hungarian economy. The atomization of the $R+D$ sphere and the devaluation of science had started and it soon accelerated.

First of all, an explanation of the meaning and importance for science of the notion "market-oriented" is needed. Why has the market to be analyzed in order to understand processes going on in science?

This is necessary in order to understand and to see where the processes to be analyzed actually originated, and to do this it is necessary to look at the pre-1969 history of the Hungarian $R + D$.

Point of departure

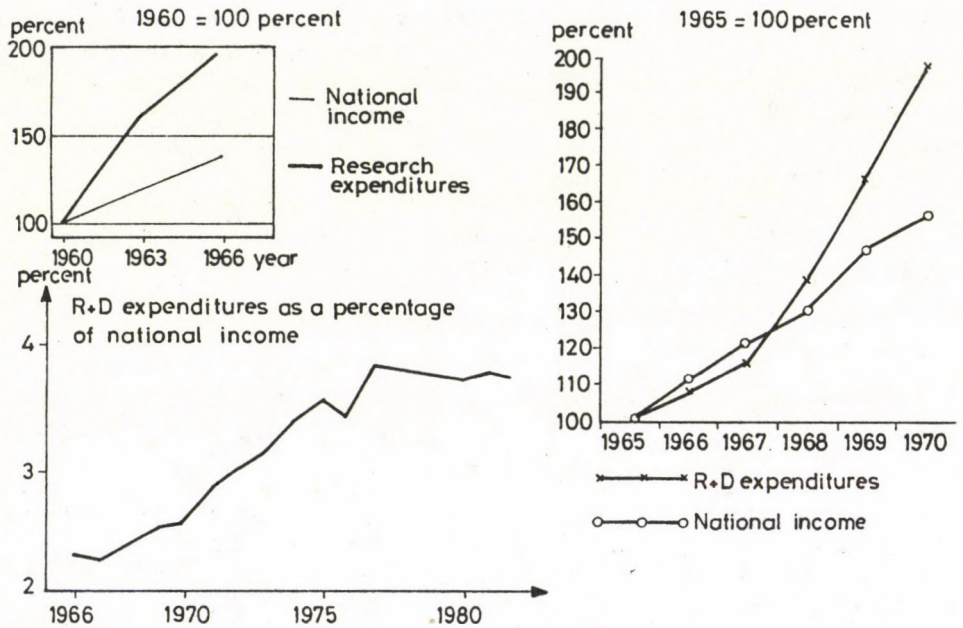
In Hungary, scientific research and development activities were separated from the economy, from companies and from all other institutions pursuing other basic activities. This is why the relationship of science ($R + D$) and practice (industry, agriculture) has to be analyzed as a relationship of separate institutions.

The systematically separated $R+D$ network was the product of the autarkic economy- and science-policy of the 1950s. The task of intitutional scientific disciplines and types of research was to help Hungarian science catch up with the world by producing autarkic scientific achievements. The $R + D$ sphere thus developed in the way outlined below.

In the spirit of specialization, rationalization and centralization (dominant features of the industrial policy, too), big academic research institutes were set up to perform original or basic research for a single discipline, and parallel to that, for each branch of industry industrial research institutes were established to conduct applied research and development. At the same time, research teams at companies were dissolved and the primary task of universities became teaching. The establishment of scientific institutes involved the regrouping of research workers and technical experts.

The build-up of the relevant $R+D$ structure and the running-in of institutions continued well into the *1960s*. The sums spent on $R+D$ grew at a faster rate than the national income. (In fact, this trend continued until the early 1980s.)

Research institutes financed their operations from that part of the state budget allotted for them and occasionally complemented from various central sources. Beside the sum spent from the budget on science and $R+D$, some two thirds of the technical development funds (the setting up of which was obligatory for companies) were centralized. OMFB[1] and the ministries disposed jointly of the centralized technical development funds. The size of share from the budget was set in line with the given institute's size.



(Uniform statistical recording of $R+D$ started in 1966; consequently, data from before and after 1966 are not homogenous and cannot be put into chronological order.)

Source: [5, 6]

Fig. 1 National income and expenditures on scientific research

Fig. 2 shows the increase of the average data of research institutes and the differences in this respect.

[1] OMFB is the abbreviation for National Technological Development Board.

Table 1

Essential data on research institutes, according to the number of research workers employed, 1966

Number of research workers employed	Distribution in percentage of					
	Research institutes	Research workers	Auxiliary scientific staff	Research expenditures	Investments	Research projects underway
1–10	8	1	1	1	0	2
11–25	26	9	6	7	6	10
26–50	29	21	18	18	18	27
51–100	24	33	32	32	36	33
over 100	13	36	43	42	40	28
Total	100	100	100	100	100	100

(Nine medical scientific institutes exluded.)
Source: [5]

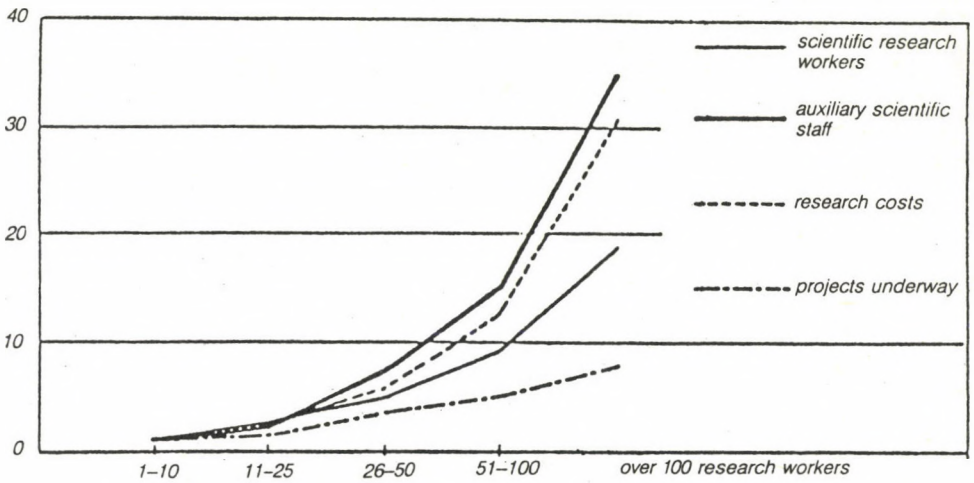


Fig. 2 Average data per one research institute, according to the number of scientific research workers (Average of institutes with 10 or less = 1) 1966

The institutes began to compete for *allocations* and *for more central resources* in order to further growth and investment. Thus the financing of research depended on the availability of resources—that is, on relationships to $R + D$ centres.

The first and foremost interest of institutes was, due to their professional commitment and central financing, to cultivate the individual disciplines on a high level and to actively participate in domestic and international scientific life.

Changes induced by the reform

As a result of the 1968 economic reform, new conditions of operation were created for $R+D$ institutions too. The central idea of the reform was that, by letting market mechanisms work, the positive impact of the market would emerge and develop. The ensuing competition, operating as a kind of selection, would improve economy's efficiency and its world market competitiveness. Accordingly, scientific research institutes were expected to serve the requirements of the economy using technical innovations; their activity was to be normative in the long run and at the same time satisfy the orders and requirements of companies. The expections were combined with new measures with regard to management. *The amount of central subsidies was frozen at the then prevailing level and new financing possibilities were provided for the research institutes.* They could *enter into contracts* with, and perform work for, other institutes and companies. They could also keep their earnings. A further source of income was state orders and $R+D$ target programmes. (Unfortunately, budget statistics of institutes are not available. Owing to changes in the number and type of institutions, aggregated data of $R+D$ cannot be used to illustrate the afore-mentioned relationship. With regard to the entirety of $R+D$, we shall return later to changes in the relative weight of financial resources.)

The economic reform did not evolve as originally expected. In the event, competition did not prevail in a limited market; the state-bound, hierarchic dependency of companies remained a decisive feature, determining interests.

This had, however, profound consequences for the implementation of scientific policy as well, since the reform failed to bring a radical change to the innovatory capacity of economic organizations; technical development or the introduction of new technical solutions are still not in the interest of companies themselves.

The readiness of companies to innovate and their relationship to new technology is of vital importance for the sales opportunities of $R+D$ institutes. In the market of scientific achievements, the products and working capacities of research institutes are on the supply side and the companies stand on the demand side. The demand which research institutes face is closely related to the introduction of new technical achievements at companies and to the interest of the companies in innovation. Therefore, to be able to analyze the demand-and-supply position of research institutes entering the market, we must get acquainted with the status of innovation in the post-reform Hungarian economy.

Facts and theoretical considerations with regard to the status of innovation

The most palpable result of innovation by companies is evidenced by the proportion of their new or updated products. The primary means of making headway in the market is to come out with new products, to improve existing ones (quality, service) or to reduce their price. In Hungary, the proportion of new products is very low (1.5 percent approx.) and over 90 percent of all products have been marketed *unchanged* for many years. It is customary to calculate the cycle of full replacement of products on the basis of the proportion of new products introduced in a given year. Taking the 1.5 percent into account, this would take some 67 years in the Hungarian economy. (It is not a good comparison but illuminating to know that the same cycle for the electronics industry of OECD countries is 6 to 10 years.) In Hungary, there has been a nationwide recording of new products since the 1980s only, but it would be futile to assume that the situation was any better before.

Table 2

Sale of industrial products—according to their up-to-date characteristics—in state-owned industries, as a percentage of the sale of products manufactured in commercial quantities

	1981	1982	1983	1984	1985	1986
Total number of products	100	100	100	100	100	100
New products in that year	1.4	1.1	0.9	1.6	1.7	1.3
Updated products	1.3	2.4	2.1	1.7	1.8	1.5
Modified products	3.2	3.9	4.1	5.0	5.2	2.4
New products for the company	1.3	1.0	0.9	1.1	0.8	1.2
Unchanged products	91.8	91.6	92.0	90.6	90.5	93.6

Source: [7]

Also, data on the applications for licences provide useful information on the innovation activity of companies. The extent of licences applied for is important for my line of reasoning because they, and their introduction (through imports) may be an alternative source of technical information to the "supply" side of domestic $R+D$ institutions.

With regard to the magnitude of innovation activity, the difference in the data of two consecutive years provides information. (This difference depends on several factors: the number of new licences, the development of sales by the branch, in the branches, etc.)

An internal comparison can be made with regard to licence imports.

Table 3

Share of sales of products manufactured by the socialist sector industries under licence, as a percentage of total sales*

	1980	1981	1982	1983	1984	1985	1986
Mining	0.1	0.1	0.2	0.2	0.3	0.3	0.3
Electric energy industry	–	–	–	–	–	0.0	0.0
Metallurgy	7.3	7.4	7.2	8.3	9.5	8.7	8.0
Engineering	8.5	7.2	8.0	9.2	9.5	9.4	9.4
Building material industry	4.4	3.6	3.9	4.9	5.4	4.9	7.8
Chemical industry	9.2	8.7	10.0	11.0	16.2	18.0	18.7
Heavy industries	7.0	6.3	6.9	7.8	9.7	10.0	–
Light industries	2.9	3.1	3.0	3.8	3.3	4.2	4.0
Food industry	1.3	1.5	1.1	1.1	0.9	1.3	1.3
Industry total:	5.3	4.9	5.2	5.9	7.1	7.6	7.5

*In Hungarian terminology this means state plus cooperative firms. (*Ed.note.*)
Source: [7]

Table 4

Licence 'imports' as a percentage of $R + D$ expenditures

The Netherlands	17.4
Sweden	5.8
Norway	11.0
Belgium	17.2
Austria	13.8
Finland	13.4
Greece	22.0
Hungary	4.0

Source: [8]

Considering countries which are particularly dependent on licence 'imports' as part of their $R+D$ expenditures, Hungary certainly appears to be lagging behind.

The source of finance for companies buying licences, as well as other $R + D$ expenditures, is the technical development fund.

As can be seen, less than 10 percent of both corporate and central TDFs is being spent on licences. Its overwhelming part could thus be spent on domestic development. Still, in the fifth and sixth five-year plan periods some one-third of the corporate TDF remained unspent. (Source: [7]).

With the above data I want to support the following assertions: that innovative activities in Hungarian industry are significant, that there are reserves in the industry that could be spent on $R + D$ and that buying licences from abroad would not harm the domestic $R + D$. (A thorough statistical verification would of

course call for a deeper analysis.) In the following I would like to raise a few theoretical thoughts as well to show why such assertions can be made about Hungarian companies.

The post-reform Hungarian economy is a resource-constrained one and it is essentially a sellers' market. The economic interest of companies is set by a hierarchic dependency. What do these facts mean for innovation?

Table 5

Licence expenditures as a proportion of drawing on the technical development funds

Corporate technical development funds (TDF)	1976-80	1981	Central technical-development funds (TDF)	1976-80	1981
1. Mining	7.6	3.5	a) Ministry of Industry	8.7	10.4
2. Electric energy industry	2.2	2.2	b) Ministry for Construction and Urban Development	11.1	13.9
3. Metallurgy	10.3	8.1	c) Ministry of Food and Agriculture	0.8	3.9
4. Engineering	10.4	5.2	d) Ministry of Transport and Post	2.4	0
5. Chemical industry	7.4	7.5	e) National Technical Development Board	6.9	7.2
6. Light industries	7.4	15.0	f) National Water Board	8.1	5.1
7. Industry, other	7.4	0	Economy total	7.5	8.3
1-7 Total	9.4	6.3			
8. Building material industry	16.4	4.5			
9. Construction industry	7.9	3.2			
8-9 Total	11.6	3.7			
10. Food-processing industry	11.8	7.2			
11. Agriculture		8.6			
10-11 Total	11.8	7.6			
12. Transport and telecommunications	0.9	0.4			
National economy, total	9.3	6.1			

Source: [8]

Innovation or the introduction of new techniques means changing production conditions. Thus there needs to be a restructuring of production, the working process and, because of the new tasks of purchasing and selling, the company's market position. This brings changes to the life of *the company as an organization*. All organizations and all established hierarchic structures tend to strongly resist any changes [9]. The change of such an organization, or that of the roles in it can only be achieved by enforcing an external interest stronger than the power interests tied up with its internal stability. In the case of changes tied to innovation, the internal interest is to hold fast in competition.

Yet in resource-constrained economy there is no genuine competition in the market.[10] It is a sellers' market where anything can be sold because demand cannot be satisfied properly. In such a market, the seller's position implies that he *does not have to fight* for the buyers by improving the quality of his product, reducing its price or adding products to the range offered. There is nothing *to force him* to upset his well-established organizational and market relationships—i.e. there is no incentive *to introduce new techniques*. What is more, the seller enjoys such a position in the market that he is able to keep his position. Thus he remains indifferent, moreover, resistant to technical development. Innovation is not in the interest of companies.

From *the stable position of companies as sellers* there follows another peculiarity of the sellers' market. Even if they appear as buyers, their attitude is preset by what they can expect as sellers. Excess demand in the market determines, as a sort of *a vicious circle*, the behaviour of sellers and buyers. The company as a buyer is competing with other buyers for the product. This compels the company to buy the more expensive products of inferior quality, simply *to keep production running*. The company, as a buyer, can make such allowances since later on, as a seller, it will pass the burdens onto its buyers. A dominant feature of the sellers' market in a resource-constrained economy is that *anything can be sold* (irrespective of price, quality, selection, delivery date etc.) *except* one group of products—and this is *the range of products embodying innovation*. This is because products and production procedures embodying new technologies do not serve the preservation but the change of current production, which companies are reluctant to do.

Analysis of the market position of companies shows their relationship to innovation with regard to their horizontal ties. The vertical dependency of companies is also of vital importance.

Companies are relieved of the pressure of competition *due to their hierarchic relationships*. The array of subsidies and withdrawals removes genuine competitiveness and, instead of risks, it creates "safety of existence". In order to win and keep a favourable bargaining position, companies do their best to get along well with the authorities and to live up to the expectations the authorities and others raise towards them.

What does technical development as an *expectation* mean in this type of economy?

An "expectation" may be an efficient means of industrial policy if firms can be called to account for its implementation. How can the authorities insist upon the implementation of innovation? *The answer is: quantitatively.* What can be observed and controlled is the amount spent on an innovation and the resultant number of new products or new processes introduced. Yet the quality of technical development cannot be insisted upon, because it simply cannot be measured.

From the viewpointof efficiency, the essence of innovation is the improvement, or at least preservation, of a market position. In the absence of competition, the competitiveness of companies cannot be measured; thus the quality and success of an innovation cannot be measured either.

It follows from the above that innovations introduced in this economy are frequently of poor quality and, their appearance is merely a formality.

In the following we want to show how science, and in it the $R + D$, have adjusted themselves to the economic environment created by the reform.

Status and position of institutes and research workers in the 1970s

The situation of institutes and research workers in the 1970s was determined by two basic factors:

— budget allocations were frozen and the way for earning incomes through contractual assignments was opened; thus the method of widening financial resources became the taking on of 'outside' jobs;

— owing to the absence of interest in new technologies and the lack of motivation, no genuine and active demand for $R + D$ institutes emerged. Moreover, economic organizations remained passive, sometimes even resistant, to the introduction of new scientific and techn(olog)ical achievements.

The shift in the financial/economic possibilities of $R + D$ institutions, along with an inflation that substantially reduced the purchasing power of subsidies, forced research managers to look to the market for the acquisition of investment goods, instruments and research materials. Thus the "reform concept" took effect in this circle of institutions: science became exposed to market influences and was compelled to adapt itself to the market in order to earn a livelihood. In the course of this *adaptation* the attitude and structure of activity of Hungarian science, research and development was gradually transformed and consequently adjusted to the situation of the economy.

The main trends in the changes which evolved are considered below. [11]

1. *In the relationship between science (R + D) and the economy a unilateral interest emerged*, this coming from the side of the science. The way to increase the

share in real value of financial possibilities became the joining of central medium and long-term programmes, getting the support of the Central Committee for Technical Development (OMFB) and entering into contracts with companies and other economic organizations. Dependence on central technical development funds resulted in limited possibilities only, so contracts became instrumental and vital for institutions. Since the economy did not actively seek $R + D$ "products", it was *the institutions who moved into action* and went to look for partners, organized cooperations, and established and maintained contacts. Such a process means that research workers must not only handle sales and perform the relevant managerial tasks but, on top of this, they must do so in a passive and sometimes even resistant atmosphere. Managerial and organizational tasks have become part of the life of institutions, and this situation has not helped scientific work. Research institutes were not designed to have an *"economic infrastructure"*, their employees must act as research workers, managers, scientists and accountants.

Since companies are not interested in buying $R+D$ products (for reasons associated with advertising, competition, price, quality, expected market advantages etc.), the realization of scientific achievements must take place in an atmosphere of indifference; consequently, it seems the best method of accomplishing such realization *to make use of informal contacts*. The basis for establishing and stabilizing personal and institutionalized informal contacts is the conciliation of interests (although not those of the competitive market).

2. *There are two major types of relationship between $R+D$ and the economy*. These depend on the "sacrifices" and efforts that confront the economic organization concomitant with its acceptance of cooperation with the $R + D$ institute:

a) *Cooperations concerning the short-term interests* of companies. Since the constant change of regulators, and the lack of accumulation possibilities and financial interest force Hungarian companies to devise mainly short-term strategies, such types of relationships are more acceptable to them. In the context of short-term interests, we find "business" forms of cooperation that do not cause too big a change in the process of production and do not require substantial intellectual, physical or material investments. Relationships concerning short-term interests are, in most cases, built *on personal acquaintances* or on common personal interest (individual professional interest, ambition, financial interests, prestige).

In this form of cooperation, research institutions are helped in fighting the indifference of companies by two factors. One is the mandatory technical development funds that the companies are permitted to spend on $R + D$ only. (The accumulation of such funds was mandatory until January 1 1985; since then only the chemical industry and engineering companies are required to observe such a practice—and they provide two thirds of the total TDF.)

If the company's technical development funds have not been used up the cooperation can be financed without any difficulties. (As I mentioned before, about one third of the TDF of companies remains unspent.)

All companies give formal recognition to the need to meet the high-level expectations concerning technical development.

b) The other type of cooperation *concerns the long-term interests of companies*—but this is much more difficult to implement. Companies dislike planning for the long run and long-term interests do not function as economic incentives. This is partly because of the changing and unpredictable economic regulators and environment and partly because bargaining—a typical relationship between company and authority—determines economic terms for companies for short periods only. Long-term cooperations change the routine company operation. They call not only for expenditures but also for organizational changes, for the reorganization of long-established production procedures, the rearrangement of market contacts and not infrequently, they also affect the position and power of certain executives. All in all, it requires efforts that are not in the primary interest of the company.

Hence to conclude such types of cooperation demands much more preparation, organization and persuasion from the research workers concerned. To persuade companies and to overcome their reluctance (or resistance) with regard to long-term planning is an enormous task which calls for ceaseless effort. Often it requires much more than the activation of personal contacts or the mobilization of the unspent TDF. For instance, institutions use their close personal and institutional contacts with the authorities who represent technical development expectations. This is done in an indirect way and, in order to realize the cooperation, they also solicit administrative pressure from authorities (OMFB, ministries).

Satisfaction of financial requirements that go beyond the technical development funds is made possible by acquiring central subsidies (for instance OMFB), by participation in development programmes or by companies and research institutes *taking part jointly in competitions for funds* (for instance provided by the Hungarian Academy of Sciences). The solution of financial problems is also the interest of researchers but this is the point where they may raise the interest of their economic partners as well. *Money raised for the purpose of cooperation may often be spent on solving other development problems of the company and may thus be used for its own purposes* as well.

c) Since the beginning of the reform process the science and the $R+D$ sphere has *complied* with the possibilities of relationships with the economy. All types of institutions have restructured their activities. They have gradually pushed basic research into the background; consequently, in academic, industrial and university research places—as well as in certain resurrected corporate research departments—*applied research and development has become the priority*, together with other paying activities. The originally rigid differentiation of the types of institutes and types of research has ceased, along with the institutional hiearchy and disunity of the innovation chain—that had been the basic idea behind the set-up of the $R+D$ network. Now, a sort of coordinative, homogenizing tendency can be observed with regard to the different types of research.

d) Adjustment to the conditions and interest relationships of economic ties has resulted in the formations described below.

The main types of the so-called "short-term" relationships are as follows:

— Financing the institute's *own research projects* as a company project by drawing on the company's technical development funds. The utilization of the resulting "study" is at the discretion of the company, and financing is no sacrifice because of the reasons mentioned before.

— Researchers *offer to cooperate* with companies in order to solve problems of mutual interest. Since the industry rarely contemplates strategic development, researchers are given tasks which, if solved, may help maintain and organize the current production—namely, they tackle actual problems. In other words, the cooperation does not go beyond daily development and application questions.

— In possession of special instruments, equipment and professional knowledge, the research institute is able to render *services*.

"Long-term" interests are affected by two forms of cooperation:

— introduction of *production technologies* and automation procedures for the modernization of products and regulation of the production process,

— introduction of *new products* developed by $R + D$ institutions.

Except for the first form of "cooperation", in all cases it is the research interests that comply with the demands of companies—more precisely with the existing technical level of the economy and with the organizational flexibility (or rather inflexibility) of the economic organization (factory). Yet compliance with the "customer", or let us say with the "market", demands not the achievement of the possible professional optimum but just the other way round: *science must lower its standards to that of the "quasi-customer"* and it can force the introduction of new techniques to the limit of the low tolerance of the receiver only.

Another typical consequence of the difficulties in industrial, economic relationships has been *postponement*—that is, the companies delay putting the products into industrial production and eventually the research institute itself starts the manufacture of new equipment or instruments. *Production became a common activity* of $R + D$ institutions in the 1970s. Beside the difficulties of transferring new ideas to industry, this was also caused by the $R+D$ institutions need to be self-financing. Owing to favourable production and sale conditions, income from the sales of their own products has become a stable part of the gross earnings of research units. Economic regulators affecting research institutes have made them *interested* in increasing their *gross output* value. Profits are accumulated in proportion with the gross output value and, due to the classification as institutions, no production tax is applied. On January 1 1985 a modified regulation of $R+D$ institutions came into force. this meant that instead of institutions, the regulation favoured the $R+D$ activity itself (such as profit tax allowances, preferential allocations, non-repayable subsidies). Regulations both before and after 1985 have made institutions interested in "in-house" production, because of the increase of the gross output value.

(Theoretical research results may be sold "only" as a value added; material costs, depreciation allowance etc. may be taken into account to a much smaller extent.) At the same time, the institutes also requested that their production be accounted for not as production but as a part of their research and development activity. (Before 1985 this was desirable so that the institute could keep its $R + D$ status.) This has meant that equipment—often produced in batches—has been sold, with slight modifications and as a specific scientific achievement or a piece of individual equipment, in the form of an $R + D$ contract.

It follows from the above-said that the magnitude of production within the $R + D$ field cannot be statistically observed. Production-related data in official $R + D$ statistics are not realistic, for they do not fully cover the actual processes.

e) Contrary to the foundation concepts, basic as well as application-oriented basic research was pushed to the background and preference was given to activities ensuring financing and financial returns. However, this structure of activities became a necessity by the late 1970s, since incomes earned on outside contracts were sufficient to cover the costs of ongoing basic research (in universities, often those of education, too [12]). With regard to the Academy, profitable production and the taking on of other jobs became a *sine qua non* of operation for the whole network of institutions belonging to the Academy.)

f) Sales contracts, cooperation agreements between science, the $R+D$ sphere and the economy (industrial companies, agricultural organizations) appear on the surface in market forms. They may also be described by using market categories—even if there are no competition-market relationships and there *happens* to be *no competition-market interest reconciliation*. Since it is the research institute that is interested in establishing economic contacts and the company is passive or resistant, contracts are usually individual agreements. Though $R + D$ products and cooperation have their prices, this does not play a critical role in establishing relationships; the ciritical factors are the personal informal relationships and the formal, hierarchic dependencies hidden in the background. There is no such thing as a "scientific-market", there is no competition among research workers, there is no market publicity and thus no demand develops. Owing to the division of research territories and the monopolistic position of the individual themes, some of the relationships with industry are forced ones, and central organs supporting preferred themes (for instance OMFB: "the money must be distributed") are also in a difficult situation—i.e. they have no choice.

In the course of the process of adaptation, the research institutes have turned from being budgetary institutions into economic organizations—that is, they form a second layer in the economics of production (industry taking first place).

Due to the fact that there is also production going on in the institutes, the whole innovation process often takes place there as well. By marketing their results, the performance of all enterprise and economic functions has become the task of $R + D$ institutes. Management has moved to the forefront of institutional and

research life and research tasks now conform to the provision of economic conditions. The internal management and the financing system of institutes (institutions) also conform to this. Subsidies from the budget are usually divided, by some time-honoured method, among departments (other units). Apart from this, the departments or units are self-financing, and their independent task is to ensure the income necessary for carrying on their work—i.e. as independent economic units. The central management of the institute has, in the process, become increasingly a mere guider, a coordinator, and its managerial functions have prevailed over scientific control. In many places a complicated system of internal management has developed: with the establishment of institutional risk funds, internal credit systems and incentive schemes. In fact, complementing the economic functions of units, the management of such institutions undertakes banking functions, too.

New developments of the restrictive period

The restrictive economic policy introduced in 1979, by modifying the system of regulators, did not change the direction of the adaptation process started in the 1970s. In fact, it deepened the existing tendency. [12] The structure that had evolved in the 1970s was stabilized, and production and management functions became prevalent. *The real value of central subsidies—nominally frozen in the early 1970s—in most cases fell.* The early 1980s saw an adverse change in the relationship between the growth of $R + D$ and the national income. Over the fifth five-year plan period $R + D$ expenditures grew by an average 9.3 percent p.a. in current prices, but by a mere 4.7 percent in the sixth five-year plan period. However, corrected by the implicit price index of the produced national income, the above-mentioned average growth was 4.1 percent between 1976 and 1980 and -1.46 percent between 1981 and 1985. In the latter period the annual average decrease of the national income (calculated with the implicit price index) was some -0.9 percent. Thus spending on $R+D$ fell quicker than the decrease of national income (used at home).

Table 6

Annual growth of $R + D$ expenditures

	1981	1982	1983	1984	1985	1986
At current prices	106.4	106.0	95.1	110.3	106.3	105.3
Deflated	100.2	99.2	90.0	103.9	100.0	–

Source: [13]

The figures show that on a national economy level, money spent on $R + D$

decreased. The relationships of researchers with industry were adversely affected by the growing tax burden on companies, by shrinking development funds, by a lid on investments and by the gradual lifting of the companies' obligations to implement mandatory accumulation of company technical development funds. As the financing possibilities of companies narrowed, the terms of establishing relationships became more difficult. Nowadays it is not enough to use the well-trodden informal or formal paths, or to operate with the given institute's prestige; nowadays it is not only interest but also the financial background that is missing—especially since nothing can be squeezed out of companies. These facts show that the managerial tasks of $R+D$ institutions are getting tougher and thus the provision of the necessary finance takes much more time and effort than before. A restructuring of the proportions of financing resources has taken place over the past 15 years. Of course aggregated data do not apply equally to changes in academic, sectoral and other $R+D$ units. At units where institutes had been almost completely financed by the state budget in the early 1970s (i.e. those belonging to the Academy), the relevant data cover deeper-going changes.

Table 7

$R+D$ costs of $R+D$ units according to the method of financing and financial resources

	1970	1975	1980	1985
From the central TDF of OMFB	3.2	5.9	4.9	3.6
From the central TDF of Ministry	17.5	14.8	13.9	9.9
From the state budget ministry	6.8	10.9	7.3	13.6
Research-development institutes	1.2	2.4	2.6	2.2
From companies	*35.6*	33.9	39.8	*41.2*
Others	2.1	7.3	6.7	
Contract, assignment total	*66.4*	*75.2*	*75.2*	*78.4*
Institute financing, from budget research subsidy	*31.3*	23.1	21.6	*16.8*
Others	2.3	1.7	3.2	4.6
Total (in percent)	100.0	100.0	100.0	100.0

Source: [6]

The processes that took place can be characterized mainly by changes in the proportion of the financing of institutes from the budget and contracts/assignments. In the 1980s new symptoms emerged and accelerated the tendency towards the independence of the research institutes and university departments, thus furthering the *atomization* of the $R+D$ sphere.

Owing to the modification of the system of regulators, new organizations emerged and spread. The formation of business work partnerships,[2] civil law part-

[2]GMKs by the Hungarian abbreviation (*Ed. note*)

nerships, and enterprise business work partnerships[3] gave research workers a greater freedom in the choice of project. It also provided them with more flexible possibilities for enterprise and greater opportunities for increasing their personal incomes. GMKs were often organized in the "shadow" of formal research institutes, based in scientific departments, and run by fellow research workers who knew each other as well as their trade. The capacity of GMKs to take risks is greater than that of the departments. The basis of such risks is the personal free time expended when investing their intellectual capital and physical labour. In the cooperation between research institutes and GMKs, both sides are interested in the market relationships. To sell its results, the GMK needs the prestige and weight of the institute and, in exchange for its name, the institute gets a share of the income.

With the spreading of GMKs, a dual structure has developed in the $R+D$ institutions. The parallelism of departments and GMKs has created a "doubling" of research teams and strengthened their nature as self-financing, independent economic units. The past few years have been marked by the level and structure of scientific research getting closer to the level of the economy and by a further and forceful atomization of the $R+D$ sphere.

Summary

A few practical and theoretical consequences may be drawn from what has been said:

1. In the wake of the reform, the $R+D$ sphere adjusted itself to its economic environment since financing regulators forced it to do so. Owing to the almost overall lack of demand for innovation in the Hungarian economy, this adjustment resulted in the devaluation of the previously heavily promoted scientific, research-development institutions.

2. It follows from the first point that should Hungarian scientific policy want ot maintain a high-standard research basis, it cannot build the activity of the latter on the demands of Hungarian industry. Experience of the past fifteen years or so indicates that research accomplishments have failed to stir up the innovative spirit of industry. On the contrary: due to disproportions in the structure of interest, it was the economy that forced "science" to adapt itself to the former's own technical standards.

3. The present $R+D$ basis may significantly contribute to the improvement of the economy's efficiency and competitiveness only if a genuine demand for its products emerges. However, demand for new techniques can be spurred on solely by adaptation to a competitive market.

[3] VGMKs by the Hungarian abbrevitation (*Ed. note*)

4. The main characteristics of the market of a resource-constrained economy do not apply uniformly to all actors and segments of the market. Unlike most of the market, products carrying the new techniques—and their distributors—do not operate in a favourable seller's market. They do not encounter an "almost unsatiable" demand and the market for their products is not that of sellers. There is no balance between supply and demand sides in the market of $R + D$ products and services either. Interest, hence defencelessness in the market, is stronger on the supply side. This is, however, caused not so much by tougher economic conditions (stricter budget constraints) but by other rules of the game. Securing incomes depends not only on the authorities but equally on the quality of relationships and bargaining with companies or with the "customer" in general. The nature of $R+D$ products results in their varying market positions.

It is safe to assume that there are even more special market segments in a resource-constrained economy that appears uniform in many respect, but their exploration and analytical study would require further research.

References

1. Laki, M.: *Új termékek bevezetése és a piaci alkalmazkodás* (Introduction of new products and market adjustment). Közgazdasági és Jogi Könyvkiadó, Budapest 1979.
2. Inzelt, A.: *Versenyképesség és az ipari struktúra változása* (Competitiveness and changes in industrial structure). Közgazdasági és Jogi Könyvkiadó, Budapest 1981.
3. Berend, T.I.: A vállalati fejlődés útjai és sajátosságai a XX.századi magyar iparban (The ways and specificities of company development in 20th century Hungarian industry). *Valóság,* 2. 1974.
4. Tardos, M. (ed.): *Vállalati magatartás—vállalati környezet* (Corporate attitude—company environment). Közgazdasági és Jogi Könyvkiadó, Budapest 1980.
5. *Kutatási bázis és fejlődése* (The research basis and its development). Központi Statisztikai Hivatal, Budapest 1967.
6. *Tudományos kutatás és fejlesztés* (Scientific research and development). Központi Statisztikai Hivatal, Budapest 1970, 1975, 1980, 1986.
7. *Iparstatisztikai évkönyv* (Yearbook of industrial statistics). Központi Statisztikai Hivatal, Budapest 1970, 1975, 1980, 1981, 1982, 1983, 1984, 1985.
8. Kardos, P.—Szatmári, T.: *Külföldi licencek a magyar gazdaságban* (Foreign licences in the Hungarian economy). Közgazdasági és Jogi Könyvkiadó, Budapest 1984.
9. Crozier, M.: *Le phenomene bureaucratique.* Edition du Seuil. Paris 1963.
10. Kornai, J.: *Economics of shortage.* North Holland, Amsterdam—New York—Oxford 1980.
11. Balázs, K.: Tudomány—szerződésre (Science on contract). *Valóság,* 1.1985.
12. Balázs, K.: Pillanatfelvétel (Snapshot '86). *Magyar Tudomány,* 2.1987.
13. Tolnai, M.: Utazás az Akadémia körül (A journey around the Academy). *Statisztikai Szemle,* 7.1987.

ОРИЕНТИРОВАННЫЕ НА РЫНОК НАУЧНЫЕ ИССЛЕДОВАНИЯ

К. БАЛАЖ

Через год после экономической реформы 1968 г. появились новые принципы научной политики. В результате их осуществления венгерские НИОКР стали действительно ориентированными на рынок, однако рынок, на котором они проводятся, не является конкурентным, а представляет собой рынок экономики с ограниченными ресурсами. На этом рынке роль инновации незначительна, поэтому не складывается спрос по отношению к предложению НИОКР. Ввиду отсутствия заинтересованности институтов НИОКР в самофинансировании и отсутствия спроса начался такой процесс приспособления, в ходе которого изменилось разделение труда между институтами, структура деятельности исследователей, основные исследования отодвинулись на задний план и большую роль приобрели проектные работы, обслуживание, производство, обеспечивающие доходы. Деятельности сети НИОКР связана с низким техническим уровнем венгерской экономики.

В экономике с ограниченными ресурсами рынок продукции, несущей новую технологию,—своеобразный частный рынок, для которого вследствие характера продукции не характерен почти неудовлетворенный спрос, это не рынок продавцов.

Acta Oeconomica, Vol. 39, (3-4), pp. 291–302 (1988)

ECONOMIC DIFFICULTIES—ECONOMIC REFORM—SOCIAL EFFECTS AND PRECONDITIONS

R. ANDORKA

In the next years the reduction of personal incomes seems to be necessary in consequence of the existing economic difficulties. In addition, the reform measures needed to overcome these difficulties might also cause temporary hardships for parts of the population. The paper analyses the social and demographic strata influenced most intensively by these hardships and suggests some measures against them. Families having children, young couples without suitable dwelling and urban unskilled workers are seen as the population groups experiencing the greatest economic difficulties.[1]

In the last two years an extensive debate has unfolded on the pages of the Hungarian economic periodicals. This debate is between the sociologists and economists who have been advocating radical economic reform, and it concerns the social preconditions and effects of the economic reforms and the social policy to be followed.[1, 2, 3] In this short study I would like to put forth my contribution to this sphere of questions.

I deem it necessary to develop the economic reforms with the aim of furthering the laws of the market such that they should grow much more predominant than they are today. Central planning should concentrate on the complex objectives of the national economy, should determine the *trend* of the changes and should only set concrete targets in the field of the public services. Parallel with this, I think it desirable to firmly support the activities belonging to what is called—not quite accurately—the "second economy" (i.e. activities outside of the socialist sector or usually additional to full-time working hours, which together have the effect of increasing national income and welfare.) It is also my opinion that, considering the present circumstances in Hungary, only a widely open foreign trade policy oriented to the world market can bring about further economic progress.

The type of economic reform as outlined above may cause some temporary economic tensions among the population. If, however, the resolute measures of the reform were not implemented, or were protracted, it would only postpone and very likely also increase the burdens laid on the people. By taking the necessary

[1] This study contains several ideas formulated during intensive discussions involving some members of the Department of Sociology in the Karl Marx University of Economics. For the views set forth here I am alone responsible, yet in the main it is the product of collective work and thus I express my thanks to my colleagues.

steps, however, there will be an opportunity to get out of the familiar economic difficulties. Consequently and in due course, the burdens lying on the population have the chance of being alleviated.

What are the economic difficulties that will very likely afflict the population in the coming years?

1. For the differentiated development of the efficient, productive economic units and branches capital investments are needed. The funds for such investments—or at least a part of them—would have to be raised by temporarily reducing the personal consumption of the population. (In the long run, of course, significant amounts will be released for this purpose by ceasing to subsidize loss-making enterprises. In addition, in order to increase the exports and to stop the tendency of growing indebtedness (and, later on, to revert it) a certain restriction of home consumption is necessary. Therefore, we must reckon with a transitory reduction of the per capita real income. However, the problem with these policies concerns the extent to which they will affect the social strata already living under unfavourable economic conditions.

2. Closing down loss-making production units will cause a temporary reduction of jobs—in other words, a certain level of structural unemployment will develop. Once again the question arises: will this not impose an even higher burden on a certain part of the population of active earning age—namely, on those already suffering from disadvantages such as the unskilled or those living in backward areas?

In the following I wish to add a few ideas to the possible development and treatment of the likely problems, based on what Hungarian sociology knows about today's Hungarian society.

Living standards and inequalities

The most often used indicator of the standard of living is the per capita real income of the population. After two decades of smooth and rapid growth, its increase came to halt in 1978 and since that time it has been rising with slight fluctuations and at minimal rates. The real wages in 1986 were, however, lower than the peak level reached in 1978. Up to 1982 income inequalities were—in contrast to the widely accepted opinion—not growing but diminishing somewhat. [4] The feeling that the inequalities were increasing may be explained by the fact that significant social and financial rearrangements had come into effect; the position not only of certain families but even of whole strate significantly improved, while that of some others grew considerably worse. Those in a deteriorating position, seeing the others "overtaking" them, felt, understandably, that the inequalities were increasing.

In the near future, for the sake of recovering from the current difficulties, it

may become necessary to reduce the personal consumption of the population. This will come about due partly to the devaluation of the currency, partly to increased price levels resulting from the introduction of an overall turnover-tax (VAT) and the implementation of a system of personal income tax. This reduction of living standards may afflict the particular demographic groups and social strata to very different degrees and may consequently lead to increasing differences in standards of living. An additional factor causing part of the society will be the job losses resulting from the closing down of loss-making enterprises. I shall deal with this in the next paragraph.

Let us see which groups and strata are most likely to be affected by this unfavourable process and what protection can be offered to them.

Almost two decades ago—at least since the introduction of the first economic reforms—a process began in which an increasing part of the population (especially low-income groups and families forced by their personal financial situation to make capital investments, primarily for the purpose of building or purchasing some form of housing) undertook various jobs after finishing their daily work in full-time jobs of the state-owned or the cooperative sector. This "extra" work served to supplement their "official" incomes. By doing so—with great efforts involved and considerable time expended—they could improve their financial position. According to a public opinion poll conducted by the Mass Communication Centre in 1980 the households also pursue the same strategy when their financial situations begin to grow worse. Thus, when asked what they would do if their families fell into an unfavourable financial position, 62 percent of the sample population responded that they would undertake additional work. [5]

Therefore such activities for the purpose of acquiring supplementary income are widespread in Hungarian society. According to Gy. *Szepesi*, the ratio of the labour incomes earned by such work within the total of personal incomes increased from 17 to 21 percent between 1980 and 1985. He estimates the time spent on surplus labour to be three of four thousand million man-hours per year. [6] According to G. *Révész* 3.9 million persons are engaged in such work—totalling a number of man-hours that would equal the man-hours of almost one and a half million full-time active earners. [7] In the opinion of T. *Kolosi* only 25 percent of Hungarian households do not participate in the second economy. [8] Although the time expended on this kind of work is very high [9]—and it may, in the long run, have unfavourable effects—the fact that a situation in which incomes are worsening may be reduced or even eliminated by people undertaking surplus work shows that there are some advantageous points attached to supplementary work. The number of people involved and the time expended are likely to continue growing, and for many, this strategy will, at least temporarily, retard the decline of their living standards. But to this end it is also necessary that economic policy should broaden the opportunities for pursuing income-supplementing jobs and create better conditions for them. The possibility of income-supplementation is not open for every family.

The people staying away from such work will primarily be those who, owing to their health conditions, are unable to perform surplus labour (or labour at all), i.e. the sick, the disabled and, to a particularly large extent, the elderly. We must emphasize that this does not apply to every elderly or pensioned person, because many of them maintain—if at a gradually declining rate—their ability to work for several years beyond the age of retirement. From the evidence of several surveys it seems that a significant number of pensioners take the possibility of employment in order to supplement their pension. Also, it appears that even more such people pursue income-supplementing activities (as opposed to paid employment)—especially in the villages, where a great many of them are involved in small-scale agricultural production. Of the total labour-time spent on small-scale production in 1982, 36 percent was performed by people of the age of 60 and over. [10] However, a large and increasing proportion (4.2 percent in 1984) of the population is older than 70 and in this age category the opportunities for supplementing incomes very probably decline.

We must also call attention to another demographic group: namely, the families with small children, especially where they take care of several children. In such cases the mothers—especially if they are active earners—can hardly find time to perform any work beside household activities.

From among the strata characterized by their socio-economic group or by domicile, the unskilled workers living in towns have the least opportunity to supplement their income. They have, in general, no possibility for small-scale agricultural production; at the same time they have no skills or starting capital for other types of income-supplementing jobs. This is why the wage level of the urban unskilled workers has been gradually This study contains several ideas formulated during intensive discussions involving some members of the Department of Sociology in the Karl Marx University of Economics. For the views set forth here I am alone responsible, yet in the main it is the product of collective work and thus I express my thanks to my colleagues. This study contains several ideas formulated during intensive discussions involving some members of the Department of Sociology in the Karl Marx University of Economics. For the views set forth here I am alone responsible, yet in the main it is the product of collective work and thus I express my thanks to my colleagues. This study contains several ideas formulated during intensive discussions involving some members of the Department of Sociology in the Karl Marx University of Economics. For the views set forth here I am alone responsible, yet in the main it is the product of collective work and thus I express my thanks to my colleagues. decreasing in relation to the average since the 1960s. According to the classification of the Central Statistical Office, which divides the population into nine strate (based on the profession of the head of the household), in 1982 the stratum with the lowest per capita income consisted of the unskilled workers living in provincial towns. [11] Their position was even worse than any strata of the pensioners' households classified by domicile (living either

in Budapest, in provincial towns, or in villages). (The income level of the unskilled workers living in Budapest or in village communities was somewhat higher.)

However, even the participants of the so-called "second economy" are, in the majority, not in a particularly favourable situation. More than one-third of them are involved in agriculture, being merely self-sufficient small-producers, who at most reduce, by their excess work, their food expenditure. [8] A quarter of them are only engaged in small-scale agricultural commodity production. Slightly more than a third work in the non-agricultural second economy (although a certain number of them work parallel with small-scale agricultural production). The average income that can be reached by small-scale agricultural production is very low. In 1982 the net output value per man-hour was 14 Ft. Only a rather small number of the agricultural small producers' households achieved an annual output value of 151 thousand Ft or more (with a considerably high—9 hours per day—labour input). [10] In recent years—owing to the fact that the raw material prices have been rising more rapidly than the selling prices—the profitability of small-scale agricultural production has declined. Therefore, the share of the income earned by agricultural small-scale producers within the total of the village population diminished, whereas the total of working hours spent on it has not decreased from the levels of the early 1970s. In the vast majority of cases, those engaged in small-scale agricultural production are not at all in a favourable income position—they merely earn a small supplement to the relatively low income earned in their full-time job.

We are much more vaguely acquainted with the income relations of the non-agricultural sectors of the second economy. In 1985, 242 thousand persons were participating in the enterprise economic work teams (VGMK by the Hungarian abbreviation) (with an average monthly income of 3000 Ft), 93 thousand were working in industrial and servicing cooperative groups (it was a full-time job for 31 thousand of them) and 60 thousand in independent economic workteams (GMK) established by private persons (18 thousand of these had this form as their full-time job). According to estimated data the incomes per hour gained by such activities were substantially higher than the hourly wages earned in the full-time jobs—even including over-time. The majority of the workteam-members, however, apparently undertake the excess work in order to cover some of their basic needs and not for the sake of luxury consumption. [12] There were 146 thousand artisans in the country in 1985 (77 thousand of these having their trade as their full-time job). Although we know little about their income relations we can conclude that their per capita income is not much higher than the average of those earning wages and salaries. In fact, only a small proportion of them achieved excessively high incomes. [13, 14, 15]

Those listed above constitute, however, only a small minor proportion of those engaged in the non-agricultural second economy; and about the income relations of the majority we know practically nothing. Such income-supplementing activities are mainly performed by skilled workers and the intellectuals but the differences, according to skills or professions, can be very high in both strata. For illustration,

it is enough to consider the extra income possibilities of a nursery school mistress and a leading obstetrician, or a skilled plumber and a skilled worker of the weaving trade. Even under such circumstances it can be stated, that very probably the members of these two strata will be able to cope with or prevent the decline of their standards of living.

From among the demographic groups, the relative income situation of families with children has unequivocally deteriorated in comparison with the average (and in comparison with childless families) since 1972. [11] On the one hand, this trend indicates the growth of a type of social inequality which can by no means be justified (after some decades, the majority of the children of currently large families will produce the national income needed as the source of old-age provisions and pensions for the now childless and one-child parents). On the other hand, it prevents the assertion of income distribution according to performance, since by the restriction of the number of children a much higher rise of the individual living standards can be achieved than by increasing labour performance. The significance of this fact cannot be played down by the argument that within the sphere of the younger generation it is hard to find families with three or more children. Indeed, in 1984 not more than 3.7 percent of Hungarian families had three or more children below the age of 15, whereas 17 percent of the children under 15 were living in families having three or more children (and if we take into account those who were older than 15 years but still dependants, this ratio is even higher).

Connected with the situation of young families with children, we must also touch upon the possibilities of obtaining a flat. In 1985, of the 72.507 new-built flats, only 12.956 were financed by the state. Thus, young married couples have almost no chance of obtaining state-owned tenement dwellings. Several sociological surveys have also revealed that it is precisely the young families at a greater than average disadvantage which have lesser chances of renting a state-owned flat; among other things, this is because in the villages hardly any state-owned dwellings are built. I must mention that the minimum income needed for a "narrow livelihood" does not contain the cost of building-up or purchasing some kind of dwelling. Therefore young couples either have to receive significant support from the parents (this is only possible if the financial situation of the parents is at least at an average level) or they must make extraordinary efforts to raise the amount needed for getting a flat. Taking as a basis the about 6000 Ft monthly average income in 1985 and the approximately 20.000 Ft/square metre current costs of housing, for a 50 m apartment (which is about the minimum size sufficient for a 4-member family), it is necessary for one of the parties to save 15 years' total income. Of course, the young couples can resort to loans granted by the National Savings Bank and other potential credits too; furthermore, it is possible to build houses from private sources at much lower costs, e.g. if a significant part of the construction work is done by the family members, relatives and friends. Whatever the options, there is no doubt that the acquisition of a dwelling imposes serious financial burdens on young people, on

top of the other grave difficulties they face. It is therefore necessary to improve the opportunities of getting a flat by providing credits for founding a family or for building dwellings; this is all the more vital because the construction of flats from state resources cannot be extended to a degree appropriate for solving the problem.

As regards the pensioners, the situation is different. The average per capita income of the pensioners' households (as opposed to families with children) has been gradually approaching the national average since 1962. One of the reasons for this is that the average pensions has moved nearer to average earnings and the other one is that the pensioners' opportunities to earn supplementary income have been improving. Despite this fact, the situation of most pensioners is deteriorating year by year, because the real value of their pensions is diminishing (except in those cases in which rising prices have been compensated for by central arrangements) and because, owing to progressing age, they are becoming less able to work for supplementary incomes. The relative betterment in the average position of the pensioned stratum is due to the fact that the older people with lower pensions are dying and their places are being "filled" by newly-retired persons receiving higher pensions. The deteriorating situation of the individual pensioners could only be eliminated by a constant revaluation of the pensions (i.e. linked to price indices, especially when greater price rises are expected). For a complete solution of the problem, however, the transformation of the pension system seems to be necessary.

In addition to solutions specific to some particular strata, a large extension of the social aid system seems to be desirable, at least for a transitory period, so that immediate support can be granted to the families finding themselves in an acute emergency situation. In 1985, 48.671 persons received regular social aid (28.896 of them receiving the whole of the standard amount, i.e. approximately 2000 Ft per month). This is less than a half percent of the population. In order to extend the coverage of aid it is also necessary to increase the network of welfare centres and the number of social workers. It is their task to notice when a family comes to face an emergency situation.

Employment

For several decades the Hungarian national economy has been characterized by full employment. What is more, in some areas of work a shortage of labour has even been present. However, there is concern that, due to the measures needed for overcoming the economic difficulties, many people will lose their job. This is a realistic expectation. In other words, if the enterprises permanently making losses cease to be subsidized from the state budget, they will have no choice but to close down. The weight of the problem can be demonstrated by the fact that at the close of 1986 Parliament granted Ft 20.5 thousand million for the transitory settling of

the debts of certain permanently loss-making large enterprises. This amount is nearly equal to that paid for family allowances in the course of the same year (21.5 thousand million Ft).

The temporary unemployment emerging in this way is an *unavoidable evil* which has to be faced for the sake of economic restructuring—although full employment must always remain the final objective. It is, namely, not valid to justify unemployment on the grounds that it would increase labour intensity and discipline. These factors are primarily dependent on proper work organization—thus it is mainly the responsibility of enterprise management to improve them. In badly organized workplaces even the workers threatened by unemployment cannot work efficiently.

Also, I do not belive that permanent, general unemployment would be unavoidable if price developments and the foreign exchange rates were to conform with market relations. In any case, however, some kind of structural and "frictional" unemployment has to be reckoned with. In order to treat it rationally, priority must be given to efficient re-training (along with the payment of re-education subsidies). This will provide the possibility of directing the labour force released from the closed down enterprises to other productive working areas. Even now, there are some sectors of the Hungarian economy which would be capable of employing a large part of the labour force released from the areas. For instance, the service sector provides such an opportunity. The share of those employed in this sector in Hungary lags far behind that found in other countries at our level of development (and could earlier be found in countries which are now more developed than Hungary but were then at an economic development level equal to our present position).

A permanent shortage of labour in the service sector is an every-day experience. Consequently, the fulfilment of society's service requirements is rather poor. True, the cost of the new jobs to be created in the sphere of the non-material services (health care, education, social care) will, by and large, be borne by the state budget. Yet if the burden of subsidizing permanently loss-making enterprises is lifted, a part of the amount saved can be spent on the creation of such jobs in the service sector.

Another large field offering potentional employment is the second economy, considered in a board sense. More accurately, I am referring to the activities pursued in small units. It is worth dealing with some particular branches of this rather heterogeneous area.

Small-scale agricultural production for self-supply may help many families—mainly those living in villages—in surviving the period of transitory income reduction; also, specialized commodity production could provide substantial additional income for a significant number of households. Creating and/or improving the necessary conditions (materials, machinery, marketing) would promote the spreading of such new types od small-scale production.

Table 1

The share of the active earners employed in the tertiary sector, in a few countries

Country	The share in percentage of all active earners employed	
	in trade	in the non-material services
Austria 1982	17.6	25.7
Finland 1982	13.9	33.2
Italy 1981	17.2	25.6
Portugal 1981	12.6	20.8
Spain 1982	19.6	21.1
Hungary 1980	9.8	19.9

In recent years the industry of *private artisans* has not developed in the way the economic leadership originally intended. In particular, the number of full-time private artisans grew far less rapidly than had been deemed desirable. R. I. *Gábor* and D. T. *Horváth* found the distrust of the potential artisans as the cause of this [13]. If this distrust could—by appropriate measures—be dispelled, and if, by granting loans (e.g. by paying unemployment benefits for several months in one lump sum), the artisans could be encouraged to make capital investments, it is sure that many more people would undertake activities which are, beside everything else, most useful for society as a whole.

In addition, employment could also be raised in other parts od the small-scale enterprise sector. A dynamic development of small undertakings would be favourable from the viewpoint of long-range economic and societal politics too, since today the centralization of workplaces is much high in Hungary than is desirable.

Nevertheless, in order to avoid acute emergency situations, the permanent establishment of unemployment benefit seems to be rather important and it should be, as far as possible,linked with re-training.

The conditions of social development over the longer term

Although it is important to concentrate our attention on getting out of the actual economic difficulties and on avoiding the emerging social problems linked with this process, it would be a mistake to forget about the questions of long-range social development. It is necessary to re-consider time and again the objectives and conditions which were formulated in earlier periods of long-term planning of the social process—primarily in the Comittee for Long-term Planning of Manpower and Living Standards, which has been working since the end of 1967 [16], and also to

assess the goods and results of the more recent poeriods of long-term planning ([17, 18]). An important factor in this respect is the long-term development conception of social policy drawn up by the Research Institute of Sociology of the Hungarian Academy of Sciences. On the basis of the recommendation of the Academy this has been accepted by the government in the form of a resolution of the Council of Ministers [19].

We have to recognize that for successful economic development, in the long run the existence of certain social preconditions is necessary. Among these we may mention appropriate demographic development (a dimishing and, as a result, rapidly aging population is an impediment to economic development), good provision for the health of the population, a high level of school education, the development of professional skills, a way of life appropriate for the most favourable human values, a spirit of culture which fosters the warmness of human relations, democracy extended to all spheres of social life and so on. Therefore special attention ought to be paid to the negative tendencies, such as the number of children per families which is insufficient even for the simple reproduction of the population, the growing disturbances in social adaptation, the conditions which lead to deterioration of the health of the population (also reflected in the data on mortality), the troubles in the operation of the health service, public education etc.

It is, of course, possible to claim that it is difficult to influence such trends. Obviously the earlier wilful approach, according to which all these social processes could be planned and influenced, was basically wrong. However, it would also be a mistake to run to the other extreme and suggest that they cannot be influenced in any way towards the desirable direction.

References

1. Ferge, Zs.: Gazdasági reform, szociálpolitika és legitimáció (Economic reform, social policy and legitimation). *Valóság,* 10.1986.
2. Krémer, B.: Gazdasági ideológiák—"szociális" kritikák (Economic ideologies—"social" criticisms). *Közgazdasági Szemle,* 7-8.1986.
3. Lengyel, L.—Polgár M.: Társadalomelmélet és társadalmi reform gazdaságideológia és szociálkritika helyett (Social theory and social reform instead of economic idology and social criticism). *Közgazdasági Szemle,* 1.1987.
4. Andorka, R.—Harcsa, I.: Az elmúlt negyedszázad társadalmi változásai (Social changes of the last quarter century). *Tervgazdasági Fórum,* 1.1987.
5. Tardos, R.: Magatartástípusok a családi gazdálkodásban (Behaviour types in family economic management). *Közgazdasági Szemle,* 1.1987.
6. Szepesi, Gy.: Életszínvonal és elosztás az 1980-as években (Living standards and distribution in the 1980s). *Gazdaság,* 3.1986.

7. Révész, G.: Munkaerőpiac az 1980-as években Magyarországon (The labour market in Hungary in the 1980's). *Gazdaság,* 1.1986.
8. Kolosi, T.: *Státusz és réteg* (Status and stratum). MSZMP KB Társadalomtudományi Intézete, Budapest 1984.
9. Andorka, R.—Falussy, B.—Harcsa, I.: *Időmérleg. Részletes adatok* (Time budget. Detailed data). Vol. I-II. Központi Statisztikai Hivatal, Budapest 1982.
10. Oros, I.—Schindele, M.: A háztáji és kisegítő gazdaságokban végzett emberi munka (Human labour expended on household plots and auxiliary farms). *Statisztikai Szemle,* 10.1986.
11. Éltető, Ö.—Horváth, Á.—Schnell, L.: *A családi jövedelmek színvonala és szóródása 1982-ben* (The level and dispersion of family incomes in 1982). Központi Statisztikai Hivatal, Budapest 1985.
12. Laky, T.: Small enterprises in Hungary—Myth and reality. *Acta Oeconomica,* Vol. 32, ., No. 1–2 (1984) ., pp. 39–63.
13. Gábor, R. I.—Horváth, D. T.: Failure and retreat in the Hungarian private small-scale industry. *Acta Oeconomica,* Vol. 38, ., No. 1–2 (1987)., pp. ...
14. Kuczi, T.: *A legális kisipar* (The legal small-scale industry). In: Kovách, I (ed.): Gazdaság és rétegződés (Economy and stratification). MSZMP KB Társadalomtudományi Intézete, Budapest 1984. pp. 336–349.
15. Vajda, Á.: A kisiparosok és kiskereskedők mobilitása (The mobility of artisans and small shopkeepers). *Statisztikai Szemle,* 4.1987.
16. Huszár, I.—Tímár, J.: *A munkaerő és életszínvonal távlati tervezése* (Long-term planning of manpower and living standards). In: Ganczer, S. (ed.): Tervgazdálkodásunk időszerű kérdései (Present-day questions of economic planning in Hungary). Közgazdasági és Jogi Könyvkiadó, Budapest, 1973. pp. 153–184.
17. Illés, J.: Hosszútávú társadalmi-gazdasági fejlődésünk feltételei (The conditions of long-term socio-economic development in Hungary). *Közgazdasági Szemle,* 10.1986.
18. Kulcsár, K.: *A társadalomtudományi kutatások a Magyar Tudományos Akadémián. Beszámoló az 1981–1985 évekről.* A főtitkárhelyettesek előadásai az MTA 1987. évi Közgyűlésén (Social Science Research in the Hungarian Academy of Sciences. Report on the years 1981–1985. Lectures of the deputy-general secretaries at the 1987 General Assembly of the Hung. Acad. Sci. Magyar Tudományos Akadémia, Budapest 1987. pp. 3–22.
19. Bihari, M.: Reform és demokrácia (Reform and democracy). *Társadalomkutatás,* 2.1986.

ЭКОНОМИЧЕСКИЕ ТРУДНОСТИ — ХОЗЯЙСТВЕННАЯ РЕФОРМА — ОБЩЕСТВЕННЫЕ ВОЗДЕЙСТВИЯ И ПРЕДПОСЫЛКИ

Р. АНДОРКА

Автор россмотривает проблемы запланированных с целью преодоления нынешних хозяйственных трудностей реформ с точки зрения социологии. В ближайшие годы может возникнуть необходимость в сокращении потребления носеления, что весьма по-разному удорит по розличным демографическим группам и общественным слоям. Для компензации этого все большая часть носеления помимо основной работы занимается розличной деятельностью с целью дополнительного заработка. Экономическая политика дольжна разширить возможности работы с целью дополнительного дохода и улучшать ее условия.

Среди демографических групп с 1972 г. ухудшилось положение семей с детьми по сравнению с бездетными семьями. Эта тенденция недопустима. Вызывает тревогу, что планируемый подоходный налог с населения, вероятно, будет взиматься по прогрессивной ставке и таких дополнительных заработков, которые необходимы для обеспечения самого скудного жизненного уровня. Это поставит почти пятую часть детей в тяжелое материальное положение. Положение молодых семей с детьми ухудшается тем, что все труднее становится приобретение жилья.

Положение пенсионеров ухудшает постоянная инфляция, то, что надбавки к пенсиям компенсируют лишь малую долю обесценивания пенсий в результате инфляции. Новые социологические проблемы создает структурная безработница, которая, по-видимому, возникнет вследствие структурной перестройки экономики. Для ослабления этих проблем нужно расширить занятость в сфере услуг, мелком предпринимательстве и на таких крупных предприятиях, на которых возможно экономичное расширение пользующейся рыночным спросом продукции.

Acta Oeconomica, Vol. 39, (3-4), pp. 303-324 (1988)

THE SIMULTANEITY OF THE EFFECTS OF DEVALUATION: IMPLICATIONS FOR MODIFIED PLANNED ECONOMIES

T. A. WOLF

The paper attempts to provide a clearer conceptual basis for exchange rate policymaking in modified planned economies (MPEs), by clarifying the interactions involved in the simultaneous determination of the price level, terms of trade, real income and trade balance effects of a devaluation. Using a three-good model, it is shown that existing empirical estimates of trade elasticities in MPEs may be downwardly biased, and that extreme pessimistic assessments of the effects of devaluation may not be entirely internally consistent. Although trade elasticities in MPEs probably are lower than in market economies, they could be raised by measures aimed at expanding factor mobility and enterprise autonomy.[1]

I. Introduction

With the partial decentralization of economic decision making and the establishment of direct links between many foreign currency and domestic prices in some planned economies, the potential significance of the exchange rate as an instrument of economic policy is enhanced. In particular, in "modified" planned economies (MPEs) such as Hungary and Poland, changes in the official exchange rate may be useful in helping to attain both internal and external balance.[2]

The addition of the exchange rate to the authorities' policy portfolio in MPEs has understandably led to increased discussion of issues of exchange rate policy, both within these economies and among outside observers. Given the long-held social and economic policy priorities of policy makers in planned economies, and in particular their commitment to relatively low rates of open inflation, they have tended to emphasize the unwelcome inflationary impact of devaluation. At the

[1]This paper was originally presented at the Tenth U.S.-Hungarian Economics Roundtable, December 1–5, 1986. A similar version is to appear in Hungarian in *Külgazdaság*, and possibly in Polish in a journal published in Poland. The author has benefited from comments on earlier versions of this paper from Katalin *Botos*, Patrick de *Fontenay*, Anthony *Lanyi*, Paul *Marer*, Michael *Marrese*, Gábor *Oblath*, Jong-goo *Park*, János *Somogyi*, Judit *Szabó*, István *Szalkai*, Imre *Tarafás*, Ádám *Török*, Peter *Wickham*, and Ernő *Zalai*. All interpretations and any errors or omissions are solely the responsibility of the author, and do not necessarily reflect the views of the International Monetary Fund.

[2]This issue is explored in some detail in Wolf [1].

same time, in recognition of existing structural rigidities and the related unwillingness, heretofore, to permit the failure of inefficient enterprises, many policy makers appear to be skeptical that devaluation would have more than a negligible impact on the pattern of resource allocation, and therefore on the trade balance. Indeed, the perception of relatively low export supply and import demand elasticities only tends to reinforce the common view that devaluation will have mainly an inflationary impact in MPEs.[3]

In some cases it is explicitly recognized that the responsiveness of enterprises to a devaluation will depend on the imposition of strict financial discipline on firms as well as the elimination of excess demand pressures on the domestic market more generally.[4] All too often, however, such a recognition is coupled with the perception that the successful shifting of resources into exports as a result of devaluation will cause the terms of trade to deteriorate and indeed will worsen rather than improve the convertible currency trade balance.[5] A high degree of dependence on imported intermediate products is seen by some observers as yet another argument against devaluation. With most or all imported inputs priced on a "transaction price" basis[6], and with domestic enterprises permitted to incorporate in the prices of final products a given mark-up over costs or to set these prices equal to their transaction prices, devaluation is viewed as having mainly an inflationary effect and possibly as causing a deterioration in the terms of trade as well.[7]

Despite the growing literature on exchange rate policy in the MPE, there continues to be a disturbing lack of recognition of the complexity of interactions involving the impact of devaluation on the trade balance, the terms of trade, and the price level. For example, the necessary and sufficient conditions for devaluation to have its maximum impact on the price level are often not clearly specified. Or the mistaken impression may be conveyed that even if the maximum price level effect of a devaluation is experienced, the terms of trade may still deteriorate.[8]

This paper clarifies the relationships involved in the simultaneous determination of the trade balance, terms of trade, real income and price level effects of a devaluation. The objective of the paper is to contribute both to a clearer conceptual basis for exchange rate policy making, and to an improved basis for empirical work in this area for MPEs. In *Section II*, a simple three-good general equilibrium model is briefly outlined; the full model is elaborated in the *Appendix*. To facilitate analysis, two of the key characteristics of the MPE, the existence of fix-price goods

[3] This view is often encountered in the literature as well, as reflected for example in *Portes* [2], *Marer* [3] and *Tarafás* and *Szabó* [4].

[4] See, for example, *Botos* and *Riecke* [5].

[5] This impression is left, for instance, by [5].

[6] See Wolf [1] for a discussion of transaction prices.

[7] Marer [3]

[8] This impression is left, for instance, by the analysis of [4].

and trade with separate "rouble" area, are not included in the model.[9] It bears stressing, however, that incorporation of these features would simply add to the very complexity of interactions which it is the purpose of this paper to highlight.

The main analytical findings using this model are summarized in *Section III*. In *Section IV* these findings are used to clarify our understanding of everal of the key issues that tend to emerge in MPEs with respect to the use of the exchange rate as a stabilization instrument. The findings are particularly relevant to the case of Hungary, but they may also be applicable to other emergent MPEs as well, such as Poland. Brief concluding remarks are presented in *Section V*.

II. The model

The model elaborated in the *Appendix* (Equations (A1) through (A18)), and used to generate the findings of *Section III* is relatively simple. The economy is assumed to produce two composite goods, both final products: an exportable and a nontradable. An imported intermediate good, not produced domestically, is used in the production of both final products, in fixed proportions. The model therefore incorporates both the effects of substitution between tradable and nontradable goods, and the possibility of changes in the terms of trade arising from devaluation. It also permits analysis of the effects of imported inputs, a consideration stressed by many close observers of the East European MPEs. Although the extension of a model from two to three goods, with the prices of two being determined endogenously, normally vastly complicates the task of solution, it was facilitated here by assuming that the imported intermediate is used in fixed proportions and that these proportions are identical for the two final products.[10] As discussed in Wolf [6], a more realistic stylized model of a MPE should also include a fixed priced good and a good which is traded only with the rouble area.[11] Expansion of the model beyond two or three goods vastly complicates the mathematics as well as the intepretation of the results, however, and such additional complexity of interaction that arises

[9] A preliminary model incorporating these features appears in Wolf [6]

[10] Other models that attempt to incorporate most or all of the above effects include *Schmid, Steinherr* and *Dornbusch* [9]. The Schmid and Steinherr models, however, only include one good with an endogenously determined price. The Dornbusch model has two endogenous prices, but is only partially elaborated and applies only to the case of variable employment.

Of course our model would be more representative of actual East European conditions if the import intensity of exportable production were assumed to be higher than that for the nontradable. Given the additional complexity and derivation time introduced by such an assumption, however, it must be saved for future work.

[11] The administrative control over many domestic prices, even in the MPE, greatly complicates the analysis of devaluation. As noted in Wolf [6], the presence of a fixed price composite good can both reinforce and work against the positive trade balance effects of a devaluation.

even within a simple three-good model. The purpose, in other words, is to focus on those interactions that exist independently of widespread administrative control of prices and the peculiarities of the foreign trade institutions of the CMEA.[12]

If simplicity were the only objective in the model, it would obviously be convenient to assume that the MPE is a price taker, with respect to both tradables, in the world market. But while the price taker assumption is probably reasonable regarding the convertible currency imports of most planned economies, many close observers of these economies question its validity on the export side. Although these countries' total exports in each case represent a negligible share of total world imports, it is plausibly argued by some that they are far from being price takers in many of the specific product markets in which their exports to the convertible currency area are concentrated.[13] The model consequently allows for the possibility that the MPE may face a downward sloping rest-of-world demand curve for its exports. Foreign real income, however, is assumed to be fixed exogenously. This economy is therefore similar to the "semi-small" economy sometimes encountered in the international trade literature.

The economy is assumed to have one financial asset, domestic money.[14] Real aggregate domestic expenditure is assumed to be positively related to real income and to be a negative function of the excess of desired over actual real money balances. The quantity of the exportable (nontradable) produced domestically is assumed to be determined by the economy's production possibilities and to be a positive (negative) function of the value added per unit of the exportable relative to that of the nontradable.[15]

The responsiveness of enterprises to relative value added rather than to relative price per see may well be a more realistic assumption for the MPE, in which value added rather than profits may effectively play the dominant role in the objective function of enterprises. Domestic demand for the exportable (nontradable) is assumed to be positively related to aggregate real expenditure and negatively (positively) related to the relative price of the exportable.

Again for simplicity, the existence of initial excess demand pressures and quantitative restrictions on trade are assumed away. The price of each good is determined solely by market forces, and domestic and foreign currency prices are linked by international commodity arbitrage. Foreign demand for the exportable,

[12] The CMEA, or Council for Mutual Economic Assistance, consists of Bulgaria, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania, the U.S.S.R. and Viet-Nam.

[13] See, for example, *Holzman* [10].

[14] The important distinction, particularly for planned economies, between household and enterprise holdings of money, is ignored in this paper, for simplicity.

[15] As long as the import intensity of the exportable is equal to or greater than that of the nontradable, relative value added per unit will necessarily be positively correlated with the relative price of the two goods.

as mentioned, is assumed to be negatively related to its price expressed in foreign currency. The foreign supply of the import is considered to be infinitely elastic from the point of view of this economy. The foreign currency price of the imported intermediate is consequently invariant with repsect to a devaluation by the home country, and its domestic currency price will rise proportionately with the exchange rate (defined as the domestic currency price of foreign currency). In this simple model, therefore, devaluation will either lead to a decline or to no change in the terms of trade.

For simplicity, the economy is assumed to be fully employed, and in an initial position of balanced trade. The focus of the model is on the short-run, when flow equilibrium is reattained after a devaluation. In particular, Section III examines the consequences of devaluation for the terms of trade, real income, the price level and the trade balance.

III. Price level, terms of trade, real income and trade balance effects of devaluation

The impact of devaluation on the domestic price of the exportable, the terms of trade, real income, the overall domestic price level, and the balance of trade is summarized in equations (A19) through (A32) in the Appendix. The impact of devaluation on each of these variables is seen to be determined simultaneously as a function of several "exogenous" elasticities and the other parameters of the model.

The exogenous elasticities include:

1. the elasticity of rest-of-world demand for the economy's exportable with respect to a change in the foreign currency price of the exportable (ε^d_{xn});

2. the elasticity of domestic demand for the exportable with respect to a change in its price relative to the price of the nontradable (ε^d_{xn});

3. the elasticity of domestic output of the exportable with respect to its relative valued added per unit (ε^s_{xn});

4. the elasticity of domestic demand for the exportable and nontradable with respect to a change in real aggregate domestic expenditure (ε^x_a and ε^n_a);

5. the elasticity of the nominal supply of money with respect to a change in the price level (ε^m_p)—essentially a policy variable; and

6. the elasticity of money demand with respect to a change in real income (γ), and with respect to a change in the price level (ϕ), respectively. The other parameters determining the impact of devaluation on prices and the trade balance are the domestic output and expenditure weights for the exportable (α^s_x, α^e_x), the ratio of domestic expenditure on, and output of, the exportable to actual exports (β_x ,δ_x), the rate at which desired hoarding adjusts to a stock disequilibrium in the money market (λ), and the velocity of money (V).

The domestic price of the exportable

By raising the domestic currency price received for exports, and thereby increasing their relative value added per unit, devaluation will initially lead enterprises to bid up the price of the exportable domestically. When the effects of devaluation in the current period have run their course, the domestic price of the exportable will have risen proportionately to the exchange rate change in only three extreme cases (see equations (A22)–(A24)). One of these is when monetary policy is fully accommodative ($\varepsilon_p^m = \phi$), and the authorities permit the nominal money supply to rise pari passu with the domestic price level, in effect permitting domestic economic agents to retain their initial level of real money balances without having to cut back on real spending. (It should be pointed out that although the MPE may still be lacking many of the institutions or instruments usually associated with "monetary policy" in market economies, governmental actions designed to cushion enterprises from adverse disturbances, in the form of subsidies or credits, have identical effects, in terms of the magnitude of domestic credit extended by the banking system, as in market economies (see Wolf [11]).

A second possibility might be that, while monetary policy may not be fully accommodative, enterprises might be completely unresponsive to the change in relative value added per unit induced by the devaluation ($\varepsilon_{xn}^s = 0$), and consumers might likewise be completely unresponsive to the changed relative price ($\varepsilon_{xn}^d = 0$). Such a situation is difficult to imagine, and would involve a downward spiral in the price of the nontradable.[16] It should be pointed out, however, that if substitution effects were totally lacking only on the supply side, the domestic price of the exportable would increase less than proportionately to the exchange rate change. This is because in this case expenditure-switching and -reducing effects of the devaluation would still free some of the exportable for sale abroad, and as long as the economy faced a downward sloping export demand curve the attempt to expand exports would put downward pressure on the domestic as well as the foreign price of the exportable.[17] Analysts of devaluation in MPEs frequently assume this type of onresponse, although the underlying reasons are not always fully elaborated. Among the factors limiting the output response of enterprises might be limitations on factor mobility, and the ease with which enterprises or divisions specializing in nontradables are able to persuade the authorities to subsidize their losses (i.e., weak financial discipline).

[16] In this case, equilibrium in both markets could only be maintained by a fall in the price of the nontradable that was sufficient to cause no net change in the overall price level and no change in either the terms or the balance of trade.

[17] A similar argument would show that a less than proportionate increase in the price of the exportable would also occur if substitution effects characterized only production (i.e., if $\varepsilon_{xn}^d = 0$, but $\varepsilon_{xn}^s > 0$).

A third case of a proportionate increase of the domestic price of the exportable following devaluation would be when enterprises face a perfectly elastic rest-of-world demand curve for their exportable ($\varepsilon_x^d = -\infty$). Later in this section it will be shown that it is only in the first case, namely, when monetary policy is fully accommodative, that the positive effect of devaluation on the trade balance is necessarily eliminated. Unless one of the three cases holds, and the second case would seem to be implausible, the domestic price of the exportable will rise by less than in proportion to the exchange rate.

The terms of trade effect

The elasticity of the terms of trade with respect to a change in the exchange rate may be summarized by:

$$\varepsilon_e^{tot} = (\varepsilon_e^x - 1), \tag{1}$$

where ε_e^{tot} and ε_e^x are the elasticities of the terms of trade and of the domestic price of the exportable, with respect to devaluation. In this model, in which the foreign currency price of the imported intermediate is fixed by the world market, the terms of trade response depends solely on what happens to the domestic price of the exportable. The greater the increase in the latter, the smaller will be the deterioration in the terms of trade. Under any of the three conditions mentioned in the previous subsection, $\varepsilon_e^x = 1.00$ and the terms of trade remain unchanged.

The price level effect

The elasticity of the domestic price level with respect to devaluation will be the expenditure-weighted sum of the aforementioned elasticity of the domestic price of the exportable and the elasticity of the price of the nontradable:

$$\varepsilon_e^p = \alpha_x^e - \varepsilon_e^x + \alpha_n^e \varepsilon_e^n, \tag{2}$$

where ε_e^p is the elasticity of the price level, ε_e^n is the elasticity of the price of the nontradable, and α_x^e and α_n^e are the respective expenditure weights ($\alpha_x^e + \alpha_n^e = 1.00$). As the price of the exportable increases with devaluation, its higher relative price domestically will induce, in general, a shift in output from the nontradable to the exportable and a shift in expenditure toward the nontradable. Aside from resulting in additional supplies of the exportable for sale abroad, these shifts will create excess demand for the nontradable. As a result its price will rise, but whether it increases proportionately to the price of the exportable depends on whether

monetary policy accomodates the overall price level effect of the devaluation. If not, consumers and producers will attempt to rebuild their real money balances, eroded by the higher price level, by cutting back on real expenditure. In effect, aggregate real expenditure falls, and this will keep the price of the nontradable from rising proportionately to the price of the exportable. In all cases other than a fully accommodating monetary policy, therefore, the relative domestic price of exportable will rise in flow equilibrium and $\varepsilon_e^n < \varepsilon_e^x$. This means that the domestic price level must rise by less than the rate of depreciation of the currency ($\varepsilon_e^p < 1.00$). Only in the event that monetary policy fully accommodates the price effects of devaluation will the maximum potential price level impact be witnessed ($\varepsilon_e^p = 1.00$).

The real income effect

The impact of devaluation on real income in this model may be summarized by:

$$\varepsilon_e^y = \alpha_x^e \beta_x^{-1}(\varepsilon_e^x - 1), \tag{3}$$

where ε_e^y is the elasticity of real income (= real value added), α_x^e is the expenditure weight for the exportable, and β_x denotes the initial ratio of domestic expenditure on the exportable to exports (= imports). If monetary policy is fully accommodative, causing both prices to increase proportionately to that of the imported intermediate, or foreign demand for the exportable is perfectly elastic, there will be no real income effect from the devaluation ($\varepsilon_e^y = 0$). Under the simplifying assumptions of this model any decline in real income will of course be larger, the greater is the deterioration in the terms of trade (i.e., the smaller is ε_e^x).

The trade balance effect

The impact of devaluation on the trade balance, assuming for simplicity that trade is initially balanced, is summarized by:

$$\varepsilon_e^B = (\varepsilon_e^x - 1) + \sigma\varepsilon_{xn}^s\varepsilon_e^v - \beta_x[\varepsilon_x^d n(\varepsilon_e^x - \varepsilon_e^n) + \varepsilon_a^x\varepsilon_e^a]. \tag{4}$$

In this equation ε_e^B denotes the export-normalized change in the trade balance (denominated in foreign currency) divided by the percentage change in the exchange rate, s is a parameter defined in equation (A28), ε_{xn}^s (≥ 0) is the elasticity of domestic supply of the exportable with respect to a change in relative value added per unit of output, ε_e^v (≥ 0) is the elasticity of relative value added with respect to a change in the exchange rate, β_x is the initial ratio of domestic expenditure on

the exportable to exports, ε^d_{xn} (≤ 0) is the elasticity of domestic demand for the exportable with respect to a change in its relative price, ε^x_a (≥ 0) is the elasticity of domestic demand for the exportable with respect to a change in real aggregate expenditure, and ε^a_e (≤ 0) is the change in real aggregate expenditure with respect to a change in the exchange rate.

The first term on the righthandside of equation (4) is the elasticity of the terms of trade with respect to devaluation (see equation (1)). As noted earlier, this will either be zero, in the event that the economy is indeed a "small country," or negative. The second term reflects the impact of substitution in production on the trade balance, after taking into account the impact that the shift in production will have on imports of the intermediate product.[18] Except in the cases in which there is no quantity response on the part of enterprises to devaluation ($\varepsilon^s_{xn} = 0$) or relative value added does not change because a fully accommodative monetary policy has nullified any potential change in relative price ($\varepsilon^v_e = 0$), this term will be positive. The third term summarizes the expenditure switching effect on the demand side. It will carry a net positive sign except in the event that there are no substitution effects in consumption ($\varepsilon^d_x n = 0$), or monetary policy is fully accommodative and there is no change in the domestic relative price ($\varepsilon^x_e = \varepsilon^n_e$). The fourth term reflects the expenditure reducing effect of devaluation. Its net effect on the trade balance will also be positive unless either the elasticity of expenditure on the exportable with respect to a change in real aggregate spending is zero ($\varepsilon^x_a = 0$, which is unlikely), or real aggregate expenditure remains unchanged ($\varepsilon^a_e = 0$), the latter occurring only in the event that monetary policy is fully accommodative, or the size of the devaluation is inadequate to eliminate an initial stock of excess liquidity.[19]

Whether the trade balance will improve with a devaluation therefore depends in this model on whether the combined positive substitution effects in production and consumption and the expenditure reducing effect are sufficient to more than offset the negative terms of trade effect. From equation (4) and the foregoing discussion it is clear that if monetary policy fully accommodates the devaluation, all four terms on the righthandside of the equation will be equal to zero and the trade balance impact will be nil. It is also clear, however, that a positive output response on the part of enterprises is not a necessary condition for an improvement of the

[18] The value for positive s will be smaller, the higher the import intensity of the exportable relative to that of the nontradable. When the import intensity of the two products is equal, as is assumed in this paper, $\sigma = \delta_x$.

[19] Of course, if the economy is characterized by an initial excess stock of money, the effects of devaluation will be more complex. But observe that if this situation initially prevails, domestic prices are not market-clearing and, unless all prices are suddenly liberalized coincident with the devaluation, there is no reason to expect that the full inflationary effect of devaluation will be experienced in this case either. Clearly the existence of initial excess demand for goods in the MPE will reduce and possibly totally eliminate the positive trade balance effect of a devaluation (see Wolf [6]).

trade balance. As seen earlier, the domestic price of the exportable will increase sharply in this case, but not proportionately with the exchange rate. Expenditure effects will be such as to leave demand for the nontradable unchanged,[20] but domestic demand for the exportable will decline, freeing additional supplies for export. It is the increased exports which, in the absence of a flat export demand curve, will keep the domestic price of the exportable from rising proportionately with the exchange rate.

Equation (4) contains four endogenous variables: ε_e^x, ε_e^n, ε_e^v and ε_e^a. When the system is solved in terms of only the exogenous elasticities, the various weights, and exogenous variables, we have:

$$\varepsilon_e^B = [\lambda V(\varepsilon_p^m - \phi)(\varepsilon_x^d + 1)C][BD]^{-1}, \tag{5}$$

where B, C and D are lengthy expressions defined in equations (A24), (A30) and (A32), respectively. Evaluation of those equations and equation (5) indicates that the necessary and sufficient condition for the trade balance impact of devaluation to be positive is the combination of (1) the existence of substitution effects in either domestic production and/or consumption ($\varepsilon_x^d n < 0$ and/or $\varepsilon_x^s n > 0$); (2) a less than fully accommodating monetary policy ($\varepsilon_p^m < \phi$); and (3) an elastic export demand curve ($\varepsilon_x^d < (-1.00)$).

Because the price elasticity of demand for the imported input is here assumed to be zero (i.e., the assumption of a fixed import intensity of domestic output), the requirement that the elasticity of foreign demand for the exportable be greater than unity becomes a kind of Marshall-Lerner condition. Observe, however, that this condition alone is a necessary but not a sufficient condition for a devaluation to improve the trade balance. It should also be noted that by equation (5) the trade balance cannot deteriorate in response to devaluation unless the export demand curve is inelastic.[21]

IV. Implications for exchange rate policy in modified planned economies

The foregoing discussion has concentrated on the mutual determination of the price level, terms of trade, real income and trade balance effects of devaluation. It has shown that conclusions regarding the direction and magnitude of these effects should only be drawn after taking into account all the pertinent elasticities, other

[20] The substitution effect will be positive but the expenditure-reducing impact will be negative.

[21] Technically speaking ε_e^B could also be negative in the event that the export demand curve were elastic, domestic substitution elasticities had the expected signs, but the monetary authorities more than compensated for the initial price effects of devaluation ($\varepsilon_p^m > \phi$).

parameters, and exogenous policy variables. Even in the relatively simple three-good model discussed in this paper, the interactions among the different variables are fairly complex. Clearly for a more complicated model that reflected more closely the reality of a real-world MPE, the interactions would be even more complex.

In the model, which is composed of two composite final products and an imported intermediate good used in fixed (and, for simplicity, identical) proportion in relation to output, a devaluation will improve the trade balance only if each of the following three conditions is met: (1) enterprises and/or consumers are responsive to a change in relative price in their output or expenditure decisions; (2) the monetary authorities do not fully accommodate the price level effects of the devaluation; and (3) the economy is operating in the elastic range of its export demand curve.[22]

In the model, in which all prices are market-determined, the overall domestic price level rises by the theoretically maximum rate following devaluation in only one extreme case—when the monetary authorities fully accommodate the initial price effects arising from the devaluation. In this event there will be no deterioration in the terms of trade nor in real income, but neither will there be any improvement in the trade balance. Yet with some notable exceptions (see [5]), the economic literature in the MPEs and the work of western analysts of these economies frequently does not make clear that the full price level effects of devaluation really depend upon monetary policy being fully accomodating. As noted in the introduction, some analysts have stressed that in MPEs domestic enterprises are often permitted to pass along to consumers the increase in costs arising from higher prices for imported intermediates. On the basis of this institutional feature and the observed high import intensity of much of domestic production, it is frequently concluded that devaluation will have an almost exclusively inflationary impact, with very limited scope for a change in domestic relative prices and an improved trade balance. While such price rules may well govern much of enterprise behaviour in MPEs, this model demonstrates that as long as monetary policy is not fully accommodative, proportionate increases of domestic prices for final products would lead to fall in real money balances, and economic agents could be expected to cut back real expenditure. At prevailing output levels this would lead to excess supplies, which could only be eliminated by cutting prices on the nontradable and some combination of price cutting and increased sales abroad of the exportable. The ultra-inflationary argument based on the existence of imported intermediates thus ultimately depends either on the assumption that monetary policy is fully accommodative, or that institutional factors prevent any downward flexibility in domestic prices.[23]

[22] In the long-run, once full stock equilibrium is re-attained in the money market, the trade balance will have reverted to its initial position. This is of course the typical finding of the so-called "monetary approach" to devaluation.

[23] In this latter case, enterprises with a hard budget constraint presumably would be forced to

It should be emphasized that a zero elasticity of output of the exportable with respect to a change in its relative price is not sufficient, in and of itself, to cause the price level to rise by its theoretical maximum following devaluation, or to keep a devaluation from improving the trade balance. Therefore the argument, frequently encountered in the MPEs, that the alleged low price elasticity of output will cause devaluation to be wholly or mainly inflationary in its impact, is not, strictly speaking, correct. Indeed, it was shown in the previous section that responsiveness of enterprises to changes in the relative price is not a necessary condition for the trade balance to improve with devaluation. As long as any initial excess demand in the economy is more than eliminated by the price effects of devaluation (combined with tight financial policies), and consumers are responsive to changes in relative prices, devaluation will lead to expanded exports. Of course, the potential for export expansion will be greater, the larger is the responsiveness of enterprises to changes in the relative price.[24]

Another implication of the analysis in *Section III* is that it is inconsistent to argue, as some have done, that devaluation in the MPE will tend to have only an inflationary impact and that at the same time it will result in a deterioration of the terms of trade. The maximum domestic price level effect depends on the domestic price of the exportable rising proportionately with the exchange rate. Yet if this happens, clearly the terms of trade cannot also deteriorate. By holding out the picture of a simultaneous maximum increase in domestic prices combined with the real income loss associated with a deterioration in the terms of trade, the opponents of devaluation as an instrument of stabilization in MPEs would appear to present too pessimistic a picture.

If the MPE faces less than perfectly elastic rest-of-world demand for its exports, and monetary policy is not fully accomodative of the price level increase triggered by devaluation, then devaluation will indeed lead to a deterioration in the terms of trade. The decline in the terms of trade will lead to some fall in real income, but it implies a deterioration in the trade balance only if the economy is in the inelastic range of its export demand curve. It is therefore a critical importance whether the export demand curve is inelastic in the relevant range.

Although the suggestion by many economists in MPEs that the overall export demand curve is downward-sloping is plausible, there is reason to suppose that it may not be as steep as commonly supposed. Those Hungarian estimates of the elasticity of export demand (ε_x^d) that are known to this writer, for example, are based on single equation estimates of an export demand function. (See e.g.

---

reduce output. In any event, the capability of the producers of the nontradable to pass along to consumers the increase in costs arising from a higher domestic price of the imported input would not in general lead to a *proportionate* increase in the price of the nontradable, because the cost of the former good accounts for only a fraction of the price of the latter.

[24] Of course, under certain circumstances high elasticities could still lead to a "perverse" trade balance response to devaluation. See [12].

[5] and [4]) Because these Hungarian empirical investigators presume that this country does not face an infinitely elastic export supply curve, and because the assumption of an infinitely elastic export supply curve would clearly not be tenable, they should really be using a simultaneous system of export demand and supply equations to estimate these elasticities. *Orcutt* [13] long ago demonstrated that such single equation estimates are likely to be downwardly biased if prices are actually determined simultaneously.[25]

Because the available export supply elasticity estimates are also based on single equation regressions, (See [4]) Hungarian empirical researchers may also have been led to overly pessimistic conclusions regarding domestic expenditure switching possibilities. It should also be noted, on the basis of the discussion of *Section III*, that an empirical finding that the elasticity of export supply with respect to relative price is statistically insignificantly different from zero implies that domestic substitution effects are absent on both the output and expenditure sides (i.e., $\varepsilon^s_{xn} = \varepsilon^d_{xn} = 0$). Such a finding would seem to be implausible from a conceptual standpoint, and raise further questions about the reliability of such estimates of export supply elasticities.

The issue of simultaneous equations bias aside, it is possible that the very low estimates of the price elasticity of export supply for the past reflect, in part, excess demand conditions domestically which, strictly speaking, have nothing to do with the price elasticities. Estimations of the elasticity of export supply with respect to a devaluation should, as indicated by equation (4), distinguish between expenditure-switching and expenditure-reducing effects.[26]

Alternatively, it might be argued that the elasticity of export supply is indeed low precisely because the budget constraints faced by enterprises in MPEs are soft and factor mobility, even in the case of hard budget constraints, is restricted. Most likely the export supply elasticity in MPEs is lower than in otherwise comparable market economies for these reasons, but it is also probably not as low as present empirical estimates might suggest, because of the lack of recognition in existing empirical work of the aforementioned simultaneity and ceteris paribus problems.

[25] The Hungarian estimates are also based on total "nonsocialist" trade. Because reported nonsocialist exports are known to include large re-exports of petroleum, which may be assumed to be determined by other factors in addition to their foreign currency re-export price, the Hungarian estimates of the export demand elasticity are probably downwardly biased for this reason as well.

[26] It should also be noted that if a devaluation were accompanied by the phasing out of various commodity- or enterprise-specific export incentives, the devaluation might result in extensive relative price and quantity changes *within* the tradable sector as well as between tradables and nontradables. tradables and nontradables.

V. Concluding remarks

The failure of many empirical researchers in MPEs to take account of the full extent of simultaneity implicit in the determination of MPE exports is consistent with, and may well even partially reflect, a more general neglect by analysts of these economies of the quite complex interaction of the effects of a devaluation. The foregoing discussion, admittedly based on the analysis of a relatively simple three-good model, but for that reason even more compelling given the emphasis of the paper on the simultaneity of interactions, suggests the following major conclusions.

First, economists and officials in the MPEs may well exaggerate the inflationary consequences of a devaluation, and in any event frequently neglect to point out that these consequences are very importantly determined by the degree of stringency of the credit and monetary policies of the authorities. Specifically, the inflationary impact of a devaluation will be less than the theoretical maximum permitted by the domestic price system as long as the authorities do not fully accommodate the price level increase through expansionary monetary policy. It is important for the authorities to realize that the inflationary impact of devaluation is determined by the stance of the monetary authorities and the relevant price elasticities, and not by input-output coefficients per se.

Second, close observers of MPEs may be overly pessimistic regarding the terms of trade deterioration that may accompany devaluation. Although a devaluation-induced decline in the terms of trade is plausible for otherwise "small" MPEs, it should also be recognized that to the extent it does occur, the inflationary impact of devaluation is correspondingly weakened. Although a deterioration in the terms of trade does involve a loss in real income, it also implies a worsening of the trade balance only in the event that the economy is actually operating in the inelastic range of its export demand curve. In any event, existing empirical studies of trade elasticities in these countries may have overstated the terms of trade implications of devaluation.

Third, these same analysts may tend to underestimate the trade balance improvement that might come with devaluation. In part this may reflect the misconceptions that exist regarding the necessary and sufficient conditions for devaluation to improve the trade balance. The pessimism has undoubtedly also been reinforced by empirical studies that conclude that trade elasticities may be negligible. While there may be good reasons to suppose, in an economy with soft budget constraints for enterprises, limited factor mobility, and widespread intervention by the authorities, that the elasticity of export supply may be low relative to that of market economies, there is also some cause for suspecting that existing empirical estimates of both export demand and supply elasticities for MPEs are biased downwards. These biases are partially the result of using econometric specifications that ignore the simultaneity among certain key variables in the MPE that is stressed in this paper.

Finally, it should be pointed out that existing price elasticities, as well as the responsiveness of domestic expenditure to devaluation, are in reality not parameters beyond the control of the authorities. Indeed, the "elasticity" of real aggregate expenditure with respect to devaluation, a rough measure of the expenditure reducing effect, is in theory very much under the influence of the financial authorities in a MPE. Regardless of the particular institutional structure of the financial system, it is the authorities that ultimately can control the extension of credit to the population and the degree of financial discipline exerted on enterprises. The various "price elasticities" are also subject to influence by the authorities, to some extent even in the short run, through policies that enforce strict financial discipline on enterprises. Over the medium term and longer term these elasticities can be raised through measures aimed at expanding factor mobility and reducing pervasive intervention by the authorities in the microeconomic affairs of enterprises.[27]

Appendix: A three-good model of devaluation

Consider a fully-employed economy with three composite goods: an exportable final product (X), a nontradable final product (N), and an imported intermediate (M) that is used in fixed proportions (i_x,i_n) in production of the two final products. Domestic output of the exportable (nontradable) is a positive (negative) function of relative value added per unit of output (v):

$$S_x = S_x(v), \tag{A1}$$

$$S_n = S_n(v), \tag{A2}$$

$$v = (P_x - i_x P_m)(P_n - i_n P_m)^{-}1 \tag{A3}$$

Here S_x and S_n refer to output of the exportable and nontradable respectively, and P_x ,P_n and P_m are the respective domestic currency prices of the exportable, nontradable and imported intermediate. If the import intensity of the exportable is higher than or equal to that of the nontradable, an increase in the relative price of the exportable will always imply an increase in the relative value added per unit of that product.

The volume of imports of this input (Q_m) is the sum of imports used in production of the two final products:

[27] The institutional and policy environment that constrains this enforcement is discussed in [3], [11] and the references therein.

$$Q_m = i_x S_x + i_n S_n. \tag{A4}$$

The domestic currency prices of the two traded products are linked respectively to their foreign currency prices by the usual international commodity arbitrage equation:

$$P_x = P_x^* e, \tag{A5}$$

$$P_m = P_m^* e, \tag{A6}$$

where P_x^* and P_m^* are the two foreign currency prices and e is the exchange rate, defined as the domestic currency price of foreign exchange. Domestic demand for the exportable (nontradable) is negatively (positively) related to the relative domestic currency price ($q = P_x/P_n$) of the two products. The demand for both goods is also a positive function of the level of real aggregate expenditure (a):

$$E_x = E_x(q, a), \tag{A7}$$

$$E_n = E_n(q, a). \tag{A8}$$

Foreign demand for the exportable (Q_x^d) is assumed to be a negative function of its foreign currency price relative to the price for similar goods in the rest-of-the-world. Both the price level and real income abroad are assumed, for simplicity, to be fixed. The home country is assumed to be a price taker for its imports (hence P_m^* is exogenously fixed), but not necessarily for its exports. The supply of exports (Q_x^s) equals the excess domestic supply of the exportable, such that the market for the exportable clears:

$$Q_x^s = S_x - E_x, \tag{A9}$$

$$Q_x^d = Q_x^d(P_x^*), \tag{A10}$$

$$Q_x^s = Q_x^d. \tag{A11}$$

The market for the nontradable is also assumed to clear:

$$S_n = E_n. \tag{A12}$$

The balance of trade, denominated in foreign currency prices:

$$B_t^* = P_x^* Q_x - P_m^* Q_m \tag{A13}$$

is assumed to be initially equal to zero.

Real aggregate expenditure is equal to the difference between real income, or value added (y), and real hoarding (h):

$$a = y - h. \tag{A14}$$

Real hoarding equals real desired hoarding (h):

$$h = h^*. \tag{A15}$$

Here the latter is a positive function of the difference between the desired level of real money balances ($M^* P^{-1}$) and the stock of real money balances held at the beginning of the period (MP^{-1}):

$$h^* = \lambda[y^\gamma P^{\phi-1} - MP^{-1}], \tag{A16}$$

where P is the price level, γ and ϕ are the elasticities of money demand with respect to real income and the price level respectively ($M^* P^{-1} = y^\gamma P^{\phi-1}$), and λ is a coefficient indicating the speed of speed of adjustment of real desired hoarding to any imbalance between the desired and actual real money stocks.

Real income is defined as the ratio of nominal value added to the overall price index for final products.

$$y = (P_x S_x + P_n S_n - P_m Q_m) P^{-1}. \tag{A17}$$

The price index is constructed in terms of expenditure weights:

$$P = P_x^{\alpha_x^e} * P_n^{\alpha_n^e} \tag{A18}$$

where α_x^e and α_n^e are the weights for the exportable and nontradable respectively ($\alpha_x^e + \alpha_n^e = 1.00$).

Equations (A1) through (A18) contain 18 endogenous variables. The production possibilities of the economy and the foreign currency price of the exportable are considered to be fixed. Policy instruments are the exchange rate and the nominal money supply, although the latter will also be jointly determined by economic agents according to the hoarding equations (A15)–(A16). Having made the simplifying assumption that the import intensity of production of the two final products is the same ($i_x = i_n$), which considerably facilitates the solution of this simultaneous system, the trade balance, price level, real income and terms of trade effects of a devaluation were derived. The interrelationships between these different effects can

best be shown by expressing them in terms of the response of the two endogenous prices, P_x and P_n , to a change in the exchange rate.

In this model the terms of trade response to a devaluation depends in effect solely on the impact of devaluation on the price of the exportable, because the foreign currency price of the import is assumed to be fixed. The elasticity of the terms of trade with respect to a change in the exchange rate is:

$$\varepsilon_e^{tot} = (\varepsilon_e^x - 1), \tag{A19}$$

where ε_e^x is the elasticity of the domestic price of the exportable (P_x) with respect to a change in the exchange rate. The greater the increase in the domestic price of the exportable, the smaller will be the deterioration in the terms of trade.

The impact of devaluation on real income may be summarized by the elasticity of real income with respect to a change in the exchange rate:

$$\varepsilon_e^y = \alpha_x^s(i_n - i_x)\varepsilon_{xn}^s\varepsilon_e^v + \alpha_x^e\beta_x^{-1}(\varepsilon_e^x - 1), \tag{A20}$$

where α_x^s and α_x^e are the initial output and expenditure weights for the exportable, ε_{xn}^s is the price elasticity of domestic supply of the exportable, ε_e^v is the elasticity of relative value added per unit of output with respect to a change in the exchange rate, and β_x denotes the initial ratio of domestic expenditure on the exportable to actual exports. Recalling that $i_n = i_x$, it is clear that if monetary policy fully accommodates the devaluation so that both domestic prices increase proportionately to the exchange rate ($\varepsilon_e^x = \varepsilon_e^n = 1.00$), and/or foreign demand is perfectly elastic, there will be no change in real income (equation (A20) will be equal to zero).

The elasticity of the domestic price level with respect to devaluation is:

$$\varepsilon_e^p = \alpha_x^e\varepsilon_e^x + \alpha_n^e\varepsilon_e^n. \tag{A21}$$

Both prices are determined endogenously in the model, but their derivation is painstaking and the resulting expressions are very cumbersome. The elasticity e , for example, is equal to:

$$\varepsilon_e^x = AB^{-1}, where \tag{A22}$$

$$\begin{aligned} A \;=\; & \varepsilon_x^d[-\varepsilon_{xn}^d\alpha_x^e + \frac{\varepsilon_{xn}^s\alpha_x^s}{1-i} - \varepsilon_a^n\varepsilon_p^a\alpha_n^e] \\ & +\varepsilon_{xn}^d[\varepsilon_a^x\mu(\alpha_x^e)^2 + \alpha_x^e\beta_x\varepsilon_a^x\varepsilon_p^a\alpha_n^e - \varepsilon_a^n\mu\alpha_x^e + \varepsilon_{xn}^d\alpha_x^e\beta_x] \\ & +\varepsilon_{xn}^d\varepsilon_{xn}^s[\frac{\alpha_x^e\delta_x}{1-i}] \\ & +\frac{\varepsilon_{xn}^s}{\beta_x(1-i)}[\varepsilon_a^x\mu\alpha_x^e\beta_x\alpha_x^s + \varepsilon_a^n\mu\alpha_x^e\delta_x], \end{aligned} \tag{A23}$$

and

$$
\begin{aligned}
B \;=\; & \varepsilon_x^d[\varepsilon_{xn}^d\alpha_x^e + \frac{\varepsilon_{xn}^e\alpha_x^s}{1-i} - \varepsilon_a^n\varepsilon_p^a\alpha_n^e] \\
& +\varepsilon_{xn}^d[(\alpha_x^e)^2\varepsilon_a^x(\mu+\beta_x\varepsilon_p^a) - \varepsilon_a^n(\mu\alpha_x^e + \varepsilon_p^a\beta_x) + \varepsilon_{xn}^d\alpha_x^e\beta_x] \\
& +\varepsilon_{xn}^d\varepsilon_{xn}^s[\frac{\alpha_x^e\delta_x}{1-i}] \\
& +\frac{\varepsilon_{xn}^s}{\beta_x(1-i)}[\alpha_x^s\varepsilon_a^x\alpha_x^e\mu\beta_x \\
& +\varepsilon_a^n\mu\alpha_x^e\delta_x + \alpha_x^s(\beta_x)^2\varepsilon_a^x\varepsilon_p^a \\
& +\varepsilon_a^n\varepsilon_p^a\delta_x\beta_x].
\end{aligned}
\tag{A24}
$$

In the foregoing equations ε_x^d (<0) and ε_{xn}^d (<0) are the (relative) price elasticities of foreign demand for the exportable and domestic demand for the exportable, respectively. ε_{xn}^s is the elasticity of output of the exportable with respect to a change in relative value added per unit, which when $i_x = i_n$ is equal to $(1-i_x)$ times the elasticity of supply of the exportable with respect to its relative price; ε_a^n and ε_a^x are the elasticities of demand for the nontradable and exportable, respectively, with respect to a change in real aggregate expenditure. The values μ and ε_p^a are defined as follows:

$$\mu = (1 - \lambda V^{-1}\gamma), \tag{A25}$$

$$\varepsilon_p^a = \lambda V^{-1}(\varepsilon_p^m - \phi), \tag{A26}$$

where ε_p^m is the assumed policy exogenous elasticity of the nominal money supply with respect to the price level and the parameters are as defined in equation (A16). ε_p^a is in effect an elasticity of real aggregate expenditure with respect to the price level. Although the signs of A and B are not formally unambiguous, it can be shown that they will both be negative provided the foregoing price elasticities have the expected signs.

If monetary policy fully accommodates the price level effect of a devaluation, preventing any decline in real money balances, $\varepsilon_p^m = \phi$, and $\varepsilon_p^a = 0$. In that event, it can be seen that $A = B$, and the domestic price of the exportable will rise by the full amount of the devaluation ($\varepsilon_e^x = 1.00$), as will the price of the nontradable. When $\varepsilon_p^a < 0$, $\varepsilon_e^x > \varepsilon_e^n$, and the increase in the relative price of the exportable will induce the shift of resources into exports, which is necessary for an improvement in the trade balance.

The elasticity of the trade balance with respect to devaluation is

$$\varepsilon_e^B = (\varepsilon_e^x - 1) + \sigma\varepsilon_{xn}^s\varepsilon_e^v - \beta_x[\varepsilon_{xn}^d(\varepsilon_e^x - \varepsilon_e^n) + \varepsilon_a^x\varepsilon_e^a)], \tag{A27}$$

where ε_e^v is the elasticity of relative value added per unit with respect to a change in the exchange rate, ε_e^a is the elasticity of aggregate real expenditure with respect to devaluation (where expenditure is the difference between real income and hoarding– recall equation (A14) and:

$$\sigma = \delta_x - \alpha_x^s(i_x - i_n)(i_x\alpha_x^s + i_n\alpha_n^s) \tag{A28}$$

The first term on the righthandside of equation (A27) is the elasticity of the terms of trade with respect to devaluation. If the export demand curve is downward sloping, this elasticity will be negative. The second term is the substitution effect on the output side, after taking into account the impact that the shift in production will have on imports of the intermediate product, and which in general would be expected to be positive. The third term reflects the combined (and generally positive) impact of domestic expenditure switching ($[-\beta_x\varepsilon_{xn}^d(\varepsilon_e^x - \varepsilon_e^n)] \geq 0$), and of the expenditure-reducing effect of devaluation ($[-\beta_x\varepsilon_a^x\varepsilon_e^a] \geq 0$).

Whether the trade balance will improve with devaluation depends on whether the combined positive substitution and expenditure effects will be greater than the (in general) negative terms of trade effect. In the case of $i_x = i_n$:

$$\varepsilon_e^B = \lambda V^{-1}(\varepsilon_p^m - \phi)[\varepsilon_x^d + 1]C[BD]^{-1}, \tag{A29}$$

where

$$\begin{aligned} C \;=\; & -\varepsilon_{xn}^d[\varepsilon_a^n\varepsilon_p^a\alpha_n^e\beta_x(\alpha_x^e\varepsilon_a^x[1+\alpha_n^e] + \varepsilon_a^n)] \\ & -(\varepsilon_{xn}^d)^2[\beta_x\alpha_x^e(\alpha_x^e[\varepsilon_a^x\alpha_n^e + \alpha_x^e] + \varepsilon_a^n \\ & + \frac{\varepsilon_{xn}^d\varepsilon_{xn}^s}{1-i}[\alpha_x^s\beta_x(2\alpha_x^e\varepsilon_a^x + \varepsilon_a^n)] \\ & + \frac{\varepsilon_{xn}^s}{1-i}[\alpha_x^s\beta_x\varepsilon_a^x\alpha_n^e\varepsilon_a^n\varepsilon_p^a] \\ & + \frac{(\varepsilon_{xn}^s)^2}{(1-i)^2} - [\beta_x\varepsilon_a^x(\alpha_a^s)^2], \end{aligned} \tag{A30}$$

and

$$D = (-\alpha_x^e\varepsilon_{xn}^d + \frac{\alpha_x^s\varepsilon_{xn}^s}{1-i} - \varepsilon_a^n\varepsilon_p^a\alpha_n^e). \tag{A31}$$

The expression C in equation (A30) will be non-zero only if at least one of the domestic elasticities of substitution is non-zero and carries the expected sign; in that event C will be negative. D will be non-zero if either or both of the domestic (relative) price elasticities are negative, and/or monetary policy is not fully accommodating ($\varepsilon_p^a < 0$); in this case, D will be positive and the denominator in (A29), $(BD)^{-1}$, will be negative. The numerator will also be negative if, in addition to C being negative, monetary policy is not fully accommodating ($\varepsilon_p^m < \phi$) and foreign

demand for the exportable is elastic. The necessary and sufficient conditions for the trade balance to improve with devaluation ($\varepsilon_e^B > 0$) are therefore: $\varepsilon_{xn}^d < 0$ and/or $\varepsilon_{xn}^s > 0$ (i.e., there exist substitution effects domestically); $\varepsilon_p^m < \phi$—monetary policy is not fully accommodating; and $\varepsilon_x^d < (-1.00)$—the economy is in the elastic range of its export demand curve. Observe, however, that there need not be substitution effects on the output side (i.e., $\varepsilon_{xn}^s > 0$) for devaluation to improve the trade balance.

References

1. Wolf, T.A.: *Exchange rate systems and adjustment in planned economies.* International Monetary Fund Staff Papers (Washington, D.C.), Vol.32 (June), 1985, pp. 211–47.
2. Portes, R.: Árfolyampolitika Magyarországon 1972–1976 között (Exchange-rate policy in Hungary, 1972–1976). In: Dobozi, I.-Simai, M. (eds): *Gazdaságelmélet, kelet-nyugati kapcsolatok, magyar és amerikai gazdaság.* Világgazdasági Tudományos Tanács, Budapest 1979.
3. Marer, P.: Economic reform in Hungary: from central planning to regulated market. In: U.S. Congress, Joint Economic Committee: *East European economies: slow growth in the 1980s* Vol. 3. USGPO Washington, D.C. 1986. pp. 223–97.
4. Tarafás, I. - Szabó, J.: Hungary's exchange rate policy in the 1980s. *Acta Oeconomica,* Vol.35. Nos 1–2, (1985) pp. 53–79.
5. Botos, K. - Riecke, W.: Einige Fragen der ungarischen Wechselkurspolitik. *Osteuropa Wirtschaft* (Stuttgart), Vol.30. No.3. 1985. pp. 181–88.
6. Wolf, T.A.: Devaluation in modified planned economies: a preliminary model for Hungary. In: Brada, J.C.—Hewett, E.A.—Wolf, T.A.: *Economic adjustment and reform in Eastern Europe and the Soviet Union: Essays in honor of Franklyn D. Holzman.* Forthcoming.
7. Schmid, M.: Stagflationary effects of a devaluation in a monetary model with imported intermediate goods. In: *Jahrbuch für NationalÖkonomie und Statistik.* 1982. pp. 107–29.
8. Steinherr, A.: *Effectiveness of exchange rate policy for trade account adjustment.* International Monetary Fund—Staff Papers (Washington, D.C.), Vol.28. No.1. 1981. pp. 199–224.
9. Dornbusch, R.: *Open economy macroeconomics.* Basic Books, New York 1980. Chapter 5.
10. Holzman, F.D.: Some theories of the hard currency shortages of centrally planned economies. In: *Joint Economic Committee, U.S.Congress, Soviet economy in a time of change,* Vol.2. USGPO, Washington, D.C. 1979. pp. 297–316.
11. Wolf, T.A.: *Economic stabilization in planned economies: toward an analytical framework.* International Monetary Fund—Staff Papers, Vol.32 (1). 1985. pp. 78–131.
12. Wolf, T.A.: Exchange-rate adjustments in small market and centrally planned economies. In: *Journal of Comparative Economics,* (New York) Vol.2. (September 1978). pp. 226–45.
13. Orcutt, G.H.: Measurement of price elasticities in international trade. In: *Review of Economics and Statistics,* Vol.32. (May 1950). pp. 117–32.

ОДНОВРЕМЕННОЕ ВОЗДЕЙСТВИЕ ДЕВАЛЬВАЦИИ: УРОКИ ДЛЯ ИЗМЕНЯЮЩИХСЯ ПЛАНОВЫХ ЭКОНОМИК

Т.А. ВОЛЬФ

В статье делается попытка уточнить концептуальную основу формирования политики валютных курсов в изменяющихся плановых экономиках с учетом воздействия понижения курсов на уровень цен, обменные пропорции внешней торговли, реальные доходы и торговые балансы. С помощью трехтоварной модели показывается, что существующие практические оценки эластичности торговли могут быть изменены в сторону понижения и что крайне пессимистические оценки, возможно, несколько преувеличенны. Хотя эластичность торговли в странах с изменяющимися плановыми экономиками и ниже, чем в странах с рыночной экономикой, она может быть повышена с помощью мер по увеличению мобильности капитала и труда и расширения самостоятельности предприятий.

Acta Oeconomica, Vol. 39, (3-4), pp. 325-340 (1988)

CYCLE AND REPLACEMENT

J. KOVÁCS - T. TARJÁN

The article raises the problem how the growing demand or replacement affects the stability of investment. The question is topical because depreciation within gross investment has become preponderant in the Hungarian economy in the eighties. The authors prove that in the case of a stern-heavy distribution of investment, when the bulk of investment projects are realized towards the end of the investment period, this surely takes place along an unstable path, while the fact that the distribution of investment is stem-heavy, that is, the projects are implemented in bulk in the first half of the period, is only a necessary but insufficient condition of the stability of the investment path. The growth of replacements makes the investment path unstable sooner or later. Presumably, this also has unfavourable impacts on the growth path itself.

Introduction

The share of investments in national income has been decreasing in Hungary since 1979. In recent years it has decreased from 1/3 to about 1/4. This process has also led to peculiar shifts in proportions within the investments. Whereas the proportion of the net accumulation compared with replacement was about 60-40 percent, this proportion has now been inverted. At first sight it may seem that this process is only affecting the rate of modernization. As a matter of fact the decrease of net accumulation holds back the modernization of the national economy by restricting the very sources needed for the introduction of the new technology. At the same time the process also has another, equally ominous grave effect. Our inquiries tended to demonstrate, how the stability of the economy is affected by these processes. In our paper we shall show, that within the investments, the prevalence of replacement could affect the economy's stability. Namely, this phenomenon may destabilize the investment and, by dint of this, also the course of growth. An article of *Tarján* and *Tényi* [1] tried first, by means of a mathematical model, to support the fact that uneven investment starts may lead to spontaneous cycles due to the later commitments which are assumed by the launchings; the authors also tried to describe the way in which this happens. The same problem appeared in very different forms in several other articles also. The aim of such analyses is to "smooth down" and alleviate the effects of such investment cycles. One of the most mature examples of the inquiries of this kind is the article of András *Bródy* [4]. This present article tries to continue and develop the themes of previous

analyses. The first aim is to examine, from the point of view of the stability of the investment process, the course of the cyclic movements generated by the investment structure; namely, the conditions under which the cyclic fluctuations of investment may approach a stable course, especially when fluctuations become a destabilizing factor. The paper tries to give an exact answer to the questions connected with the so-called "stem-heavy" and "stern-heavy" investment- repartitions as proposed in [1], to which, in the forementioned article, only conjectures could be enunciated. Thereafter, in possession of a possible answer, the paper will try to reply to the questions which touch upon the role of replacement.

Description of the model

It has long been understood in investment practice, that the launching of investments is necessarily accompanied by such later commitments, the superposition of which leads to cyclical overstrain (more exactly, to regression). This problem has been dealt with by a number of authors in the economic literature concerning cycles, particularly with respect to investments (see, for example [1], [4] and [5]). How can this cycle-generating effect be described by a mathematical model? Let us start with an example:

Example 1

In our example let the gestation period of investments, from launching to putting into action, be 4 years. Let the technical coefficients of cost-shares in successive years be 0.3, 0.4, 0.1 and 0.2 and let us assure that these coefficients remain constant. This means, that if we start a 100 unit investment, then in the first year we must invest 30 units, in the second year an additional 40 units, in the third year 10 units and in the fourth, final year, 20 units. These figures represent the cost proportions during the gestation period. For the sake of simplicity let the annual allocation of investments be exactly 100 units. We must suppose a starting state for the first year: let us suppose that from the previous year's launching a commitment of 40 units remains, from the launching effected two years earlier a commitment of 30 units, and from the launching effected three years earlier a commitment of 10 units. Since the limit is 100 units, this year we can start with 20 units only. It can be easily calculated, that our next (second) year's commitments will be the following: from the first year's launching $(0.4/0.3)20 = 26.7$ units; from the launchings effected two years earlier (0 year) $(0.1/0.4)40 = 10$; and finally from the launchings effected three years earlier (-1 year) $(0.2/0.1)30 = 60$ units. Thus, being in the second year, all the earlier commitments due in this (2nd) year total

96.7 units, and for new starts (again considering the limit of 100) only 3.3 units remain. The counting for the next years we may continue in a similar way.

Table 1

	$\alpha^{(1)} = 0.30$	$\alpha^{(2)} = 0.40$	$\alpha^{(3)} = 0.10$	$\alpha^{(4)} = 0.20$	
t	$b_t^{(1)}$	$b_t^{(2)}$	$b_t^{(3)}$	$b_t^{(4)}$	c_t
1	20.0	40.0	30.0	10.0	100.0
2	3.3	26.7	10.0	60.0	100.0
3	68.9	4.4	6.7	20.0	100.0
4	0.0	91.9	1.1	13.3	106.3
5	68.5	0.0	23.0	2.2	93.7
6	0.0	91.3	0.0	46.0	137.3
7	39.9	0.0	22.8	0.0	62.7
8	1.2	53.2	0.0	45.6	100.0
9	85.1	1.6	13.3	0.0	100.0
10	0.0	113.5	0.4	26.6	140.5

However, at year 4 we already encounter a problem; namely, the total of our previous year's commitments surpasses by 6.3 units the 100 units considered as a limit. If we now advance these 6.3 units to the next year's allocation, we can proceed in such a way that in the 4th year we launch nothing (0 launching); this of course would have consequences in the 5th year also. At the same time, due to the fact that from the 5th year's allocation 6.3 units in the 4th year have already been exhausted, in the 5th year a total of 93.7 units only can be used. This reduced allocation means that in the 5th year there will be a launching of 68.5 units and therefore all our commitments, even without a new, 6th year's launching, surpass the 100 units. Nevertheless, the overshoot is much higher, because our commitments in the 6th year total 136.3. In continuing the operation, it turns out that in the 7th year a total of 62.7 units can be made use of and in the 10th year our limit is, by a commitment of 140.5 units, again considerably surpassed. This process can be illustrated by means of *Fig. 1.*

The model

Let us try to formulate our algorithm of calculation in a general form. We indicate the investments' cost share during their gestation years by $\alpha^{(1)}, \alpha^{(2)}, \ldots \alpha^{(k)} \ldots \alpha^{(T)}$ and we consider them constant. In our example: $\alpha^{(1)} = 0.30$; $\alpha^{(2)} = 0.40$;

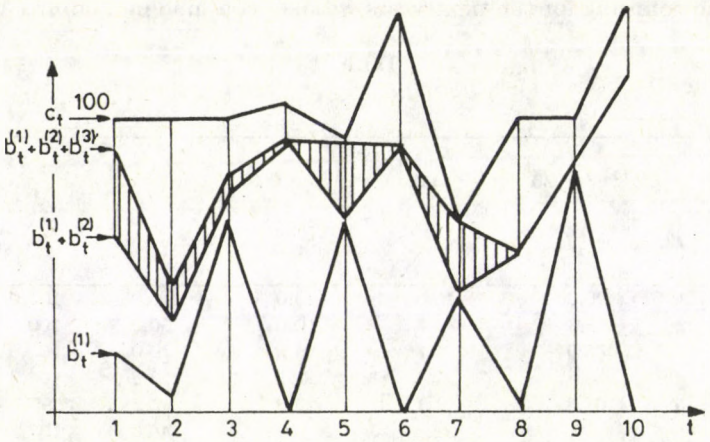


Fig. 1 An unstable course

$\alpha^{(3)} = 0.10$; $\alpha^{(4)} = 0.20$ and $T = 4$. In year t we indicate by $b_t^{(k)}$ the commitments resulting from the previous year's launching. According to the meaning, $b_t^{(1)}$ is the launching of the t-th year. Let us note, that by definition

$$\sum_{k=1}^{T} \alpha^{(k)} = 1 \tag{1}$$

$$\sum_{k=1}^{T} b^{(k)} = C \tag{2}$$

Let us now suppose, that in our example the commitments of the first and of the second year have been successively

$$b_1^{(1)} = 20b_1^{(2)} = 40b_1^{(3)} = 30b_1^{(4)} = 10 \tag{3}$$

$$b(1)_2 = 3.3b(2)_2 = 26.7b(3)_2 = 10b(4)_2 = 60 \tag{4}$$

The value of C has been, in our example, 100.

Our argument retains its validity, if the limit is supposed to be incrasing or decreasing uniformly; therefore let us formulate the relation (2) in some more general way as follows:

$$\sum_{k=1}^{T} b_t^{(k)} = C_0\gamma \quad -\infty < t < \infty \tag{5}$$

wherein γ is an optional positive constant.

The cost-shares of the investment were supposed to be constant. From this, i.e. from the fixing of the alphas, it follows that the relation

$$\frac{\alpha^{(k)}}{\alpha(1)} = \frac{b_t^{(k)}}{b_{t-k+1}^{(1)}} \quad 1 \leq k \leq T, -\infty < t < \infty \tag{6}$$

is valid. This relation enunciates that the proportions of the cost-shares are identical with the proportions of the relative investment units. (In our numerical example the commitments of the successive years were obtained precisely on the basis of this relation.) The system of conditions of our model is given by the formulae (1), (5) and (6). By substituting the relation (6) in (5) we obtain the following difference equation:

$$\sum_{k=1}^{T} \frac{\alpha^{(k)}}{\alpha^{(1)}} b_{t-k+1}^{(1)} = C_0\gamma^t \tag{7}$$

This is a continuous inhomogenous linear difference equation with constant coefficients. Our model is reduced to the solution of this equation.

The solution of the mathematical model

In order to make things more manageable we transform (7) to its homogenous form. (See [1]).

$$\sum_{k=1}^{T} a_k \varepsilon_{t-k+1} = 0 \quad -\infty < t < \infty \tag{8}$$

wherein

$$a_k = \frac{\alpha^{(k)}}{\gamma^{k-1}} \quad 1 < k < T \tag{9}$$

$$\varepsilon_t = \frac{b_t^{(1)}}{\gamma^t} - \frac{\alpha^{(1)} C_0}{\sum_{k=1}^{T} a_k} \quad -\infty < t < +\infty \tag{10}$$

We can obtain the solution of the above homogenous equation by applying the theory of difference equations, in the usual way, and with the help of its characteristic equation. The roots of the equation (see e.g. [6]):

$$\sum_{k=1}^{T} a_k z^{T-k} = 0. \tag{11}$$

From the characteristic polynomial (9) we can see that the solution depends on the α_k cost-shares and on the γ rate of increase. The paper of Tényi-Tarján [1] claims that by means of the roots of the (11) characteristic polynomial the general solution of the (8) homogenous equation can be obtained, and that by means of (10) the general solution of the (7) in homogenous equation concerning the investment launching[1] can be obtained. If the largest root radius of the characteristic polynomial is 1, or larger than 1, the investment given by the model follows an unequivocally unstable course; if it is under 1, the investment course is unequivocally stable. The stable and unstable characters of the course depend therefore, through the roots of the characteristic polynomial, on the growth rate of the investment barrier and on the cost-shares, respectively. This model has been described in the paper [1] of Tarján—Tényi also. The issues raised by the paper were the following:

— The cost-shares may have a cycle-generating effect. (The root-radius of the characteristic polynomial > 1).

— The cycles may

– decrease spontaneously (stable course), as in the following example (root-radius < 1). (See *Fig. 2*)

– spontaneously explode (unstable course), as in the example 1 (root-radius > 1).

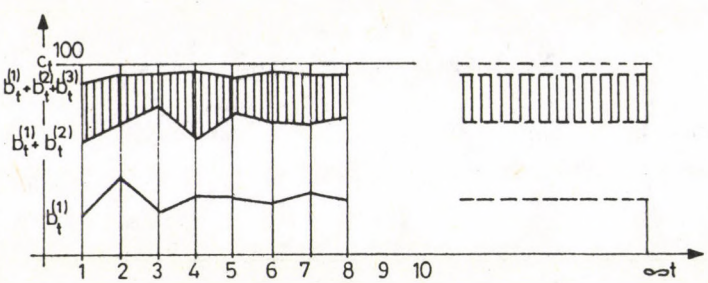


Fig. 2 A stable course

The paper of Tarján-Tényi also formulated the following conjectures:

1. Certain cost-share configurations—called "stem-heavy" distributions, where the bulk of investment must be effected in the first years are of a stabilizing nature;

[1] We note, that in this model, due to the fixing of the alphas, the b investment launchings are proportional to the total volume of investment launched in the same year. $\left(\sum_{k=1}^{T} b_{t+k-1}^{(k)}\right)$

Table 2

	$\alpha^{(1)} = 0.30$	$\alpha^{(2)} = 0.40$	$\alpha^{(3)} = 0.25$	$\alpha^{(4)} = 0.05$	
t	$b_t^{(1)}$	$b_t^{(2)}$	$b_t^{(3)}$	$b_t^{(4)}$	c_t
1	20.0	40.0	30.0	10.0	100
2	42.3	26.7	25.0	6.0	100
3	21.9	56.4	16.7	5.0	100
4	32.2	29.2	35.3	3.3	100
5	31.8	42.9	18.3	7.1	100
6	27.2	42.4	26.8	3.7	100
7	31.9	36.3	26.5	5.4	100
8	29.5	42.5	22.7	5.3	100
9	29.6	39.3	26.6	4.5	100
10	30.6	39.5	24.6	5.3	100

2. The "stern-heavy" distributions—where the bulk of investment is postponed toward the end—are of a destabilizing nature.

The exact argument, disproving these conjectures, was missing at the time. Strictly speaking, this inquiry continues the research initiated in the article of Tényi—Tarján. First of all we tried to decide whether the above conjectures are true. For this purpose we succeeded in obtaining a convenient mathematical instrument, by means of which we can assess the investment process exactly: whether it is stable or unstable. This method is an adequate application of the Hurwitz-proposition [2] known in algebra, which concerns the relation of the roots and of the coefficients of a polynomial. In this way an exact concept is given about the conditions of stability. Finally, the concept of the investment process is extended to the problem of replacement, and we try to answer the question concerning the effect of the increase of the weight of replacement (within the investment activity) on the economy's stability.

Stable and unstable courses of investment

The necessary conditions of stability

The Hurwitz-proposition [2] affords the necessary and sufficient condition for all roots of an n-degree polynomial to belong to the sphere of complex num-

bers having a negative real component.[2] On the other hand, in our problem the necessary and sufficient condition must determine the coefficients of the (11) characteristic polynomial, in order that the absolute value of all roots should be under 1. The Hurwitz-proposition, by means of a proper complex transformation, provides and answer to this problem also. However, we cannot make use of the Hurwitz-proposition in its full generality, for the necessary and sufficient condition concerning the coefficients is perplexing, that its economic interpretation is nearly impossible. Therefore we believe, that we will "hold more" for the economist, if we "grasp little". Instead of the necessary and sufficient condition we rest satisfied with the interpretable necessary conditions relating to the coefficients. Let us define the amounts s_1, s_2, s_{T-1}, s_t by means of the (11) characteristic polynomial (9) in the following way:

$$s_1 = \sum_{k=1}^{T} a_k; s_2 = \sum_{k=1}^{T} a_k^{(T-2k+1)} \tag{12}$$

$$s_{T-1} = \sum_{k=1}^{T} (-1)^{k-1} a_k^{(T-2k+1)}; s_T = \sum_{k=1}^{T} (-1)^{k-1} a_k \tag{13}$$

1st proposition. In order that the absolute value of all the roots of the (11) characteristic polynomial are under 1, it is necessary that both $s_1 \cdot s_2 > 0$ and $s_{T-1} \cdot s_T > 0$ are fulfilled.[3] We try to interpret our above necessary conditions in the following. The reader, who has had to struggle through our expatiations, must excuse us if he cannot yet see the economic advantage of this; however, in order to facilitate the presentation of the economic statement, we will now make use of a physical analogy. First of all let us turn to the demonstration of the positive character of the product of the multiplication $s_1 \cdot s_2$. In order to demonstrate, when s and s are of opposed or of similar sign, we avail ourselves of the system of parallel forces known from physics, which act on a lever. Let us take a $T-1$ meter long horizontal lever. From the left, in k metres ($1 \leq k \leq T$), an a_k force acts downwards, if a_k is positive; it acts upwards, if a_k is negative, where $a_k = \alpha^k/\gamma^{k-1}$. In our case for all $1 \leq k \leq T$, $a_k \geq 0$, so all forces act downwards.

It is well known from physics, that—s figuring in [7]—is the magnitude of the resultant of the force-system, whereas $s_2/2$ is the momentum calculated on point 0 at $(T+1)/2$ metres. This, according to our definition, coincides with the momentum on point 0 of the resulting force. It is easy to see, that if the resultant attacks leftwards from 0, the signs of s_1 and s_2 are identical; whereas they are opposite, if it attacks from the right. Our 1st proposition therefore states, that if the resultant of the parallel system of forces acting downwards and compiled from the coefficients

[2] For the idea of applying the Hurwitz-proposition, acknowledgement is due to György *Molnár*.

[3] We do not intend to burden with proofs the mind of the economist not interested in mathematical details. The detailed proof can be found in [7].

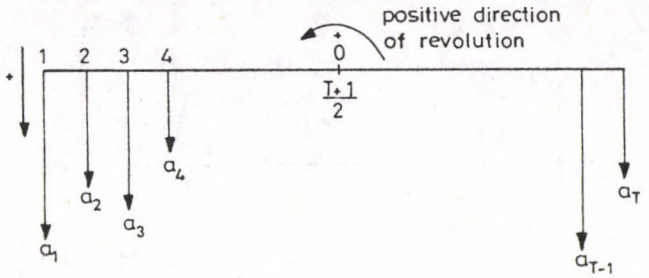


Fig. 3 System of parallel forces acting downwards

attacks from the right of 0, not every root (its absolute value) of the characteristic polynomial is under 1, i.e. the investment takes place on an unstable course. Therefore we may call "stem-heavy" distributions those distributions, where the resultant of the force-system (comprising them and attacking downwards) attacks in the centre 0, or to the left; and we call "stern-heavy" those distributions, the resultant of which attacks from the right of the centre. On the basis of the above, the proposition can be enunciated.

2nd proposition. In the case of "stern-heavy" distributions the destabilizing effect arises surely, hence the investment takes place on an unstable course. With this proposition the 2nd conjecture concerning the "stern-heavy" distributions has been verified, whereas the 1st conjecture concerning the "stem-heavy" distributions is not valid. A proper counter-example for this is the 1st example, which is evidently "stem-heavy". It appears from the table that it leads to an unstable investment course. For the sake of exact demonstration of this the roots of the (11) characteristic polynomial should be determined by the substitution $\gamma = 1$. This is a $(T-1)$ cubic polynomial. Instead of the demonstration of the roots of this polynomial let us obtain s_3 and s_4, which are obtainable and are successively 100 and -20, i.e. the second condition of the 1st proposition is not fulfilled and thus the course is unstable. In order to illustrate the positive character of the product of multiplication $(s_{T-1} \cdot s_T)$ let us compile, as above, the system of parallel forces acting on a lever. On the $T-1$ metre-long horizontal lever, at k metres from the left $(1 \leq k \leq T)$ a force of $(-1)^{k-1}a_k$ may act downwards, if $(-1)^{k-1}a_k$ is positive, and upwards, if negative—which means $a_k = \alpha^{(k)}/\gamma^{k-1}$. Since in the case of every $1 \leq k \leq T$ the $a_k \geq 0$, all the forces of odd index act downwards and those of even index upwards; hence the system of forces alternates.

Similarly to the above interpretation, the magnitude of the resultant of the alternating system of forces is s_1 , whereas $s_{T-1}/2$ is the momentum, at point 0, of the system of forces at $(T+1)/2$ metres. According to the definition this coincides with the momentum of the resulting force at point 0. Similarly it can be seen that if the resultant attacks to the left from the 0 centre, the signs of s and s are the same; and it can be seen that they are opposed if the resultant attacks from the right.

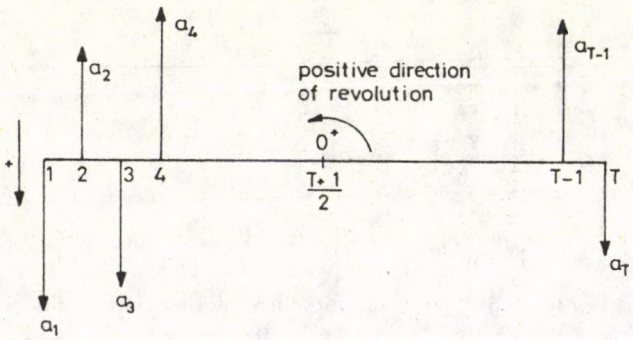


Fig. 4 Alternating system of forces

Hence our 1st proposition states: if the resultant of the alternating system of forces made of the coefficients attacks to the right from 0, the absolute value of not all the roots of the characteristic polynomial is under 1, hence investment takes place on an unstable course. Already the 1st example casts light on the importance of the positive character of the product $s_{T-1} \cdot s_T$, since $s_1 \cdot s_2 > 0$ ("stem-heavy") and $s_3 \cdot s_4 < 0$. In this case the instability of the investment process is demonstrated by the condition concerning the alternating system, since stable and unstable courses may equally belong to the "stem-heavy" distribution. The condition concerning the positive character of the $s_{T-1} \cdot s_T$ product of the alternative sums becomes especially important, if replacement is also considered.

Extension of the model

The model, taking into account also the sums spent on replacement, corresponds to our foregoing model in mathematical respects. However, from the economic point of view it differs from it, because here not only the investment process is considered, but the—much later effected—replacement is also included.

1. As initial condition the cost shares of replacement are also considered fixed.

2. The profile of distribution changes in such a way that the $\alpha^{(k)}$ coefficients approach 0 within 4–7 years after being put into service (0 period). Thereafter they will again be positive on an essentially lower level.

3. In the C_t limits of spending the replacement costs are also included. Hence the value of T changes from between 3–6 to 10–20 years.

Formally and identical model describes the discontinued and—much—later finished investment-processes. However, in this case the part following the 0 period of the investment profile does not represent replacement, but the continuation of the "frozen" investment process. If the a_k values taken in the substitution period do

not surpass the mean of the a_k values obtained in the investment period[4], then it is easy to see that the distribution is always "stem-heavy"—namely, the resultant of the downwards-acting parallel system of forces attacks to the left from the centre 0. Therefore, only the necessary condition concerning the alternating system of forces can be taken into account. We underline, that it is also only a necessary condition of the stability. The condition concerning the alternating system of forces indicates, that the possible "small" fluctuation of replacement may destabilize the investment process in spite of the "stem-heavy" character of the distribution. To put it clearly, from the stated condition, it follows that this case can really take place. Moreover, curiously, the more balanced the investment period, the more powerful will be the destabilizing effect of the smaller fluctuations arising in the replacement period. In the first instance, let us take the resultant of the alternating system of forces for the investment period only. The resultant calculated for this period may be zero, or very small, if the absolute values of the positive and negative forces are very near to each other—i.e. if the $\alpha^{(k)}/\gamma^{k-1}$ total of the a_k quotas discounted by and realized in even and odd years is nearly equal or equal. In this case the small fluctuations arising in the substitution-period—especially over a longer period—displace the point of attack of the total resultant to the right from the centre and in this way destabilize the process.[5]

In the foregoing we pointed out the fact, that the fluctuation of the investment fulfilments may introduce a destabilizing element in the investment-process. However, in the following we should also point out that the extreme protraction of the replacement period—that is, the extreme postponement of the replacement of capital equipment—may destabilize the investment process in the same way that it is made "stern-heavy". One kind of extension of the Tarján-Tényi model consists, therefore, of the drawing into the conceptual sphere of the technical-economic structure of investments the replacement-demand. Namely, the introduction of new capacities is, after a shorter or longer period, necessarily followed by the replacement of the equipment used up. In the beginning this, compared to the volume of investment, may be negligible. However, if the lifetime of the investments is relatively long, this demand for replacement necessarily increases and we must take it into account in view of the whole investment process. A peculiar relation exists between wear and tear and the really necessary replacement. Under normal condi-

[4] However, this can be assumed to be a "customary" distribution, which takes into account replacement.

[5] Disregarding the illustration of the system of forces, the above can be summarized in the following. If in the investment period the b difference of the even and odd a_k coefficients is, in comparison with the similar p difference, insignificantly small for the replacement-period, then the investment process takes place on an unstable course. To be more exact, if b and p are of opposed signs, it is sufficient that $|b| < |p|$, and if b and p are of similar sign (supposing, say, a 5 years' investment period, a 5 years' 0 period and a 10 years' replacement period) $2|b| < |p|$ is certainly sufficient for this purpose.

tions the amortization fund has the task of ensuring, in due course, the refund in value of the investment and has to create an adequate source for renewal and, for the replacement of worn equipment, replacing them with more up-to- date items. If the period of return is not too long and the replacement takes place at the normal rate of change of new up-to-date technology, it is possible to rearrange the amortization within comparatively large frames and to utilize the amortization fund for the necessary structural changes. However, if we operate the capital equipment for too long, this restricts our freedom. The replacement-demand of the time-worn capital equipment increases, and an unavoidable pressure for direct replacement arises. This extracts a more and more important part of the amortization fund from the sphere of reallocation. Consequently, let us modify our model slightly.

1. We regard the α_k henceforward as fixed but, taking into account the substitution period, we do it in principle for a very long time. This is feasible, because the capital equipment realized by means of the investment can operate in a proper sense indefinitely, while more and more parts of it are renewed and replaced. At the end perhaps not a single part of it will be original, but the equipment is still producing in its original form.

2. The T investment time-level is not regarded as technologically given in advance, but is at our discretion, eligible at any point of the replacement period.

It is easy to see that by stretching out the T time-level, the replacement-period also becomes longer while the replacement-demand increases more and more (after a certain point the α_k coefficients increase monotonously). The result is that if we put the T time-level far enough, the investment-course may become "stern-heavy". This takes place necessarily, if the coefficients of the replacement-period reach the average level of the net investment period. In the sense of the enunciated proposition this means, that in this case the destabilizing effect certainly takes place. In order to illustrate how this happens in the economy, let us take an example. Let us consider road transport. In order to organize road transport, we buy 100 motor vehicles. We purchase these over a period of 4 years, in the following partition: 30, 40, 25, 5 (see the 2nd example). We have seen that this is described with the C barrier, which is constant in the net investment model and is a stable process. Let us suppose that the normal life-time of the motor-vehicles is a period of 8 years. This means that in the four years following the investment period the investment-coefficients are negligible (zero-period). However, following this a more and more important replacement-demand appears. At first, the motor vehicles purchased in the first year begin to break down and so, increasingly, do the later purchased ones. More and more motor vehicles require the replacement of major components and a complete overhaul. If we want to extend the T time of their running to, say, 15 years, there will be, by and by, not a single vehicle in which the original (not replaced or renewed) parts would still be in operation. It is easy to see that at the end of the overextended period the demand for replacement will be approximately the price of 25 motor vehicles. (Every motor enthusiast knows

that assembling a motor car from parts costs more than the purchase of a new car; this is due to the relative expensiveness of the parts, not to mention the fact that after a certain time original parts are not available and their special fabrication is even more expensive). Finally, the satisfaction of the replacement demand may, even in this case, come up against a barrier, if this barrier is regarded as a constant one—and this is without considering a case in which the barrier is decreasing. Our model does not deal with production; therefore in our illustration we cannot speak of the losses, which are due to the fact that the outputs of supply are behind the nominal capacity. This has further effects. Of course the message of the model could be similarly illustrated using the example of, say, an agricultural machine park, or of any branch of industry. In this way we can reach an easy understanding of the investment problems of the whole national economy. As a comprehensive illustration of our message we give a numerical example, wherein the distribution is evidently "stem-heavy", the level of replacement is under the level of the net investment and the course pertaining to it, with the addition of replacement, still becomes unstable. See *Table 3* and *Fig. 5.*

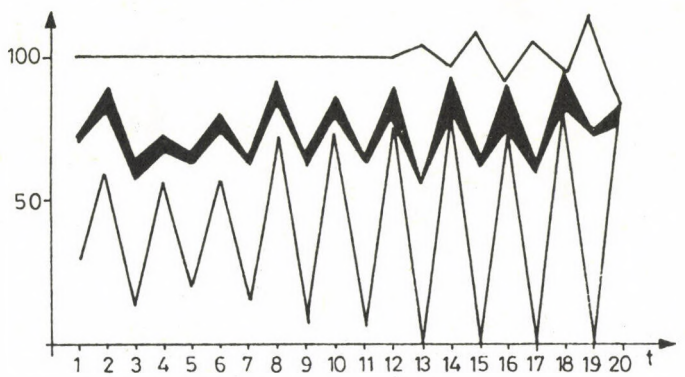


Fig. 5 A stem-heavy course, unstable because of replacement

So far we have only demonstrated that the technical-economic distribution of the investment, especially with regard to the long-postponed replacement, may render the investment process unstable; however, it follows also from our model, that the instability of investment may go hand in hand with the instability of growth itself. The model contains a number of limitations; however, we think that despite its limits we have succeeded in demonstrating the following:

1) The suspension of the investments embarked on, or the postponement and protracted rearrangement of the gestation periods may weaken the economy's stability due to the fact that the proportions of the commitments change, and the coefficients defining the previous stable course may become unfavourable. In this way the investment course turns from "stem-heavy" into "stern-heavy".

Table 3

	$\alpha^{(1)} = 0.40$	$\alpha^{(2)} = 0.30$	$\alpha^{(3)} = 0.00$	$\alpha^{(4)} = 0.00$	$\alpha^{(5)} = 0.05$	$\alpha^{(6)} = 0.25$	
t	$b_t^{(1)}$	$b_t^{(2)}$	$b_t^{(3)}$	$b_t^{(4)}$	$b_t^{(5)}$	$b_t^{(6)}$	c_t
1	30.0	40.0	0.0	0.0	2.0	28.0	100.0
2	60.0	22.5	0.0	0.0	8.5	10.0	100.0
3	12.0	45.0	0.0	0.0	5.5	37.5	100.0
4	56.8	9.0	0.0	0.0	6.7	27.5	100.0
5	20.3	42.6	0.0	0.0	3.8	33.3	100.0
6	58.5	15.2	0.0	0.0	7.5	18.8	100.0
7	17.1	43.9	0.0	0.0	1.5	37.5	100.0
8	72.6	12.8	0.0	0.0	7.1	7.5	100.0
9	7.5	54.4	0.0	0.0	2.5	35.5	100.0
10	74.4	5.6	0.0	0.0	7.3	12.7	100.0
11	5.5	55.8	0.0	0.0	2.1	36.6	100.0
12	76.1	4.1	0.0	0.0	9.1	10.7	100.0
13	0.0	57.1	0.0	0.0	0.9	45.4	103.4
14	82.6	0.0	0.0	0.0	9.3	4.7	96.6
15	0.0	62.0	0.0	0.0	0.7	46.5	109.2
16	77.9	0.0	0.0	0.0	9.5	3.4	90.8
17	0.0	58.4	0.0	0.0	0.0	47.6	106.0
18	83.7	0.0	0.0	0.0	10.3	0.0	94.0
19	0.0	62.8	0.0	0.0	0.0	51.6	114.4
20	75.9	0.0	0.0	0.0	9.7	0.0	85.6

2) The replacement-demands may likewise have a part in the stability of the investment course and through it in the stability of growth, in the same way that the technical-economic composition of inevestment does. If we extend the lifetime of the equipment created by means of investment in a such way, that it augments the need for replacements: a—at first the fluctuations in the replacement may make the investment-course unstable; b—later the ever increasing weight of the volume of replacement may make the course "stern- heavy" and again unstable.

3) The results of the model emphasize the theoretical consequences of the [3] Kovács—Virág-model[6]:it is practical to plan the investment periods. Moreover, if it is possible, we should connect these to technical generational modernization so that as much as possible will be realized at the beginning of the reconstruction period—that is, we are taking a "stem-heavy" investment course.

[6]The growing interest in this topic is shown by the Banai–Lukács [8] paper, which gives a generalization of this model. It demonstrates that the optimal path has to satisfy our "stern-heaviness" criterion to secure stability.

Conclusions

It follows from the cycle-generating affect of the investment-launches and from the commitments deriving from them, that it is necessary to make the investment statistics suitable to research of this character. The detailed investment-statistical data becomes necessary. The expectable lifetime of investments must be very carefully assessed. It follows from this that there is a need to assess and plan the periods of change of the technical generations. The assessment of the replacement-needs made in the lifetime of investments is probably more important than was thought previously. Replacement must be also planned. The strengthening of the economic autonomy of enterprises, being indispensable for the enhancement of the market-processes, does not reduce the responsibility of the central planning authorities in the field of investment-planning. On the contrary, for it ensues from this that the demand for investment-information from the central planning bodies should not decrease, but increase. Only in possession of proper information can the central planning bodies calculate satisfactorily the investment periods and prepare themselves for the possible cycles (overheating and regressions) which might occure in due course.

References

1. Tarján, T.—Tényi, Gy.: Kísérlet a beruházási folyamat modellezésére (An attempt to model the investment process). *Szigma,* 1–2. 1977. pp. 11–24.
2. Kuros, A.G.: *Felsőbb algebra* (Superior algebra). Tankönyvkiadó, Budapest 1966.
3. Kovács, J. - Virág, I.: Periodic versus continuous growth. *Acta Oeconomica,* Vol. 27. Nos 1–2 (1981) pp. 41–55.
4. Bródy, A.: A beruházási ciklus elmélete és szabályozása (The theory and control of the investment cycles). *Gazdaság,* 3. 1983. pp. 57–71.
5. Lackó, M.: Cumulating and easing of tensions. *Acta Oeconomica,* Vol. 24. Nos 3–4 (1980) pp. 357–377.
6. Gelfond, A.O.: *Differenciálszámítás* (Difference calculation). Akadémiai Kiadó, Budapest 1954.
7. Tarján, T.: Orrnehéz és farnehéz beruházási megoszlások (Stem-heavy and stern-heavy investment distributions). *Szigma,* 3.1985. pp. 137–147.
8. Banai, M.—Lukács, B.: Beruházási pálya és variációs módszerek (Investment path and variation methods). *Közgazdasági Szemle,* 4. 1987. pp. 432-440.

ЦИКЛ И ЗАМЕНЫ

Я. КОВАЧ – Т. ТАРЬЯН

В статье рассматривается влияние роста потребности в заменах на стабильность капиталовложений. Этот вопрос актуален для венгерской экономики потому, что в 1980-е годы значительно возросла доля амортизации внутри валовых капиталовложений.

Авторы исходят из результатов, полученных Т.Тарьяном и Д.Тени, которые показали, что неравномерное распределение освоения капиталовложений внутри инвестиционного периода приводит к цикличности. Они подтверждают высказанные в работах этих авторов предположения, что т.н. инвестиции с кормовой перегрузкой. Т.е. когда большая часть капиталовложений осваивается в конце инвестиционного периода, приводят к нестабильности, однако т.н. капиталовложения с носовой перегрузкой, т.е. когда основная масса освоенных инвестиций падает на начальную часть инвестиционного периода, являются необходимым, но отнюдь не достаточным условием инвестиционной стабильности.

Опираясь в основном на два названных условия, авторы доказывают, что увеличение доли замен рано или поздно приведет к нестабильности инвестиций. А это, повидимому, неблагоприятно скажется и на пути экономического роста.

Acta Oeconomica, Vol. 39, (3-4), pp. 341–355 (1988)

THE AFTER-LIFE OF NEP

L. SZAMUELY

The "New Economic Policy" (NEP) introduced in Soviet Russia in 1921 is usually considered the prototype and the legitimate point of reference of economic and social reforms put from time to time on the agenda in Soviet-type societies. This is why the interests and counter-interests attached to the reforms produce an imbroglio of NEP interpretations. In fact, even the political struggle going on about the necessity and direction of reform appears under the disguise of different interpretations of NEP.

> "In reality, the elementary relations of which such categories as commodity, price, wage, profits, etc. are the ideological expressions, do and do not exist, at the same time. They do not exist, but appear in such a way that they seem to exist, and do exist in such a way that they seem to be non-existent. They subsist in some queer, ghostly realistic and realistically ghostly manner, as the souls of the dead in ancient Slav imagination, or as the pagan gods in pious Christian religion."
>
> N. *Bukharin* ([7] p. 125)

Although the passage quoted above is about the fate of value categories during the period of War Communism in Soviet Russia (1918-21), the description would just as well fit the fate of NEP, i.e. the "new economic policy" which replaced War Communism. The first and, so far, the most radical reform experienced by a socialist system is entangled in a mesh of innumerable old and new interpretations so that, after 60 years, it has lost its clear outlines and even its very existence is questioned by some [15, 18]. What lends a "ghostly cally ghostly" after-life to this short chapter of economic and political history is that NEP is usually considered the prototype, in some case the pattern, but in any case the legitimate reference point, of the economic and social reform initiated at 10–15–20-year intervals in the Soviet-type socialist systems. Therefore, interests and counter-interests attached to socio-economic reforms and economic policy changes do not only produce an imbroglio of NEP interpretations (almost justifying the Orwellian dictum: "Who controls the past controls the future: who controls the present controls the past"), but also the ideological and political struggle going on about the necessity and direction of changes sometimes appears under the disguise of different NEP interpretations.

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

In this paper I shall try to answer the following questions:

1. Why is NEP an appropriate tool for justifying different economic and political strategies and trends?

2. What can be considered as the lasting legacy of NEP, and has NEP at all ended?

3. Which aspects of NEP have usually been stressed at the various stages of the East European societies' development since World War II?

The three trends of NEP

What actually gives scope for the different interpretations of NEP is that the switch-over to it in 1921 gave rise to the simultaneous development of three significant features:

1. First of all, there was the change from a war economy to post-war reconstruction, and all available resources were spent on this objective.

2. The economic policy towards the non-proletarian groups of society was changed; this involved the peasantry but in a broader sense it also included the different strata of the middle-class (artisans, merchants, industrialists). The power-holding communist party switched over from its restrictive-eliminating policy to a tolerating-stimulating one, albeit within certain bounds. It gave up the principle of total nationalization (and the forced organization of cooperatives), allowed private enterprise, the private employment of wage-workers, and the import of foreign capital (direct investment) in the form of concessions; these developments led to a peculiar mixed economy never known before in history.

3. The trade and market were legalized; certain methods of market economy were introduced instead of centralized management without exchange of commodities and money, the money circulation, banks and credits were restored. Thus the immediate realization of an economy with no money and market, i.e. of socialism-communism thus interpreted, had to be given up (at least for a time).

It is quite easy to see that the three trends were organically linked. The solution of a seemingly pragmatic task such as post-war reconstruction—under No.1—was only enabled by asserting the points specified under Nos 2 and 3. This is also an early and clear illustration of what can develop from the concentration of economic, political and ideological decision-making in the same hands (characteristic of the new system that had emerged after the October Revolution): a sort of political and ideological fight is necessary even for the success of endeavours motivated by pure economic rationality.[1]

(One can bring a newer counter-example to show to what extent points 2 and 3 were necessary for the success of the "reconstruction" feature of NEP, and this is

[1] This particularity of the Soviet model is treated in another paper of mine [31].

supplied by Vietnam: in the revolution, civil war, and the war of independence—and after much bloodshed—the communist party won universal triumph. However, it cannot "win" the peace: twelve years after the war, economic consolidation and reconstruction have not been achieved, since the socio-economic system, political objectives, methods, and ideological priorities have not been revised.)

However closely the different aspects and trends of NEP are related and overlap each other, they represent separate processes and require different ideological, political and economic-political interpretations. The different interpretations can then be turned against one another, positions that are disliked can be made relatively unimportant and one trend can be used to cover up the other in the course of the reform debates. Let us see the typical interpretations that emerged as early as the introduction of NEP, or not much later.

The Stalinist interpretation stressed the transition from a war- to a peace-time economy: official ideology proclaimed this as a doctrine through long decades. War Communism was thus seen as nothing else but necessity of a war economy, which the Soviet state gave up without delay after the war, reverting to the economic policy proclaimed before the civil war in early 1918.[2] The glossing over of history had its obvious apologetic aim: not only is the party policy shown to be perfectly consistent, but it is proved to have always been correct and justified. What is more, it had been conceived as such right from the beginning. This trend of NEP ended with the completion of the reconstruction, somewhere in the mid-1920s. Of course, it is not especially relevant for today's socialist systems, apart from a few exceptions.

Lenin's best known interpretation of NEP concerns the second trend i.e. the toleration of a mixed economy: according to it, NEP was a "concession" to the commodity producing nature of the peasantry, a "retreat" in the struggle against capitalist forces. In this interpretation, the main point of NEP was coexistence with the non-socialist economic sectors, yet it had to lead in the long run to the organization of the small-scale commodity producing peasantry into cooperatives on the one hand, and to the suppression and elimination of capitalist enterprise on the other. The Leninist formula "retreat—gather forces—then push forward" covers this aspect of NEP. All the controversies within the Bolshevik Party were actually concerned with the scheduling of the phases covered by the formula, and the scale of the processes involved. The "great debate" of the mid-1920s—centred on the industrialization issue—was also concerned with this trend, since the answers given to its main question (i.e. the provision of resources wanted for industrialization) raised two alternatives: either fruitful cooperation with the non-socialist economic sectors, or their expropriation and elimination. The latter course eventually also

[2] A more detailed description can be found in my book which deals with the subject. ([29] pp. 7-9)

signalled the end of NEP. As for the real course of history the second trend turned out to be the most important, even decisive, aspect of NEP.

There is more uncertainty with regard to the precise moment at which this decisive trend of NEP ended. If NEP is assumed to have ended when the Soviet state abandoned the policy of economic cooperation with non-socialist sectors and began to forcibly abolish them—this is the commonly accepted view reflected in the realistic treatments of the issue—then the date coincides with that of the mass collectivization of agriculture, i.e. the so-called years of the great turn: 1928-9. However, official Soviet textbooks and encyclopaedias give the late 1930s as the end of the transitory period and, thereby, of NEP. Obviously, they rely—at one time it was explicit but in the last thirty years it has been implicit—on Stalin's famous announcement of November 1936 to the effect that "in the main we have already achieved the first phase of communism: socialism" ([26] p.548). Either way, according to the traditional interpretation of socialism when state cooperative owner-ship—the latter almost the same as the former—had become exclusive, NEP had to be ended.

Nevertheless, looking at the experiences of the 50 years since that time, it is exactly this interpretation of socialism that has proved to be changeable. The practical operation of Soviet-type economies of several decades has demonstrated that such principles and values of socialism as economic rationality, economizing on social labour, satisfaction of the different and changing needs of the people, the many-sided development of the individual and his self-realization in productive activity, self-management and industrial democracy, etc. come into conflict with the established monopolistic character and monolithic structure of state ownership. It is no mere coincidence that the reform programmes of the socialist countries all have it on their agenda not only to transform the existing structures of state ownership, but to stimulate and enlarge group, individual, and private activities.[3] In other words, a plurality of the ownership forms is acknowledged in the socialist economy. This phenomenon is, of course, incompatible with the old NEP approach of "retreat—push forward", and today's situation cannot and should not be interpreted in that light, either. In this original sense, NEP has definitely ended. Nevertheless, if the necessary changes in the interpretation of socialism are seen clearly enough and their consequences are looked at with an open mind, it is certainly not irrelevant to refer to NEP. After all, NEP in fact provides the first example of the feasibility of a successfully functioning pluralistic, multi-sectoral economy in a "really existing" socialist socio-economic system. It is true, however, that NEP was introduced under special historical circumstances and it was not independent of them. Namely, it was introduced within the framework of a peculiar ideological-political conception, wanted to see the experiment last for the shortest possible time.

[3] See, for example, one of the studies by G. *Popov*, [20] an eminent representative of the Soviet conception of economic reform.

Today, of course, it is the third trend of NEP—legalization of the market, and the restoration of trade and money—that is most appealing to the socialist countries. Related to this is the interpretation of NEP as a radical reform of the economic mechanism, and this interpretation has gradually been universally accepted. It is in this sense, too, that Lenin considered NEP as a correction of the "error" of War Communism. He saw NEP as a secure road for the building of socialism, while he continued to use certain concepts taken from the ideology of "retreat-push forward". Yet although NEP was a *practical* revision of the socialist economic management methods, by its restitution of money on pragmatic considerations, it in fact questioned the *theoretical* interpretation of socialism as an economic system without commodity and money.

The ideologues of the period did not see this quite clearly: in their interpretation the market economy was tied only to the NEP period—namely, to the *transition* to socialism. Take Bukharin for example, justly considered the leading ideologue of the NEP strategy. In the summer of 1925 he wrote, in a booklet which he himself regarded as the best theoretical summary of his views:[4] "*It is through a struggle on the market, by means of market relations, and in the course of a competitive fight* that state-owned enterprises and cooperatives will drive back their competitor i.e. private capital. Ultimately, the development of market relations—together with trade, money, credit, stock exchange, etc.—state-owned industry and cooperatives will subdue all other forms of economy and gradually drive them out definitely by means of the market so the market itself will gradually die out, since the distribution of the goods produced by state and cooperatives will replace everything." ([8] p.289). Obviously, in the mid-1920s, the elimination of the non-socialist sectors was still equal to the disappearance of the market, the exchange of commodities, and money.

However, five years later, when the private sector had in fact been eliminated in villages and towns, the official ideology came up against a problem it was unable to solve. If it was to declare the end of NEP, it ought also to declare the end of commodity and money relations. Yet these were far from being dead. On the contrary, exactly with a view to more efficient economy, a campaign was launched to strengthen economic accounting (the *khozraschet*), and financial discipline. If, on the other hand, it was to acknowledge the survival of commodity and money relations, then either socialism was not to be considered as an accomplished aim, or the official doctrine was to be declared wrong. As is now known, the solution was ambiguous: the achievement of socialism as well as the end of NEP were announced, while the existence of commodity and money relations was also admitted (more

[4] Boris *Nicolaevsky* mentions that on his last visit abroad in 1936 Bukharin told him, among other things, that this particular work of his also rendered Lenin's views in the most precise manner, which the latter had elaborated in long talks with Bukharin in autumn 1922. (Nicolaevsky was a Marxist historian in exile: his memoirs are quoted in [12] pp. 51-2).

exactly, prolonged)—but theoretical revision was not undertaken. To this day, these theoretical ambiguities have not been properly resolved. It can be added, as a humorous footnote to the history of ideology, that *Stalin*, then already proclaimed as theoretician number one, was compelled to tamper with his own words at a later date, in order to satisfy contradictory ideological challenges. At the 16th Party Congress in June 1930 Stalin reported on the "victorious advance of socialism" and commented on the question of the ending of NEP, saying: "In going over to the offensive along the whole front, we are not yet abolishing NEP, for private trade and capitalistic elements still remain, *commodity turnover and money economy still remain*—but we are certainly abolishing the initial phase of NEP, and developing its next phase, the present phase of NEP which is the last phase of NEP." ([22] p. 37) In the 10th edition of the "Problems of Leninism" in 1937, however (i.e., after the announcement of the realization of socialism), as well as in the post-war edition of Stalin's Works, the said congress report was printed with the following change in the underlined words: "'free' commodity turnover still remains." ([25] p.307)[5]

Accordingly, if we accept Stalin's original words of 1930, the last phase of NEP is still on, since money economy has not come to the end, and still trade is pursued instead of product exchange.

This humorous episode only accentuates *the most important and valid legacy of NEP:* the survival of commodity production and money economy in socialism. That is why,—and it also indicates the extent to which—NEP can be regarded as the most thorough reform of a socialist economy, and the one with the longest-lasting effect.

As for the various trends of NEP and their relevant interpretations, it has to be made clear, what kind of trend *was not to be found* in NEP. This is because subsequent interpretations in (not the professional) literature often seem to suggest the opposite, or at least they fail to throw light on the real situation. NEP was not a political reform, as for either the mode (institutional system, methods), or the contents (trends, objectives) of ruling. It was strictly limited to the economic sphere (although it is true that this sphere covers a rather broad field of social relations). The emphasis was laid on the so-called economic link between state-owned big industry and private peasant farms, i.e. not on a policy of alliance as it is understood today. It was during the NEP years that the one-party system was definitively established and all legal functioning of the remnants of earlier socialist parties (social-revolutionaries, Mensheviks) abolished. Within the Bolshevik Party, it was the 10th Party Congress, which launched NEP, that prohibited the estab-

[5]The subsequent 'correction' in Stalin's words is reported by the Finnish economist Pekka *Sutela* [28]. Referring to the eminent British scholar R.W. *Davies*, he reports on another "text-amendment" of Stalin: in one of his articles of 1930, Stalin wrote that NEP would end when "we have the possibility of arranging economic links between town and countryside via product exchange", while in the later version "product exchange" is replaced by "our own trade organizations." ([24] p.187)

lishment of fractions (groups taking a different stand on the political platform) and laid down severe punitive sanctions for disobedience. (Later on, this proved to be highly useful for Stalin, enabling him to silence all contrary opinions, to finish with his opponents and to build his undivided personal power.) True, during the NEP period, jurisdiction was restored to quasi-normal: judicature in political matters was taken out of the hands of the political police (Cheka, and later the GPU). However, this lasted only 3-4 years for, by the summer of 1927, as economic and international tensions began to rise, the old practices were re-established, including preventive and collective retaliations ([21] pp. 11-18). The impression of liberalization is igven by the livening up of intellectual (scientific, cultural, artistic) activities after the war, following the economic consolidation. This is especially true if a comparison is made with the pre-NEP (War-Communism), and the post-NEP (Stalinist dictatorship) periods.

In this sense, NEP was the prototype of a successful economic reform implemented with the political power relations remaining intact.

NEP as a point of reference

In an economic, political and ideological sense—related to current developments—NEP was not referred to in the socialist countries until the mid-1950s i.e. after 20 years of silence. This occurred first in the Central and Eastern European "people's democracies." This silence had two causes. First, since Stalin announced in November 1936 that socialism had been accomplished in the Soviet Union, NEP ceased to be relevant, for the transition period had officially come to an end. Second, social transformations in the Central and Eastern European countries did not start with the conditions of war communism. On the contrary, it was within the framework of mixed economies that, over shorter or longer intervals, differing from country to country, the state-owned sector was extended and made predominant, and the collectivization of agriculture was started. In other words, the communist parties had, from the beginning, followed the NEP strategy[6] and applied its methods—but they did so tacitly, without referring to it. In those early years they wanted to avoid even any hint that they might be intending to introduce the Soviet model in their respective countries (which even most of their own members would have probably disliked). Also, they did not need to make such references, since they did not make changes of direction necessitating self-examinations of the NEP-type and their ideological legitimation.

[6]This was pointed out in Iván T. *Berend*'s doctoral dissertation, in which it is emphasized ([3] pp. 239-246) that in Hungary NEP methods had already been used before the "year of turn" i.e. under the government of the coalition parties for the restriction and repression of private capital.

However, the situation was different in the mid-1950s. After Stalin's death it became obvious in most socialist countries that the Stalinist social and economic model had to be revised, and policy practices had to be changed without delay. In the Soviet Union this change of direction could not refer, for obvious ideological reasons, to NEP. However, NEP could be mentioned in the other socialist countries, for they were still in a "transition" phase because of the unfinished agricultural collectivization.

In Hungary, the change of direction started with the "new government programme" of the Imre Nagy government. This was announced in July 1953. Its central idea was the elimination of the autarkic development of heavy industry, the forced collectivization, the neglect of agriculture and the falling living standards. It also ended the reprisals taken against whole groups of the population ("kulak" lists, deportations, internments). The declared intentions (and the measures taken) were as yet not aimed at dismantling the Stalinist model. The purpose was to mitigate the grave consequences of its mode of operation. The modification of the economic policy, and the few changes in the domestic policy methods (it was expressly questions of degree, and not objectives or principles that were subject to revision) required ideological legitimation: the supporters as well as the opponents of the changes produced ideological arguments to defend their positions in politics and economic policy.

References to NEP served such purposes for Hungarian political terminology in the autumn of 1953. Drawing a parallel between the "new government programme" and NEP had primarily and expressly *"agitprop"* objective: to prove the "Leninist-Stalinist" character of the new line, and the unbroken continuity of the policy. Pro forma, the first *conference on economics* for many years (held in March 1954) followed the same line of reasoning in its main paper. The lecturer was Tamás *Nagy*. He discussed the Hungarian application of NEP, while concentrating on the criticism of the two most serious economic policy problems of the 1950s: exaggerated industrialization and forced collectivization: "During the 5-year-plan period (the first 5-year-plan began in 1950—L.Sz.), the basic principles of NEP were increasingly damaged for the following reason: first, the undermining of the small-scale commodity production of the peasantry, and reduction of the aid to individual farmers; second, the permanent and excessive raising of the peasants' compulsory delivery obligations, which diminished the volume saleable on the free market; and finally, putting too much burden on the peasantry and thus decreasing their financial interest in production. These errors, having taken place in the course of the application of NEP, had shaken the economic basis of the building of socialism: the worker-peasant alliance; they were also partly responsible for the fact that the living standards of neither the workers, nor the peasants had shown any satisfactory development." ([17] pp. 31-2)

As can be seen, reference was clearly made to the second trend of NEP (i.e. the policy towards the non-socialist sectors) and it continued along this line

until the end of the decade—at least in Hungary. The most significant reform of Hungarian economic policy within this trend was the abolishment of the system of compulsory deliveries in agriculture in autumn 1956. (This followed much later in other socialist countries—in Poland, for example, it did not occur until 1971.) This was, as a matter of fact, just a repetition of the development of NEP after 30 years. Compulsory deliveries exactly corresponded to the famous tax in kind by which NEP was started in 1921, and which was replaced by a normal tax in money in 1924.

The question arises: why is there no reference in the Hungarian literature of the 1950s to the third trend of NEP—the reform concerned with the market economy—despite the fact that Hungarian reform conceptions went along the same lines? In attempting an answer, two possible reasons should be mentioned (beside the fact—and it is not by chance at all—that it was this aspect of NEP that got most blurred in the darkness of the Stalinist era; it was unknown to later generations and had to be rediscovered).

One reason is that the change in policy that began in 1953 first centred on economic policy and domestic policy questions. The analysis of these, as we have seen, contained ample references to NEP. Questions of an economic mechanism reform came up later, in 1956-7. However, the sudden speed-up of political events rendered any ideological and political legitimation unnecessary. In other words, there was as yet no need to resort to the example of NEP to provide ideological justification of the reform conceptions.

The other reason may be that the Hungarian reform conceptions of the 1950s, while rejecting the Stalinist model of a command economy—as I have explained in more detail in another paper ([29] pp. 18-21)—failed to build a consistent alternative model of a regulated market economy. Therefore, there was no need to search for theoretical precedents, either. In contrast with this, in Poland, for example, alternative socialist economic models were already being sought in 1956-7. (The use of the term "model" in this sense is also of Polish origin.) That is why, by the late 1950s, it was exactly this aspect of NEP which was eagerly being discussed in the Polish literature. A clear illustration of this is, for example, W. Brus's book [5].

However, the second wave of economic and social reforms in the European socialist countries (that came about in the 1960s) referred to NEP expressly as the prototype model for a reform aimed at establishing a regulated market economy. A sudden flourish of literature chose NEP for its subject, primarily in the two "ace-countries"[7] of the reform wave of the period: Czechoslovakia [9, 13, 14, 32] and Hungary [1, 4, 10, 11, 29]—this was almost without precedent.[8] What really

[7] This characterization does not refer to the intensity or success of respective reform programmes, but to the radical and basically consistent nature of the reform conceptions.

[8] An apparently complete list of the Hungarian publications is to be found in the Notes of János

caused a stir, however, was the reference—in the positive sense—to NEP in Soviet literature. G. *Lisichkin* intended his book [16], published in 1966, to inspire a drive towards the market economy. The reference to NEP as the great precedent was called upon to justify its acceptability from the ideological viewpoint by the authority of Lenin. The Soviet economic management reform (the so-called "Kosygin reform") of 1965, was fraught with many contradictions, yet it was "open-ended" i.e. it was to be shaped in the course of implementation. Lisichkin's book rendered the notions of 'market' and 'market economy' respectable in Soviet economic literature as well as in everyday language, for some time at least (in fact, until the Czechoslovak reform was ended by military intervention in 1968, when the "open end" of Kosygin's reform was also closed.)

Why did the reference to NEP spread exactly in connexion with the reforms of the 1960s? Beside the more general reasons (that criticism of the Stalinist regime became possible after the 20th and 22nd Congresses of the CPSU; also, not independent of it, the "renaissance" of Marxism in the 1960s increased interest in the Soviet historical experience, especially on the part of nations liberated from the colonial status and seeking new ways of development, etc.), more attention was paid to the type of socialist market economy that had existed in the NEP period. This was because the reformers of the 1960s, in all socialist countries (from the GDR to China), had to combat the expressly antireform ideological, political and police campaign that unfolded after 1956. To start the reforms, the reform idea itself had to be "rehabilitated".

It is for the same reason that, almost two decades later, the reform movement initiated by the Gorbachev leadership refers to NEP to provide the theoretical and ideological basis for the necessity of change—with unprecedented intensity. *Gorbachev* called the radical reform he had launched a "veritable revolution" (for the first time he did this was in a speech delivered on 31st July 1986 in Khabarovsk), and he cited "Lenin's NEP" as the precedent to be studied. Today it is hard to find a piece of Soviet press or professional literature which discusses the economic and social restructuring without reference, in one form or another, to NEP and its precursor: War Communism.[9] Those two notions have by now become almost symbols. Yet this sign language, used by reformers and conservatives, goes back to the Brezhnev era—labelled the "stagnation period". Since the word "reform" was then deprived of its content (and even official ideology preferred to see it as a type of "perfection" of an existing situation) and "market" was again a prohibited word, the protagonists of change hid behind Lenin's quotations to support the necessity of change and to demand the ending of "War Communism".

Mátyás *Kovács*'s study [15].

[9] See, for example, a few outstanding works published in 1987 each producing a wide response [19, 23, 27].

Earnest ideological battles fought in the form of a shadow play are no novelty in societies in which political decisions are made behind closed doors, whereas the ideological legitimation of the eventual decisions and, in the final account, the mobilization of large groups of society, are indispensable. Let us just think of the strange parables heard in China of the 1970s! The stand taken against the "great cultural revolution"—initiated by Mao Zedong and shielded by his authority—first emerged in plays, novels, and publicists' meditations on the actions of the ancient emperors of China, warlords, and wise and vile courtiers. Only gradually was it stripped of such disguise.

In the Soviet Union, of course, the system of signs does not go so far, nor are allusions so abstract. The fact that the direct references to NEP are drawn into today's political acts makes it clear that the debate is not about the past, but about the present.

The best, and perhaps best known, illustration of this hardly disguised controversy was the argument between a peripheral professional journal and the central journal of the party in 1984 (i.e. the year of Chernenko's short general secretaryship, when the late Andropov's tidying-up campaign had already brought a breath of change, however, no real change, and even the breath could hardly be felt). In the historians' periodical, *Voprosy Istorii*, the political scientist Ye. *Ambartsumov* wrote an article [1] on how Lenin had handled the crisis that broke out in 1921, and how that had led to NEP. The author did not hide his opinion, saying that he saw an analogy between the socialist countries' situation in the 1980s and the economic and political crisis which had resulted in NEP. The analogy enabled him to write about such "heretic" subjects as the objective possibility of "social and political crises" in socialist systems and to find their root "in an intra-system conflict: that between power and a part of its social base".([1] p.17.) He qualified the biggest upheavals in the socialist countries (the GDR 1953, Hungary and Poland 1956, Czechoslovakia 1968-9, Poland 1970 and the early 1980s) as the outbreak of such crises. The author found the actual cause of the 1921 crisis in the inadequacy of the "socio-economic model" of War Communism. ([1] p.18) Lenin's primary merit was, according to him, to have found in NEP the "strategy of overcoming the ciris", which "grew into a strategy for building socialism". ([1] p.25) The author stressed as a positive value of this strategy, the "stimulating of small owners' activities" and cooperation with foreign capital (in the form of concessions and joint ventures).

The answer, in a sharp tone of condemnation, came out in the periodical *Kommunist* [4]. Its author Ye. *Bugayev*, (at that time) on the editorial board, accused Ambartsumov of perverting the Leninist approach. He said that Lenin had interpreted NEP as the economic policy of the transition period. Therefore, it was not justified to use it to refer to countries in which a socialist system had already been built up. As for crises, they are the consequences of the external and internal class enemies' subversion. (The author, however, failed to explain what kind of class enemies still existed in the socialist societies.) He did not regard

NEP as a new policy, but as a return to the policy conceived before the civil war. As can be seen, Ambartsumov's No.3 interpretation of the NEP was countered by Bugayev's Nos 1 and 2—in line with official ideology and with a view of confirming the unfailing wisdom of current policies.

Thus today's NEP-"renaissance" in Soviet public life and in the Soviet press serves primarily, and almost exclusively, an ideological legitimation. This is shown most clearly by the fact that references to NEP are still made by relying on Lenin's quotations and they mention few economichistorical facts—although Lenin's creative intellectual activity ceased in early 1923 i.e. in the second year of NEP, when its characteristic processes had only just started to emerge. The socalled "NEP crises", and the controversies about the crucial economic policy questions all began afterwards. *Referring to NEP is not the same as analyzing it*—and it seems that the time for the latter has not yet come. The outstanding figures of the period are mentioned but their works are unknown or unavailable, and the drastic and radical transformations that were made are still evaluated in conformity with the self-praise of those who made them. In fact, notwithstanding the mass of special studies published on questions of detail, there is still no synthetizing work on NEP. This is primarily because such work is also absent in the field of the political history of the period (apart from the Western literature—filling whole libraries—which includes a number of works which partly compensate for this absence). Since the success of the restructuring that has started in the Soviet Union depends in the last resort on the changes in the mutual relations between the place and role of ideology, politics and economy within society, the conditions of such a synthesis will also be established only with these changes. Thereby the "ghostly realistic and realistically ghostly" after-life of NEP will also come to an end: from a point of reference serving to legitimate various economic policies, it will grow into the subject of objective historical analyses—an important element of historical self-recognition.

For different reasons, in the other socialist countries the legitimating role of NEP has already ceased to exist: first, because in a number of countries (certainly in Hungary, Poland, China, Yugoslavia, and perhaps in other countries, too) the progress of socio-economic reform presents such tasks as go beyond any NEP-type reform; second, because of the changed economic, political, and ideological relations between the Soviet Union and the other socialist countries, the reference to some economic, political or institutional methods applied in the Soviet Union is no longer a source of ideological and political legitimation. (This does not refer to the influence of current policies, as can be seen from the enormous reformstimulating effect today's Soviet reform policy has in these countries.) Conversely: although NEP does not play an important role any more as a point of reference in other socialist countries in the reform wave of the 1980s, this particular role will—for quite a time—continue to be important and alive in the Soviet Union. This is because, although the Chinese, Yugoslav, or Hungarian experiences are stimulating for the Soviet experiment, the role of ideological legitimation is still to be primarily played

by NEP (as long as it is at all necessary), since this is what proves the Soviet primogeniture of the reform of socialism.

References

1. Ambartsumov, Ye.A.: Analiz V.I.Leninym prichin krizisa 1921 g.i. putie i vyhoda iz nievo. (Analysis of the causes of the crisis of 1921 and V.I. Lenin's views on the ways out of it.) *Voprosy Istorii,* 4. 1984. pp. 15-29.
2. Barla-Szabó, Ö.: *Az 192O-as évek gazdasági vitái a Szovjetunióban* (Economic debates in the Soviet Union in the 1920s). Kossuth Könyvkiadó, Budapest 1971.
3. Berend, T.I.: *Újjáépités és a nagytőke elleni harc Magyarországon, 1945–1948* (Reconstruction and the fight against big capital in Hungary, 1945-48). Közgazdasági és Jogi Könyvkiadó, Budapest 1962.
4. Berend, T.I.: A szocialista gazdasági stratégiáról folytatott régi vita és néhány új tanulsága (The old debate on the socialist economic strategy and a few of its new lessons). *Valóság,* 6. 1967.
5. Brus, W.: Ogólne problemy funkcjonowania gospodarki socjalistycznej. PAN, Warszawa, 1961. In English: *Market in a socialist economy.* Routledge and Kegan Paul, London 1972.
6. Bugayev, Ye.: Strannaya positsiya. (A strange position). *Kommunist,* 14. 1984. pp. 119-126.
7. Bukharin, N.: *Ekonomika perehodnogo perioda* (Economics of the transition period). Gosudarstvennoye izdatelstvo, Moscow 1920.
8. Bukharin, N.I.: Put' k sotsializmu i raboche-krestianskii soyuz (The road to socialism and the worker-peasant alliance). In: *The road to socialism in Russia.* Selected works by N.I. Bukharin. Omicron Books, New York 1967.
9. Hábová, V.: *Informácia o základnej problematike sovietských ekonomickych diskusií 20. rokov* (Information on the fundamental issues of the economic debates of the Soviet Union in the 1920s). Bratislava, 1968.
10. Hegedűs, A.: Lenin és a szocializmus gazdálkodási rendszerének alternatívái (Lenin and the alternatives of the economic management system of socialism). *Közgazdasági Szemle,* 4. 1970.
11. Hegedűs, A.: Economic reforms and the fundamental types of control systems established in socialist societies. *Acta Oeconomica,* Vol.5, No. 4 (1970). pp. 289-303.
12. Heitman, S.: Introduction. In: *The road to socialism in Russia.* Selected works by N.I. Bukharin.Omicron Books, New York 1967.
13. Hronovský, J.: Ke kritice nezbožní koncepce socialistické ekonomiky. (Contribution to the criticism of the non-commodity conception of the socialist economy). In: K. Kouba et al.: *úvahy o socialistické ekonomice* Nakl. Svoboda, Prague 1968.
14. Klacek, J.—Rybáčková, J.: *Sovetsky ekonomove dvacatych let o mechanismu fungováni ekonomiky* (Soviet economists of the 1920s on the functioning mechanism of the economy). ČAV Ekonomicky Ustav, Prague 1967.

15. Kovács, J.M.: Gazdasági intézmények történelmi(etlen) párhuzamai (A NEP és a magyar gazdasági reform) (The (un)historical analogies of economic institutions. [NEP and the Hungarian economic reform]). In: *Gazdaságpolitika, gazdasági szervezet* Bulletins of the Institute of Economics of the Hungarian Academy of Sciences, Budapest 1982.
16. Lisichkin, G.S.: *Plan i rynok (Plan and market). Ekonomika,* Moscow 1966.
17. Nagy, T.: A NEP alkalmazásának egyes kérdései Magyarországon. In: *Gazdasági életünk egyes kérdései a közgazdaságtudomány tükrében* (A few issues concerning the application of NEP in Hungary. In: A few issues concerning the Hungarian economy, as reflected in economics). Proceedings of the first scientific session of the Karl Marx University of Economics. Tervgazdasági Könyvkiadó, Budapest 1954.
18. Pető, A.: NEP-rajz (A sketch of NEP). An interview with J.M. Kovács. *Heti Világgazdaság,* 7.11. 1987. p.12.
19. Petrakov, N.: Zolotoi chervonets vchera i zavtra (The golden chervonets yesterday and tomorrow). *Novi Mir,* 8. 1987. pp. 205-221.
20. Popov, G.H.: Perestroika ekonomiki i individualnii trud (The restructuring of the economy and individual work). *Nauka i Zhizn',* 9. 1987. pp. 2–10, 78–79.
21. Reiman, M.: *The birth of Stalinism. The USSR on the eve of the "second revolution".* Indiana University Press, Bloomington, Indianapolis 1987.
22. *XVI siezd Vsesoyuznoi Kommunisticheskoi Partii(b)* (The 16th Congress of the Soviet Communist Party(b)). Stenographic record, 2nd edition. OGIZ - Moskovskii Rabochii, Moscow 1931.
23. Shmelev, N.: Avansy i dolgi (Advances and debts). *Novi Mir,* 6.1987. pp. 142-158.
24. Stalin, Y.: Otvet tovarishcham sverdlovstam (Answer to the comrades from the Sverdlov University). In: Y.Stalin: *Sochineniya.* Vol. 12. Moscow 1949.
25. Stalin, Y.: Politicheskii otchet Tsentralnovo Komiteta XVI s'ezdu VKP (b), 27 iyunia 1939 g. (Political report of the Central Committee at the 16th Congress of the Soviet Union's Communist (Bolshevik) Party on 27.6. 1939. In: Y.Stalin: *Sochineniya,* Vol. 12. Moscow 1949.
26. Stalin, Y.: On the draft constitution of the USSR. In: Stalin: *Problems of Leninism.* Foreign Languages Publishing House, Moscow 1947.
27. Strelianyi, A.: Prihod i rashod (Assets and liabilities). *Znamia,* 6. 1987. pp. 175-203.
28. Sutela, P.: Economic incentives in Soviet pre-War economic thought. In: Hedlund, S. (ed.): *Proceedings of the Eighth Arne Ryde Symposium* , Frostavallen, 26–27 August 1985. Croom Helm, London-Sydney 1987.
29. Szamuely, L.: *First models of the socialist economic systems. Principles and theories.* Akadémiai Kiadó, Budapest 1974.
30. Szamuely, L.: The first wave of the mechanism debate in Hungary (1954-1957) *Acta Oeconomica,* Vol.29, Nos 1–2 (1982) pp. 1–24.
31. Szamuely, L.: Ideological features yet to be overcome in Soviet-type economies. Paper presented at the international conference on Economic Systems and Reforms in a Changing World. Seoul, South Korea, September 1-3. 1987.

32. Urban, B.: *Zrod a konec velké diskuse* (The beginning and end of the big debate). Karlova Universita, Prague 1968.

ВТОРАЯ ЖИЗНЬ НЭПА

Л. САМУЭЛИ

Новая экономическая политика, введенная в Советской России в 1921 году, считается общепринятым, легитимным прообразом общественно-экономических реформ, предпринимаемых с 10-15-20 летней регулярностью в социалистических обществах советского типа. Противо- положные интересы, связанные с этими реформами, сменами курса экономической политики, не только порождают сложное переплетение различных толкований НЭПа, но и сама идейная и политическая борьба вокруг вопросов о необходимости и направлении перемен в определенные периоды публично выступает, рядясь в облачения этих различных толкований.

Объективной основой различий в интерпретации НЭПа является тот факт, что переход к НЭПу в 1921 году имел, по крайней мере, три стороны: 1. переход от военной экономики к послевоенному восстановлению; 2. изменение экономической политики правящей коммунистической партии в отношении непролетарских классов, в первую очередь крестьянства, но в более широком смысле—всех частных товаропроизводителей и предпринимателей; 3. легализация товарообмена и рынка, восстановление денежного обращения, кредитно-банковской системы, отказ от непосредственного осуществления идеи нетоварного и безденежного хозяйства.

Хотя эти стороны НЭПа тесно и нераздельно связаны друг с другом, все же они выражают разнородные процессы, требующие различного идеологического, политического и экономического толкования, приводящие к различным выводам. В статье анализируются разные исторические толкования НЭПа, ставившие во главу угла ту или иную его сторону, и их значение для современности.

Во второй части статьи рассматривается, как использовались ссылки на НЭП для идеологической легитимации попыток реформ, предпринимавшихся в странах Централной и Восточной Европы в пятидесятых и шестидесятых годах. Особое внимание уделяется своеобразному »ренессансу« НЭПа в советской литературе и публицистике восьмидесятых годов. По мнению автора, это явление объясняется стремлением к идеологической легитимации радикальной реформы, развертывающейся в СССР. В то же время НЭП потерял такого рода легитимационную роль для других социалистических стран. Причины этого кратко рассматриваются в конце статьи.

Acta Oeconomica, Vol. 39, (3-4), pp. 357-367 (1988)

REVIEWS

A CHAPTER OF RECENT ECONOMIC HISTORY—MERGERS OF AGRICULTURAL COOPERATIVES OVER TWO DECADES IN HUNGARY

GY. SZŐKE

In the last two decades centralization has been the most important organizational change in the Hungarian cooperative movement. Economic centralization has appeared in the form of mergers (or amalgamations—both terms are generally used for the phenomenon in current literature) and continues to take place even today. The prevailing legal rules on cooperatives have—contrary to general political intent—made it easier than before for the cooperatives to merge. This has been made possible by the provision that in cases where cooperatives of different sizes merge, they allow the larger economic unit to incorporate the smaller one without having to elect new management.

In the Department of Food Economy[1] of the Institute of Economics of the Hungarian Academy of Sciences throughout the last five-year plan period research has been going on into the issue of how the system of enterprise organizations—and, within it, food economy—should be transformed in Hungary in order to make it more adaptable to the principles of the new reform policy proclaimed in 1968. In the course of our investigations the problem was formulated as follows: first, we should review the current organization of our economy and collect as much empirical material as possible, and evaluate the gathered material on the basis of the reform's principles; second, we should explore the occasional deficiencies; and finally, we should propose changes of organization which seem to be necessary. In my opinion, however, the matter is not as simple as that. It is not enough and not even possible to change the economic structure by resolutions. The changing of any system has its own inherent logic. My personal experience strongly suggests that—as in a capitalist economy, where the changes in enterprise organization are mostly influenced by the rate of profit—in the socialist system the economy also has a large degree of autonomy in its movement, and specific features are attached to this.

It was exactly the case of the food economy which recently bore witness to

[1] In Hungarian terminology "food economy" is a comprehensive term for agriculture plus the food-processing industry. (*Ed. note*)

the fact that changes in organization have a certain self-movement which—despite the sporadic counter measures—still tend towards centralization. (Recent counter measures in the food economy include the liquidation of the large trusts of the food-processing industry, the establishment of enterprises for artificial insemination, etc.)

If economic policy really wanted to accomplish a reorganization of enterprises in Hungarian agriculture in conformity with the reform—and economic constraints undoubtedly act with increasing power in this direction—the first and perhaps most important task of research into organization patterns would be to understand the centralizing trend in the self-movement of Hungarian economy.

This paper is a contribution to solving this task by the following:

— I will demonstrate the centralization which occured between 1960 and 1984 in the sector of the Hungarian economy which, even today, is the most decentralized one (i.e. that of agricultural cooperatives). This will be done on the basis of the available statistical data.

— Using statistical methods, I am going to investigate the fluctuation of the centralization process in agriculture and try to attach the trends to certain economic-political actions.

The system of farm organization in socialist agriculture between 1962 and 1968

It is worth beginning the discussion of agricultural centralization with a broader review of agriculture, without such a review the misleading conclusion might be arrived at that, since the ownership relations in the agricultural cooperatives were, for a long time, considered a lower category, centralization affected them more deeply than it did the state enterprises.

The data of *Table 1* reflect the fact that, despite the strong centralization (the total number of enterprises decreased by 64 percent), a significant number of enterprises in Hungarian agriculture are still cooperatives. Yet, in spite of the strong centralization in the organization of Hungarian agriculture in the 1960s and 1970s, in principle the organizational conditions allowed a certain economic competition. In this respect the best example is the cooperative sector where (despite continued centralization and specialization) several hundreds of farms still produced the same products even in 1984. The competitive conditions in agriculture were also strengthened by the fact that—in contrast to other branches of the national economy—rather than a shortage of products, recently overproduction has become a characteristic. Thus the buyer does not run after the seller, but the vendor has to make efforts to find the customer.

Since the question of the present study is not whether healthy economic competition can or cannot develop in agriculture under the current circumstances of enterprise organization and other economic conditions, but is aimed at a survey—

Table 1

The number of agricultural enterprises in socialist ownership in 1962 and 1984 in Hungary

Types of farms	1962	1984	1984 as a percentage of 1962
State farms	217	128	59
Agricultural cooperatives	3611	1279	35
Special cooperative farms	249	62	25
Fishery cooperatives	22	16	73
Total of agricultural enterprises	4099*	1485	36

Source: Statistical handbooks of agriculture, Központi Statisztikai Hivatal Budapest, covering the years 1961–1984

**Notes*: Taking 1962 as the first year in the table is justified because the socialist transformation of Hungarian agriculture had been completed by then. In 1959 the number of the farms owned by individually farming peasants was more then one million, yet a year later, in 1960 this was already only 500 thousand, and by 1962 not more than 140 thousand individual peasant farmers were left in Hungary.

A further comment I must make is that *Table 1* only refers to those types of enterprises which survived over the whole period. For example, the agricultural machine stations are not included. In 1962 231 machine stations existed in the country, but this form was liquidated during the 1960s. Similarly, the various forms of associations are also not shown, since in 1962 no such forms existed—whereas in 1984 54 cooperative associations were recorded. Also taking into account the missing—not comparable—enterprise forms, the number of agricultural enterprises in Hungarian agriculture was 4330 in 1962 and 1539 (36 percent) in 1984.

Special cooperatives are a lower type than the "normal socialist production cooperatives" as in the special cooperatives—in contrast with the production cooperatives—the means of production are not in full common property.

relying on numerical data—of the centralization that went on over a period of two decades in the Hungarian agriculture, let us return to the analysis of the data found in *Table 1*.

This shows very clearly that within the sphere of agriculture centralization was typical in all types of enterprises, though its intensity varied according to the particular forms of organization. It was most dynamic in the case of the special cooperative farms (a 75 percent decrease) and was least in the fishery cooperatives—where decrease was 23 percent. Though, on the one hand, not all enterprise forms were affected by centralization to the same degree (e.g. for a long time the special cooperatives were considered transitory forms of organization to be liquidated later on), on the other hand we must remember that centralization was not carried out simultaneously in respect of all the particular forms. This can be well illustrated through the example of the state farms and the cooperative farms. The organization and centralization of the state farms was accomplished much earlier than that of the agricultural cooperatives. The number of state farms was at its largest in 1955.

At that time there were 472 state farms in Hungary and in our base year of 1962, by the time cooperative reorganization had been completed—and centralization just started - this number had sunk by more than half, to 217. Therefore, even if there are signs giving the impression that the process of centralization affected the different forms of ownership to different degrees, one must be very cautious with such statements and keep in mind that centralization in the various types of enterprises was not simultaneous.

In the following I shall investigate, paying attention to the chronology of developments, how centralization has been accomplished in the sphere of agricultural cooperatives. In my opinion, however, a thorough economic analysis of the inequalities of centralization, as indicated by statistics, would significantly contribute to the understanding of the essence of centralization, i.e. the movement of the centralization process. Even a rough analysis makes it easy to demonstrate the connection between certain periods of economic-political actions and the dynamism in the process of centralization.

Methodological comments concerning the statistical survey of centralization

The examination of cooperative centralization could be based on the development of collective property, or on the average land area, or—and this seems to be the most simple—on the changing number of the cooperatives. In the following I am going to use the development of the number of cooperatives for surveying the centralization process. Along with its simplicity and the unequivocal sequence of data, another reason for taking this approach is that if the number of cooperatives has decreased in Hungary, this is almost exclusively because of the mergers of cooperatives. In the period under analysis no agricultural cooperative was converted or transformed into a state farm and not one was divided into smaller units. The series of data might only be distorted if farming cooperatives were converted into special cooperatives or, the reverse of this, special agricultural cooperatives into agricultural cooperative farms. (During the period under consideration the economic-political management did not resort to the former possibility.) As far as I know, there was only a single occasion when, a few years earlier, the Román-Magyar (Hungarian-Romanian) agricultural cooperative of the village Méhkerék (East-Hungary) was converted into a special agricultural cooperative. The latter case, however, when special agricultural cooperatives were changed into agricultural cooperative farms, occured more frequently, exspecially in the early 1960s. If, however, in the course of the analysed period more special cooperatives were changed into agricultural cooperatives than the other way round, then this means that the statistics practically underestimate the centralization of the agricultural cooperatives.

Table 2

Statistical analysis of fluctuations in the centralization of the Hungarian agricultural cooperatives between 1960 and 1986

Year	A	B	C	D	E
1960	4 507	4 507	–	–	–
1961	4 204	4 282	303	225	135
1962	3 721	3 994	483	210	230
1963	3 611	3 535	110	186	59
1964	3 413	3 430	198	181	109
1965	3 278	3 242	135	171	79
1966	3 181	3 114	97	164	59
1967	3 033	3 022	148	159	93
1968	2 840	2 881	193	152	127
1969	2 678	2 698	162	141	115
1970	2 445	2 544	233	134	173
1971	2 373	2 323	72	122	59
1972	2 313	2 254	50	119	42
1973	2 199	2 197	114	116	98
1974	1 917	2 089	282	110	256
1975	1 598	1 821	319	96	332
1976	1 470	1 518	128	80	160
1977	1 425	1 397	45	73	62
1978	1 369	1 354	56	71	79
1979	1 350	1 301	19	68	28
1980	1 338	1 283	12	67	18
1981	1 320	1 271	18	67	27
1982	1 302	1 254	18	66	27
1983	1 285	1 237	17	65	26
1984	1 279	1 221	6	64	9
1985	1 270	1 215	9	64	14
1986	1 267	1 206	3	64	5

Source: Statistical handbooks of agriculture, Központi Statisztikai Hivatal, Budapest, covering the years 1960-1986.

*Notes:*A: Number of agricultural cooperatives

*Notes:*A: Number of agricultural cooperatives
(empirical series of data: $A_0, \ldots, A_{26}$)

B: Calculated number of agricultural cooperatives
(theoretical series of data: $A_i = A_{i-1} \cdot 0.95$)

C: Decrease in number of cooperatives in one year: $(A_t - A_{t-1})$

D: Decrease in number of cooperatives
in the theoretical series of data $(A_t - A_{t+1})$

E: The actual decrease in percent of the theoretical decrease: C/D

In Hungary 4507 agricultural cooperatives were working in 1960, but 1267 of them were left by 1986, i.e. 3240 cooperatives were liquidated during the 26-year period.

In the course of the 26 years in the Hungarian cooperative movement there was in fact not a single year when the number of the agricultural cooperatives did not decrease. Presuming a uniform decrease throughout the period, the annual average reduction was 5 percent.[2]

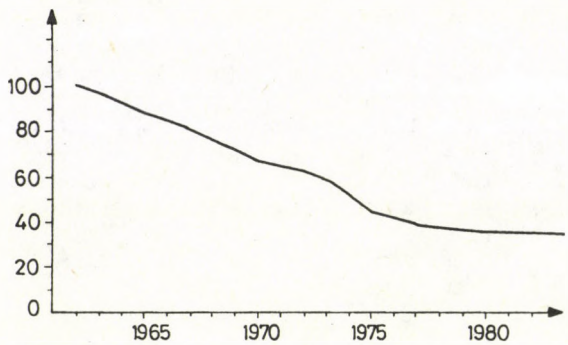


Fig. 1 Changes in the number of agricultural cooperatives in Hungary between 1962 and 1986 (1962 = 100 percent)

This figure represents the average rate of centralization. The shape of the curve in *Figure 1* indicates, however, that the decrease was not uniform. I have summarized the statistical calculations regarding the fluctuation of centralization in *Table 2*; the calculations involve two preceding years and start with 1960 because, during preliminary analysis of the data, I discovered that, parallel with establishing the cooperatives in Hungary, during the course of reorganization a dynamic process of cooperative mergers already took place and I did not want to miss the first peak period. Between 1960 and 1986—assuming an even rate of decrease, the number or cooperatives declined by 5 percent per annum. Since the establishment of cooperatives was still taking place in 1960 and new cooperatives were being organized even in 1960-1962, this again means that—as I mentioned in the case of the special cooperatives—in reality centralization was even more dynamic than that. (In connection with this also take note of what we shell say later on in connection with the first peak of the centralization curve.)

[2] The equation is: $1.05 = \sqrt[26]{4502/1267}$;
4507 is the number of cooperatives in 1960;
1267 is the number of cooperatives in 1986.

The calculations were made as follows: based on the 5 percent calculated rate of decrease between 1960 and 1986, I worked out a theoretical series of data and compared the theoretical decreases per annum—obtained by this computation—with the empirical (actual) series of data. In such cases when the decrease calculated from the theoretical series of data was lower than that computed from the actual ones, the dynamism of centralization was higher than average; in the opposite case it was lower than average. I call those years "peak periods" when the decrease in the number of farms, computed from the empirical data, essentially exceeded the decrease computed from the theoretical series of data.

Three peaks of centralization in the cooperative movement and the economic-political actions (ideologies) that inspired them

The first wave of centralization appeared in the finishing period of organizing large-scale farms in 1961-1962. Searching for the causes the researcher is, well after the events, reduced to conjectures. However, I think it logical that this centralization wave was linked to the socialist transformation of Hungarian agriculture. In the first period of organizing cooperatives—in the late 1950s—it was presumably easier, due to a quasi-adherence to the Leninist principle of progressiveness, to establish smaller cooperatives and, in the following phase, amalgamate the previously established ones. Thus, by uniting already organized cooperatives, the not much earlier small-scale peasant farms (i.e. the peasantry itself) came to be estranged from private ownership to such a degree that the organization of the cooperative movement grew irreversible. Some data demonstrate the extent of centralization: taking into account the theoretical rate of decrease, in 1961 and 1962 the reduction in the number of cooperatives ought to have been 436. The actual decrease was more than one and a half times greater, standing at 786. This figure ought to be increased by the number of the new cooperatives organized in 1961 and 1962. However, this figure is unknown. My hypothesis is also supported by the fact that in the second year of the centralizing wave, namely 1962 (when the establishment of new cooperatives could no longer be the source of an increase in the number of cooperatives), centralization was much higher than in the preceding year. In 1961 the figure stands at 96 percent. It is interesting how the "tide" of centralization suddenly changed into an "ebb" in 1963. According to the theoretical trend, the number of cooperatives should have decreased by 186 in 1963, whereas the actual fall was only 110. By contrast, in the next year centralization again grew stronger and the decrease was greater than expected. There was a decrease of 17 agricultural cooperatives and, following this, from 1965 to 1968 the dynamism of centralization was again lower than the average for the whole period. Practically the only year

when a higher than average decrease can be discovered, was 1964. I presume that for some reason (e.g. because of weather conditions adverse to agricultural production) in 1963 the organization of agricultural cooperatives could not be changed and therefore the final period of the centralization wave which completed the cooperative reorganization process, came to pass a year later.

The centralization impetus of 1961-1962 was followed by a second one in 1968-1970. The 1968/70 peak was lower than that of 1961/62 but, nevertheless, statistics clearly show it. While my hypothesis is that the first peak was called forth merely by political or economic-political reasons, in the centralizing impetus of 1968/70 it is very likely that economic causes played a major part. Remembering the events of that time, it was the period when the agricultural cooperatives built up their large-scale capacities—primarily their stock-breeding facilities. According to the average trend the decrease in the number of cooperatives should have been 427 within three years—in reality it was 588. Searching for the causes we must not forget that this second centralizing impetus showed up directly after the introduction of the new system of economic management. Thus the question of whether it was the mechanism itself which produced the second wave of centralization unavoidably arises.

Although centralization is a phenomenon contrary to the spirit of the economic reform, the above assumption is not unfounded, for the way in which the reform was actually implemented in agriculture must have been a contributory factor to the strengthening of centralization. Market-oriented management of the agricultural cooperatives actually started in a period when they had hardly any equipment really suited for large-scale farming.

After the economic reform—for more or less obvious reasons—the creation of large-scale farming capacities was carried out in the framework of a centrally controlled, subsidized programme of technological development. For the smaller than average farms this process was unfavourable because the amount of the state subsidies which were granted for investment projects was too large to be assimilated to the economic power and the size of smaller than average cooperatives. These subsidies were mostly granted for definite projects or for projects which had been carefully and accurately circumscribed. Hence, the smaller than average cooperatives had little opportunity for developing a suitable production capacity within the given system and in the majority of cases they were actually unable to do so. (In an earlier study I demonstrated that the smaller than average cooperatives were only able to apply for government subsidies for investment projects if they had accumulated resources in their development fund over several years. Therefore, such state-subsidized projects necessarily created an investment cycle in the small cooperative farms and it was very difficult to fit them into the given organization of farming.)

According to the statistical data the most dynamic centralization wave in the history of the Hungarian cooperative movement developed between 1974-1976. In

the course of these three years almost three times more cooperatives were liquidated than indicated by the general trend. Data which provide the most typical characterization of the power of the centralization process are shown on the summit of the wave, i.e. in 1975—within one year—the number of cooperatives declined by 17 percent and the average size of their land area increased from one year to another by 23 percent. I should like to illustrate the then prevailing official opinion by a personal experience. In 1975 I was a participant in a district conference organized for young agricultural experts in Berettyóújfalu, Hajdu-Bihar county.

One of the lectures at this conference, the head of the district Agricultural Department, stated with unswerving confidence that the optimum size of an agricultural cooperative in Hungary is a land area of ten thousand hectares. At that time studying the "optimum farm size" was a fashion in agrarian economics—of course the conclusion of this fashion was that farm dimensions should grow. Yet not one of the theoretical experts claimed, as this district executive did, that the cooperative mergers should be continued in the country until the average size of a farm approached ten thousand hectares.—I must note that for developing cooperatives of such mammoth dimensions a radical reorganization would have been required, since the average land area of the Hungarian agricultural cooperatives did not exceed 2800 hectares in 1975—even with the ongoing progress of excessively powerful centralization. In the Bihar region—where the lecture was delivered—in the area of the Körös and the Berettyó rivers, land is cut into much smaller pieces than it is in the interior parts of the Great Hungarian Plain, so that the average area of the cooperatives reached not even one-fifth of the optimum size recommended by the district leader. However, such was the public feeling with regard to economic policy in the period of the third centralization wave.

Now, coming back to finding the causes, if we really want to trace the facts comprising the background of the centralizing wave, I believe they can be found in the then current ideas of how to develop Hungarian agriculture.

Although in the world economy the oil crisis had long ago halted any exaggerated rate of modernization, in Hungary (a few years after the extremely successful modernization of agriculture in the third world—the "green revolution", as it was called at that time), recent changes in the world economy were still not recognized.

Paradoxically, and contrary to the developmental and ideological changes and to those which were then going on in the world economy, this period represented a boom in the development of Hungarian agriculture. It was the time when so-called "production systems" became widespread and it was indeed fit to be called, according to the terminology rather fashionable at that time, the "industrialization of agriculture".

The conspicuous economic achievements gave birth to economically unfounded illusions about development. Seeing that the technology of corn production and breeding of broiler chickens introduced from oversears could successfully be adapted to Hungarian agriculture, a general opinion concerning agricultural development

became widespread—namely that in a very short time the other branches of agriculture could be modernized at the same pace.

Many people in Hungary thought that for such modernization to take place nothing else was needed but the creation of organizational conditions, i.e. increasing the area of the agricultural enterprises by amalgamating farms. This top-level ideology of development—the idea of unlimited possibilities for technological development—unfortunately coincided with the political and economic interests of the technocratic leaders of the larger cooperatives. The political interest concerned the fact that the power of these leaders could, once and for all, be confirmed by the adoption of large-scale production techniques. These would not suit the earlier middle-peasantry who were still present in most cooperatives, often in leading positions. The economic interest was hidden in the wage system, according to which the salaries of the leaders were—and still are—primarily determined not by the successful operation of the cooperative but by the magnitude of the economic unit managed by them. This is why I think that in the events leading up to the peak in 1974/76, the interests of the sectoral and farm leaders played a substantial part. The strengthening of centralization was so powerful that, albeit with a slight exaggeration, one might refer to it as a second "socialist transformation".

The end of the story was that, owing to technical and economic reasons, development at a rate similar to that of poultry raising and corn production could not be realized in the other labour-intensive branches of Hungarian agriculture. What is more, it is not unlikely that the resources of technological development were so scarce that the development of the above-mentioned two areas drew away from other branches the essential material resources needed for the maintenance of their production levels. This is, however, only a hypothesis which ought to be investigated in greater detail.

It is in any case a thought-provoking fact that in 1976 a veritable crisis evolved in Hungary in the production of labour-intensive products, so serious was the shortage of such commodities.

The political leadership realized in 1977 that the merging of cooperatives was not in harmony with economic reality and the Central Committee of the HSWP took a resolution in order to slow down the process, in spite of the branch interests of agriculture.

Has centralization come to an end in Hungarian agriculture?

The question mark in the title is not simply a case of loose speculation. More than ten years have passed since the last impulse of cooperative centralization. Soon after the aforementioned resolution of the CC, from 1977 on, the 5 percent rate in the merging of Hungarian cooperatives diminished to 1 percent p.a. and this ten-

dency has since become permanent. However, the driving forces of centralization, despite the resolution, did not cease to exist.

Studying the amalgamations of cooperatives which have occured since the 1970s, experience shows that in the majority of cases the dominant reason for the merger was economic bankruptcy among the small cooperative farms.

The conditions of economic management changed so that the smaller than average agricultural enterprises went bankrupt by the dozen. The "victims" of the centralization waves were always the small cooperatives. The Handbook of agricultural statistics for 1960 recorded those farming on a land area below 40 hectares as the smallest category of cooperative farms; the group of the largest agricultural cooperatives consisted of those having more than 2878 hectares. (The dimension limit is not a round figure because in 1960 cadastral yoke[3] was used as the unit of land area and I had to convert it into hectares according to the current standards.) In the same statistical publication of 1984 2000 hectares is given as the maximum area of the smallest cooperative farms in Hungary and 8000 is the minimum in the group comprising the largest cooperatives.

Between 1960–1963 the rate of decrease in the number of agricultural cooperatives with less than a 1000 hectare area was, annually, 19 percent—i.e. about four times higher than the average (5 percent) decrease in the total number of agricultural cooperatives. In 1960 there were 3346 farming cooperatives in the country which had areas of less than 1000 hectares, yet in 1983 there were no more than 19.

Such small-size cooperative farms are needed at present, since the conditions of business economy in these enterprises are relatively favourable for producing labour-intentsive products. Due to the lack of smaller-category cooperative farms a division of labour is evolving according to which the production of labour-intensive products is transferred to the rather unstable small-scale farmers (i.e. who can guarantee neither domestic supply, nor the safety of exports).

Despite top-level political intentions, centralization in the Hungarian cooperative movement has not yet come to an end, because—in the case of the larger than average cooperative farms—preferences based on enterprise size and (in the case of the smaller than average cooperatives) non-preferences, are inherent in the system of economic management. I cannot, however, digress upon this area of enquiry, for such a study would require another paper. Hence I close my present study on the centralization process, which has been going on since 1960 in the Hungarian cooperative movement, by saying that the danger of centralization has not yet passed and if political brakes were to start loosening it is possible (and under given economic conditions it is logical that such a result can be expected) that centralization of cooperatives would acquire even greater momentum.

[3] 1 cad. yoke = 0.57 hectares or 1.42 acres.

Acta Oeconomica, Vol. 39, (3-4), pp. 369-383 (1988)

HUNGARIAN TRADE IN CONSUMER GOODS—SOME QUESTIONS RELATED TO CHANGES IN ENTERPRISE STRUCTURE

O. LUKÁCS

In the repeated interruptions of the Hungarian economic reform process the system of organization of the enterprises and institutes has played its part.[1] In my paper I wish to deal with the systems of organization both in retail and in wholesale trade. Recently certain changes came to pass in the system of retail trade. The most important changes are: the appearance of cooperatives in towns, the running of several shops by contracting, in the form of "income-interested" leasing (though without changing the system of organization of the enterprise), and the rapidly increasing number of the private retail shops.

These changes—undoubtedly progressive—failed to bring about the expected results, since the control system, as well as the system of organization of retail and wholesale trading enterprises remained unchanged, and also because the reform process stopped in other areas. Despite the declaration of a system of free circulation, the majority of commodities still move in the Hungarian market through traditional channels. Under various epithets (such as "keeping hands on", "surveying" and "market surveillance", the old quantitative distribution system continued to prevail in practice. In the domestic market, producers and commercial enterprises are only very slightly market-oriented.

Hence, it is worth studying the organization of enterprises in Hungarian retail and wholesale trade in order to ascertain the degree to which competition has developed, the extent to which nationwide or regional monopoly positions still exist, and whether or not market shares have changed in the branches where more than one enterprise are present in the market.

[1] With the exception of the international part, this paper has been written on the basis of a study made for the Institute of Economics of the Hungarian Academy of Sciences. As the research was finished at the beginning of 1985, the latest data referred to are those of 1983. Since that time, however, no significant changes have occurred.

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

An international comparison[2]

The West European countries include other sectors in what is called wholesale trade than does Hungary. These include sectors which consist of—to use Hungarian terminology—enterprises trading in the means of production, foreign-trade companies, procurement, and even the warehouses of the big industrial firms which are entitled to carry out commercial activities. Most wholesalers are both exporters and importers and often trade in consumer articles and trade in the means of production are also not separated. Furthermore, it must also be mentioned that in all sectors the vast majority of the numerous wholesalers are one-, or two-person enterprises. (In most countries 90 percent of wholesale trading enterprises are small-scale undertakings.)

Retail trade is, in turn, very precisely defined and comparable internationally. The difference is merely that in the western countries public catering is not classified as retail trade; together with hotels, it belongs to the service sector. Since these data are also recorded separately in Hungary, a comparison, at least as regards order of magnitude, is possible.

The analysis that follows will encompass 13 European countries: Austria, Belgium, Denmark, the UK, France, the Netherlands, Ireland, the FRG, Italy, Portugal, Spain, Switzerland and Sweden.

Retail trade transactions in these countries are carried out by the following types of organizations:

1. Chain-store enterprises, department stores, hypermarkets and hypermarket chains

A chain-store enterprise is a form of retail trade integration where many (in general more than four or five) shops belong to the enterprise and the entrepreneur proper is the enterprise head office. Such enterprises possess one or more warehouses, they purchase almost all their goods from the producers, usually in large lots. Hence, costs such as administration and storage are covered by the lower purchase prices (in Hungarian terms, by profiting from the wholesalers' margin).

The autonomy of the shops in purchasing is limited and they are, in general, only allowed to place orders with the enterprise head office. With the aid of up-to-date computers the head office fulfils the orders within 24 hours; the inventory pattern is always known, and producers are continuously delivering in accordance

[2]The international comparison is written on the basis of [1] thus, the data referred to were current as of 1978. The data that have became available since then show that in the meantime neither trends in methods of operation, nor trends in the proportions of enterprise groups to one another have changed.

with required specifications. Thus, despite the fact that the head office is the entrepreneur, market-orientation is assured. The department stores, the hypermarkets and the so-called chains that they set up can also be grouped in this category. Their operating principles are the same as those of the chain-store enterprises.

Except in the UK and Denmark, the ratio of the chain-store enterprises is below 35 percent, and in the less developed countries (like in Italy, Spain, Ireland and Portugal) it is 17 percent, or even less.

Thus, if Hungary conformed to the situation that exists in countries on a similar level of development, the share of chain-store enterprises within retail trade would be similar to the latter countries. However, if we consider state-owned organizations as chain-store enterprises, this share is 64 percent in Hungary. Yet, the majority of these enterprises are unable to utilize the advantages inherent in having a chain of stores (in having large-scale enterprises). Namely, they have no central warehouses, and they do not purchase goods directly from producers. This means that the actual purchaser is—without any risks—the shop, relying mostly on the wholesalers (who very often do not know enough about the market). There are several reasons for this. On the one hand, a significant portion of these enterprises are simply a number of haphazardly grouped shops of varying size (perhaps with very different profiles) within a certain geographic area. On the other hand, according to the conventional distribution (allocation) system, a large proportion of commodities are forwarded to the retail shops through wholesale organizations. In some spheres, where the distribution is not done by the authorities, often large industrial enterprises carry it out (as with meat, durable consumer articles and building materials). Implementing sales through wholesalers is advantageous both for the producers and for the authorities. For the authorities it is easy to find, or "tokeep its hands on" the responsible entity, and the producer is able to transfer its products at any time, even to correspond with fluctuations in its output, to the large-size wholesale organizations (most of which are in monopoly positions).

Often storehouses and an appropriate technology are missing. Only a few of the retail enterprises can be considered actual chain-store enterprises, and even these not completely so: such enterprises are "Centrum" and "Skála", [3] some monopolistic national enterprises, and certain enterprises trading in industrial products in the Budapest area. The share of these within total retail turnover is 17 percent. We must strongly emphasize that for some of these only 40relationships with producers are direct. This is very far from the share of purchases that are direct in Western Europe which amounts to almost one hundred percent. One of the most important reasons for this is the existence of a traditional path for the goods

[3] In this study the Hungarian enterprises are mentioned by their most commonly used tradenames, acronyma, or abbreviations. "Centrum" and "Skála" are department- store organizations with some retail shops. (The first one is state-owned, the second cooperative.) (*Ed.note.*)

(a path which is maintained by superior strength.) Thus, of course, no competition can develop.

2. Consumer's cooperatives

In Western Europe the consumers' cooperatives merged into some large-enterprise-like organizations which are operating on the basis of the same principles and systems as chain-store enterprises. What is more, in some cases they also have some productive units and collaborate with the cooperatives of other countries (in purchasing and production).

The role of consumers' cooperatives is significant in only a few countries. Aside from Scandinavian countries, their importance is worth mention only in Austria. Ireland and Switzerland. Here the cooperatives have united in associations and are, in the final analysis, working much like the big enterprises, with central warehouses, advanced technology, direct procurement from producers etc.

In Hungary 1374 consumers' cooperatives existed in 1960, which, in the wake of centrally initiated campaigns, became through amalgamations 284 by 1983. For these, however, the conditions necessary for them to operate as chain-store companies have not come into being. ("Skála" is an exception, but this is a cooperative enterprise.) At the same time, the possibility of democratic control, i.e., a proprietary consciousness, ceased to exist. Cooperatives represent 30 percent of the total retail turnover.

3. Self-reliant, independent small shopkeepers

In the commercial life of western countries this form has great significance, owing both to its weight and to the personal contacts such shopkeepers develop with consumers. In the countries we have mentioned (with three exceptions) their share in the turnover is more than 60 percent, and what is more, in certain less developed countries it might reach or even exceed 90 percent. In order to establish direct relationships with producers, many of the independent shopkeepers united in associations. Otherwise they purchase some commodities from small and medium producers, and some from wholesalers.

In Hungary the share of really independent shopkeepers in total retail turnover, according to estimates, is 6-8 percent.

4. Mail-order houses

The share of mail-order houses approaches 4-5 percent in only a few countries (the UK, the FRG, France), and in the others it remains below 2 percent of turnover. In Hungary this commercial form is practically non-existent; orders by telephone (for durable consumer articles) can only be placed with one enterprise.

Summing up, it can be found that in the West-European countries the sector of independent self-reliant small shopkeepers is still the most significant one.

In Hungary, on the contrary, chain-store enterprises and the cooperatives that function like chain-stores account for about 94 percent of turnover, but in a manner that the majority cannot utilize the advantages inherent in the nature of large-scale enterprises.

The organization of Hungarian trade in consumer goods

Table 1

The number of the enterprises and cooperatives classified as belonging to the trade of consumer's goods (1965-1983)

Subsector	1965	1968	1970	1975	1980	1983
Chain-store retail trade	117	88	91	100*	103	107**
Pharmaceuticals	21	20	20	20	20	20
Public catering	54	51	51	46	42	41
Retail trade of miscellaneous activities***	600	567	578	497	282	280
Wholesale trade of consumer's goods	89	78	80	54	47	51
Total without private shops	881	804	820	717	494	499
Private trade	10484	9735	10229	11403	19293	22394

*The increase is the result of statistical regroupings from the wholesale trade into the retail trade (e.g. Merkur, Tüzép's, Ofotért, Óra- és Ékszer etc.)

**Including the so-called "demigros" trade (halfway between wholesale and retail trade).

***The number of consumers' cooperatives was 1374 in 1960.

Source: [2]

The trend shown is clear: the overall number of enterprises and cooperatives decreased in every sub-sector—except in pharmaceuticals' and the retail shop network—while the number of private merchants grew. For instance, the number

of enterprise units decreased from 881 to 499 between 1965 and 1983 (the picture is even more marked if we compare it to 1960, in which case the decrease is from 1706 to 499). In order to analyse the decrease, let us consider changes in the number of shops and in their total floor space during the same period.

Table 2

Development of the number of shops and their floor space (Without private shops)

	1960	1965	1970	1975	1980	1983
Number of shops	44818	47260	52192	54861	54731	55428
Floor space of the shops in thousand square metres	–	3903.9	5116.7	6228.0	7649.3	8277.1

Source: [3]

Thus, since 1965 the number of the shops increased by 17 percent, the floor space more than doubled, and turnover increased two and a halffold. Hence, the mergers cannot be justified by economic constraints (declining turnover etc.). Given these facts, the questions arises, whether the mergers were carried out for the sake of rationalization. However, there is no evidence to support such a conjecture. For example, the increase in floor space almost equalled the growth in the quantity of turnover.

The only possible rational reason for the mergers in the chain-store trade would have been that, owing to their size, the large-scale chain-store enterprises are able to purchase directly from the producers. In this way not only the market-orientation of the producers and the merchants could be improved but retailers' profits would also increase, because the wholesalers' margin would also become part of their revenues. This, however, was not realized, and the position of the wholesale enterprises remained practically unchanged. Direct procurement in the retail trade remained almost the same.

The amalgamations in wholesale trade were even less justified than those in retail trade, since—contrary to what was desired—monopolies (or oligopolies) gained a new strength, which supported the maintenance of the mechanism based on distribution (allocation).

Especialy conspicuous was the decrease in the number of the cooperatives, which was halved between 1960 and 1965, and halved again by 1983, when it became the quarter of the original number. This process of mergers—imposed by higher authorities—eliminated the possibility of democratic control over these—mainly rural—organizations. The power inherent in federation decreased, without resulting in a more rational economic management.

Summing up, it has been shown that, instead of moving closer to effective

market relations by abolishing nationwide and regional monopoly (oligopoly) positions, a contrary process—a uniting of enterprises—took place even from 1963 on. It was only in the private sector that there was a significant increase in the number of enterpreneurs but, since these entrepreneurs only account for a few percent of turnover, they do not have a decisive impact on the market.

The development of the retail-trade enterprise structure

As shown by the foregoing, the system of organization of state-owned (chain-store) retail trade has not changed in practice. This can also be demonstrated by studying the distribution of the enterprises by the number of their employees.

Table 3

The distribution of chain-store retail enterprises by the number of their employees

At year's end	Percentage of the enterprises employing						
	–500	501–750	751–1000	1001–1300	1301–1600	1601–	Total
	persons						
1968	13.6	32.9	26.1	11.4	7.9	7.9	100
1969	8.0	33.0	27.3	13.6	7.9	10.2	100
1970	8.8	53.8		27.4		9.9	100
1975	11.8	11.8	33.3	18.3	11.8	12.9	100
1980	10.3	17.2	35.6	25.3		11.5	100
1983	12.4	20.2	33.7	23.5		10.1	100

Source: [3]

As the table shows, even in this respect no significant change occurred. The ratio of the enterprises employing less than 1000 persons hardly changed (from 68.3 to 66.3 percent). This is obvious, since in every county generally a single enterprise operates for each major groups of commodities, while in Budapest more deeply specialized enterprises can be found. Hence, every enterprise has a unique product mix (commodity line) and there is no state-owned enterprise to compete with it. Only cooperatives which have penetrated urban markets offered any competition, and this competition has been sporadic, since they also work in specific areas (except the "Skála"). All this happened despite the resolutions of the higher state bodies which declared that the enterprises and cooperatives have to work independently, unconstrained by public administration frontiers. Conceptions that are based on "responsibility for supply", the ownership of the local councils, the influence of local authorities, all contribute to preventing changes in the structure. The fact that the wholesalers belong to the ministries and the retail organizations to the local councils also inhibits change. The dependence on these bodies remained fairly strong even after the introduction of the new forms of enterprise management.

As a result, not even market shares are likely to change significantly. We have examined, for instance, how the share of the food retail trading enterprises (Csemege, KÖZÉRTs, county food-store enterprises[4]) in the turnover has changed.

Table 4

Breakdown of real-trade turnover by enterprises, in percent

Enterprise	Gross return from sales		
	1975	1980	1984*
"Csemege" (Delicates)	9.9	11.3	12.0
Budapest "KÖZÉRT" foodstores	37.3	35.1	32.8
Foodstore enterprises in the provinces:			
Baranya county	4.5	4.4	4.2
Bács county	2.5	2.5	2.4
Békés county	1.8	1.8	1.8
Borsod county	3.4	3.6	3.6
Miskolc (town)	3.5	3.7	3.8
Csongrád county	1.8	1.7	1.6
Szeged (town)	2.1	2.1	2.0
Fejér county	1.8	1.8	2.5***
Győr county	2.3	2.2	2.1
Sopron (town)	1.0	1.0	1.2
Hajdu-Bihar county	3.6	3.8	3.7
Heves county	2.1	2.1	2.2
Dorog (town)**	–	–	–
Tatabánya (town)**	–	–	–
Nógrád county	1.7	1.7	1.7
Cegléd and its environs	1.9	1.9	1.9
West Pest county	3.3	3.4	3.4
Vác and its environs	2.3	2.6	2.7
Somogy county	1.9	2.1	2.1
Szabolcs county	1.8	1.9	1.9
Szolnok county	1.7	1.8	1.7
Vas county	2.0	2.1	2.4
Veszprém county	3.7	3.5	4.5
Zala county	1.8	2.0	1.9
Total****	100.0	100.0	100.0

*I–III quarters of the year
**Recently merged into general enterprises
***United with public catering
****Rounded data

The shares of Csemege and the county enterprises remained practically un-

[4] "Csemege" is a national organization of delicacy shops. "KÖZÉRT" is the enterprise of foodshops in Budapest, organizaed by districts.

changed. Our study showed that changes were very small everywhere, and even where they occurred, this was not the result of competition, but was rather due to other circumstances.

The decreasing share of the Budapest KÖZÉRTs was connected partly with the appearance of the cooperatives in the city (Skála, ABC[5]), and partly with the fact that the growing population of Pest county compelled the building of new ABC supermarkets in the greater Budapest metropolitan area (e.g. in the communities of Dunakeszi, Érd, Budaőrs etc.), and so fewer shoppers commuted.

Other changes were insignificant, and can be explained by general factors.

The only factor which increases competition is the penetration of cooperatives into the urban markets though this, too, is impeded by the continued existence of monopoly in wholesale trade. In retail trade of industrial articles, the study of state-owned enterprises cannot be carried out as simply as in the aforementioned branches, owing to the large diversity of such commodities, but both the number of state-owned enterprises, as well as their responsibility for local supply remained unchanged. Hence, the situation is actually the same as it is in the food market. This section of the market is somewhat more "coloured" by the increasing number of shops opened by wholesale enterprises but this means, at the same time, a superior power position for them.

Table 5

Turnover of the Budapest KÖZÉRT organization broken down by district enterprises (in percent)

District enterprise	Gross return from sales		
	1975	1980	1984*
Angyalföld	6.3	6.1	7.1
Belváros	12.9	11.9	11.6
Budapest	7.2	8.3	8.8
Erzsébet	7.9	7.9	8.0
Józsefváros	11.4	10.8	10.7
Kelenföld	10.5	10.4	9.9
Kispest	6.3	6.3	6.9
Kőbánya	6.9	8.2	8.0
Óbuda	10.4	10.5	10.3
Újpest	7.4	7.3	7.4
Zugló	9.6	9.4	8.5
Édességbolt (Municipally centralized confectionery shops)	3.1	2.9	2.8
Total**	100.0	100.0	100.0

*I–III quarters of the year
**Rounted data

[5] ABC is an organization of supermarkets.

We have also examined the competitive position of the retail trade by individual counties. The turnover, beyond that of those state enterprises that operate at a national level (Merkur, Áfor, óra- és Ékszer, Ofotért, Bizományi, Tüzép etc.)[6] is transacted in each county by state- (or council-) owned enterprises and by a few regional county cooperatives, all of which are separated by gerions within the counties. (Exceptions are the two national state enterprises. Centrum and Csemege.)

In examining the retail trade of food and delicacies, we found that in 1983 the cooperatives realized on the average 55 percent of turnover in the counties (in 1970 this was only 50 percent), while one-third (33.7 percent in 1983, and 37.2 in 1970) of it was transacted by the enterprises of the individual local councils. Altogether 17.7 percent was retained by all the other state organizations (stores of Csemege, Centrum, of other, mainly catering organizations called "Hungária", "Pannónia", "Danubius", the retail shops of the wholesale organizations and the sample shops of the producers etc.). One could also say, and it is partly true, that competition has taken place between the state-owned, and the cooperative sector, since the cooperatives made some progress and gained ground. This situation is the result of the cooperatives entering into the urban markets and of their flexible business policy. While the enterprises of the councils are engaged only in certain commodity groups, the consumers' cooperatives not only deal with the most varied products, but pursue industrial (especially food-processing) activities, purchasing, and construction, too. Out of the profits of these, they are able to build up new stores, with their production they can diversify the supply of goods etc.

Still, if we take into account that, for the most part, the council enterprises work in the towns and the cooperatives in the villages, competition is rather faint. Even in the larger villages there is usually only a single cooperative operating, and a town's food is mostly or entirely supplied by a single enterprise of the local council. This is why it is even possible for the enterprise or the cooperative to easily close down a shop for long periods, because the customers are mostly forced to go to the neighbouring shop of the same organization. This is inconvenient only for the customers and not for the enterprise, and the latter, as a result, suffers no loss.

For instance, in Pest county 42 percent of the food turnover is carried out by the council enterprises and of this 36 percent (i.e., 85 percent of the turnover) is realized in the towns and the so-called preferential settlements.

Thus, competition, and the degree of choice offered to buyers is minimal even in the food trade, where the problem cannot be explained by the supply situtation. In this sector of retail trade, the difficulties which the population experiences can also be explained by existence of local monopolies.

[6] "Merkur" is engaged in selling passenger cars, "Áfor" in filling stations, Óra/ és Ékszer is the organization of watchmakers and jewelry shops, "Ofotért" deals with photo and opticians articles, "Bizományi" with second-hand goods, "Tüzép" with fuels and building materials.

Reviewing the distribution of the turnover of the industrial products by enterprises, the first thing to be taken into account is that there are several retail trading enterprises in a national monopoly position (Óra- és Ékszer, Ofotért, Tüzép, Áfor, Bizományi, Merkur etc.). The commodities that are included in their product mixes may only peripherally—if at all—be marketed by the council enterprises of the local councils and the cooperatives can only deal with the following products: clothing, household chemicals, engineering articles, hardware and ironmongery, stationery, toys and sports articles. Thus, the national enterprises appear in the counties as factors that do not strengthen competition but rather hinder it.

The development of the wholesale enterprise structure

As we have seen, wholesale trade consists almost totally of large-size enterprises in national or regional monopoly positions. (By this I mean that in the given product group one enterprise deals with the majority of the commodities.) We have also stated that since 1968, with a single exception, the mergers that took place only served to further increase the power of these monopolies.

I shall not go further in dealing with the national enterprises, since in this sphere no wholesale competitor whatsoever can be found.

At the same time, I will address in detail spheres where there are wholesale enterprises which share similar product mixes and so, according to the principle of free trade in commodities,—they might compete with one another. (This, of course, is counteracted by the fact that they continue to be accountable to the supervisory authorities for their conventional "spheres of supply".) When examining the level of competition we should not be misled by the fact that these enterprises also make some deliveries to other areas (so-called cross-deliveries). Such cases occurred in the plan-instruction system too, (although only based on central dispositions), since the system of central distribution, erroneous purchases, non-scheduled shipments etc. all necessitated that occasionally the retailers of one region must accept deliveries from wholesalers of other areas.

This is, of course, not competition, occurs only by chance, and is mostly balanced. Real competition would appear in significant changes of market shares, especially over the long run. (We examined 15 years.) We conducted such a study with the wholesale enterprises of foodstuffs and chemicals—called "Füszért"s—(see *Table 5*). in the wholesale trade of clothing, and of iron-, and engineering articles; the study involved five factors on the basis of the enterprise balance sheets of the years 1968-1983, namely gross and net receipts from sales, profit, stock of assets, and the average number of employees.

Table 6

Breakdown of gross returns from sales of food wholesale enterprises in percent 1969-1983*

	Gross returns from sales				
	1969	1971	1975	1980	1983
Budapesti Élelm.V. (Food wholesale ent. of Budapest)	16.6	15.5	14.5	14.0	18.8
"FÜSZÉRT"s of Pest-Komárom counties	11.0	11.3	10.8	12.3	14.4
Baranya-Tolna counties	6.7	6.7	6.9	6.6	6.3
Borsod-Heves counties	10.4	10.6	10.7	10.5	10.4
Csongrád-Bács counties	8.9	9.2	8.8	8.9	9.2
Hajdu-Szabolcs counties	9.0	9.1	9.7	9.4	9.8
Fejér-Veszprém counties	8.5	8.6	9.0	8.6	9.0
Győr-Vas counties	6.5	6.3	6.7	6.7	6.8
Somogy-Zala counties	6.2	6.2	6.7	7.3	7.4
Szolnok-Békés counties	7.4	7.5	7.4	7.3	7.8
Vegyianyag NKV (Wholesale Trading Co. of Chemicals)	8.7	8.8	8.8	8.4	–**
Total***	100.0	100.0	100.0	100.0	100.0

*The totals include both the food and the chemical trading enterprises, since they can be competitors.

**The Chemicals Trading Co. was amalgamated into the food wholesale companies of Budapest and Pest-Komárom counties in 1982.

***Rounded data.

In the wholesale food trade market shares changed less than 2 percent, i.e. parctically remained unchanged (even these small differences were fluctuating throughout the period). The market share of the Wholesale Chemical Trading Company fell from 8.7 to 8.4 percent which is also within two percentage points (after this the enterprise was amalgamated partly with the Budapest Füszért and partly with the Füszért of Pest-Komárom county). The share of the Budapest Füszért decreased between 1969 and 1980 from 16.6 to 14.0 percent, and that of the counties Pest-Komárom increased from 11 to 12.3 percent. These changes are in a great part owing to the appearance of some retail shops in the Budapest metropolitan area (Dunakeszi, Érd, Budaőrs etc.) which were built up with central support. The only enterprise with really permanently growing share is the "Balaton" food and chemicals wholesale enterprise of Somogy-Zala counties, but that is mostly connected with the growth of international tourism. Such degrees of changes as shown by our examination may also be caused by simple structural differences (such as varying consumption, the differences in the turnover and the consumption of spirits etc.) and by price changes. This means that the Füszért enterprises are not in the least competitive with one another, and that the retail

shops are almost completely defenceless against those which have sources of superior strength in purchasing (and are provided with capital, storehouses, transport vehicles etc.).

Summing up: In the wholesale food trade no significant change occured since 1968. The enterprises have consistently maintained their regional monopoly position.

To study the *wholesale trade of clothing* as a whole is difficult, because the enterprises are strictly specialized. The "Röviköt" wholesale enterprises are specialized in haberdashery and knitwear; in the provinces the Enterprises for Textile and Clothing deal with piece-good textiles, household textiles and ready-made clothing. "Bétex" of Budapest is specialized in piece-goods and household textiles, the Enterprise for Overclothes deals with ready-made clothing (amalgamated from two earlier separate enterprises for men's wear and women's apparel). Finally, there are separate enterprises for footwear. Every enterprise has its own area (and product mix), though in principle they are free to pursue sales anywhere. The situation is not quite similar to that in the trade of foodstuffs, for in this sphere selection (the range and assortment of goods offered) is a much more important factor. In order to clarify the situation, we first studied separately enterprises trading in clothing and footwear and then looked at the distribution of the turnover of "Röviköt" and that of clothing excluding "Röviköt".

Even here no significant shifts can be seen in market shares (between one and three percent), but we wish to point out some phenomena. The first one is that the share of the (largerst) enterprises of Budapest decreased. This was, in part, the result of the growing rigidity in the "distribution" method of the large producers, though it was also true that when certain enterprises in the provinces happened to have excess inventories, the retailers in Budapest were encouraged to buy from them. Wholesalers in the country also undoubtedly tried to sell their articles in Budapest, if they had enough to do so. In general, the provincial enterprises engaged in clothing steadily increased their market share, which was presumably connected with the increasing foreign tourism (at Lake Balaton, the western border areas etc.).

The share of sales of enterprises that went to their "own region" continued to be so high (70–75 percent) that real competition which might have compelled them to perform more market-oriented and effective work, could not develop. The causes are, to some extent, similar to those experienced in the food market (being held accountable by the local authorities for the "responsibility for supply", distribution of the wares by the big producers etc.). All this has been insufficient to enforce competition or even a market orientation within the past 15 years.

Perhaps, on of the worst cases is presented by the footwear trade. Here the significance of choice and sizes is even greater than is the case in most of the clothes trade. Since 1975 a total of three wholesale enterprises have been working in the whole country and each of them accounts for about one-third of turnover. With

such concentrated power a significant number of retailers are completely defenceless. In addition, there are unusually large footwear producing enterprises in Hungary. Only two changes have occurred in Hungary's footwear trade since 1968. The turnover of the wholesale enterprise in Budapest began to drop significantly owing to the direct purchases of the "Cipőbolt" (Shoe-shop) retail enterprise from the producers, so that it had to be reorganized. This was followed by the ever obvious solution: the six enterprises were consolidated into three.

The organization of the wholesale trade in hardware and engineering articles changed inasmuch as the eight enterprises in the provinces were amalgamated into four. Each of them has its specific segment of the iron and engineering market. In Budapest (and vicinity) the market is segmented into two parts, with the "Ravill" enterprise specializing in engineering (and radio + TV) articles and "Vasért" in ironmongery. For some consumer's goods such rigid specialization does not exist. Finally, the "Mobil" enterprise is engaged in marketing certain vehicles (bicycles and motorcycles) and components, including those of motor cars. This enterprise became a monopolist in the sales of components to certain motor car types. The turnover of Ravill and Vasért decreased in the early seventies, owing to the extensive and successful direct purchases carried out by the "Keravill" and "Vas-Edény" retail dealer enterprises. In the years since, no significant change in market shares came about. The proportions in the returns from sales between the early 1970s and 1983 showed changes below 1 percent, except in one of the four wholesale enterprises, i.e. "Ferovill", where it was 1.4 percent. Thus, it can be seen that the danger of losing market share is non-existent. In addition to the conditions we have mentioned above (with regard to the wholesale of food and clothing), this is supported by two special circumstances. One of them is that precisely in the market of durable consumer goods, hardware, and components, shortage is a permanent phenomenon which unambiguously brings aout the necessity of allocation by the Ministry of Home Trade or the producers. Allocation is generally carried out on the basis of criteria other than price (considering the figures of the base period), and thus obviously has a conservative effect. The other circumstance is that thestrongest "specialist trading committee" was established and working in this sphere up to the early 1980s. This subsequently developed into an official cartel office, called "Interunion". By now, this has ceased to exist.

In Interunion, decisions were made not only on the allocation of commodities (especially imported ones), but also prices were agreed upon.

In summary, it can be stated that we have organized neither retail nor wholesale trade in a manner appropriate to market relations—this still seems far away. While, in retail trade at least certain measures were taken for the sake of rational operation and for developing a market (contracting, operation based on leasing and maximizing profit, private shopkeeping etc.), in the sphere of the wholesale trade hardly anything happened to bring about competition or more rational performance.

References

1. *Retail trade international 1980* Euromonitor Publications, London 1981.
2. *Statisztikai évkönyv* (Statistical yearbooks, 1970–1983). Központi Statisztikai Hivatal, Budapest 1970–83.
3. *Belkereskedelmi évkönyv* (Yearbooks of internal trade, 1970–1983). Központi Statisztikai Hivatal, Budapest 1970-83.
4. *Belkereskedelmi zsebkönyv* (Pocketbooks of internal trade). Belkereskedelmi Minisztérium, Budapest (various issues).
5. *A nagykereskedelmi vállalatok mérlegbeszámolói 1969, 1971, 1975, 1980, 1983* (Balance sheets of the wholesale trade enterprise 1969, 1970, 1975, 1980, 1983.)
6. *Területi statisztikai évkönyvek* (Regional statistical yearbooks). Központi Statisztikai Hivatal (various issues).
7. *A Világbank jelentése 1978* (Report of the World Bank 1978).
8. *A Belkereskedelmi Minisztérium gazdálkodási jelentései 1970–1984* (Economic management reports of the Ministry of Home Trade 1970–1984).

Acta Oeconomica, Vol. 39, (3-4), pp. 385–408 (1988)

BOOK REVIEWS

KORNAI, J. - RICHET, X. (eds): *La voie hongroise. Analyses et expérimentations économiques* (The Hungarian path. Economic analyses and experiments). Collection Perspectives Economiques. Calmann-Lévy, Paris 1986. 320 p.

Is Hungary on a specific path to socialism? Such is the underlying question of the book edited by János *Kornai* and Xavier *Richet* which tries to convince French readers that an accurate answer must be positive. In the foreword, J. Kornai emphasizes that there are 27 countries in the world where a Marxist-Leninist party is in power and where the state sector controls the major part of economic activity: among them Hungary is regarded as the home of the most wide-ranging new experiments. These latter are especially influential on China, Bulgaria, Poland and even on the Soviet Union. The two editors then provide a sample of ten articles from Hungarian economic literature, nine of which had been formerly published in *Acta Oeconomica*, between 1979 and 1983. The sample is representative of major trends in the Hungarian economic reform and of debates among various Hungarian reformers.

Though necessary for making French readers aware of the Hungarian path, all ten articles are well known by Hungarian economists. So I shall comment on them either as an outsider or with a look to what has occured since then in the Hungarian reform process.

The first part of the book is comprised of a single article by J. Kornai assessing the present state (in 1982) and the prospect of the economic reform. Between 1978 and 1982, two main purposes of the reform were to tighten the budget constraint on state enterprises and to adjust domestic prices to prices of foreign trade achieved in hard currencies. After the reshaping of the price system, profitability soon came back to the same pattern as before. Moreover, domestic profitability increased when profitability on exports was decreasing. Exactly the opposite of what was expected. J. Kornai explains these adverse effects by the following reasons. New regulation measures are to some extent artificial and illusory and so is the profit target. Enterprises go on bargaining about subsidies and taxes with administrative authorities, thus levelling income between efficient and non-efficient producers. Very few inefficient enterprises were closed down or liquidated, this fact giving the proof that the budget constraint has remained soft.

As to the prospects, J. Kornai expects the state to create new small enterprises and cooperatives, to stimulate several kinds of non-state business such as personal economic activity, a legal private sector replacing the illegal second economy, independent working collectives instead of moonlighting and the black labour market, self-employed and so on. Quenching the thirst for investment, reducing shortages and decreasing state paternalism must be on the agenda of the reform. J. Kornai concludes faithfully: despite ideological and conservative hindrances, many supporters of the reform are fortunately to be found in the highest economic authorities of Hungary giving the new trend a good chance to succeed. Of course, the Hungarian Socialist Workers' Party launched the second stage of the reform in March 1985. Had it been written now, J. Kornai's article would however be more pessimistic considering the economic slump affecting Hungary since 1985.

The second part of the book deals with stages of the economic reform. It opens with László *Szamuely*'s article on the first wave of the "mechanism debate" in Hungary (1954-1957). This chapter makes it clear that the old debate is still relevant today. More radical reformers of that time already assumed that fewer new plan targets (even profit) and new incentives would not be enough to alleviate economic misdoings linked to overcentralization. They urged for less formal ties between economic decision makers, i.e. for a reshaping of the economic mechanism. The two last words appeared as a specific Hungarian concept as early

as the middle of the fifties. Precisely, László *Antal* emphasizes that Hungary needs a thorough change in the practice of its economic mechanism concerning not only the price system and the regulation through finance, but also major shifts in institutions of the planning system, in the structure of industry, in the decision process and in personal incomes. If this change were not implemented, the reform could slow down—as was the case at the beginning of the seventies when enterprises did avoid what they considered to be harmful consequences of the new regulation by means of a lasting bargain with central power. The latter was then obliged to recentralize regulating levers.

The third part of the book is an appraisal of what the editors call an adjustment of the Hungarian economy. It begins with "Hard and soft budget constraint" published by J. Kornai at the same time as his *Economics of shortage*. The microeconomic behaviour of every unit depends on its capacity to survive after exhausting all its financial resources: if it does survive, the budget constraint is soft, if it does not the constraint is hard. Now well known around the world, this definition is not to be commented further here. J. Kornai's chapter is followed by the no less famous article by Tamás *Bauer* on "Investment cycles in planned economies". Its fame reached a peak among French "sovietologists" at a colloquium held in Paris last year [1] which T.Bauer attended. Quite apart from what was then discussed, let me focus on two points. Consumption (or wages) and foreign trade act as countervailing factors against the investment cycle as T.Bauer designed it with four stages. As far as the cycle is generated through bargaining about investment funds between enterprises and planners, it must be regarded as an inner process of the Hungarian economy (and of other socialist countries).

T.Bauer's thesis is, however, based on data which mainly do not cover the post-1975 period. If we look at Hungarian statistics in the late seventies it may be questioned whether investment has reacted to foreign trade deficit and not the other way round [2]. In Poland, investment also was cut because of the imbalance in foreign trade, and at the beginning of the eighties this appears to be a general policy throughout Eastern Europe, except for the Soviet Union [3]. Investment or foreign trade, which is the prevailing and the countervailing force of the cycle in planned economies today? It remains to be analyzed thoroughly. A next chapter by András *Köves* and Gábor *Oblath* raises the same problem. The Hungarian foreign trade imbalance, especially with Western countries, was maintained throughout the seventies. First, Hungarian terms of trade deteriorated. Second, Hungary has an unfortunately high elasticity of imports from the West with respect to changes in the national income, so that planned exports to the CMEA increase the foreign trade imbalance in hard currencies. Third, Hungarian commodities have to face tough competition on the world market from newly industrializing countries. A. Köves and G. Oblath call for an adjustment policy and criticize its postponement as well as an insufficient brake put on investment. Their judgement would probably have changed somewhat if they could have taken into account the austerity policy implemented since Hungary joined the International Monetary Fund (the data only cover the seventies). Anyway, their trend of thought seems quite correct.

As to Mihály *Laki*, he delivers an interesting study on the liquidations and mergers in Hungarian industry which affected 532 enterprises and cooperatives between 1971 and 1979. Generally speaking, mergers did not succeed in improving profitability and in reducing subsidies to merging enterprises. This study has now been updated [4]: growing austerity since 1982 has made traditional bargaining less workable for money-loosers and low-efficiency producers. Firms in the red were liquidated raising the need of a new legal framework concerning failure and bankrupcy in state-owned enterprises. A new law on bankrupcy was thus enacted last year in Hungary, permanent insolvency being declared as the legal justification of liquidation [5]. French readers cannot be aware of this even on reaching the end of this book.

The last part of the book is devoted to further solutions and their limits. Erzsébet *Szalai* shows how big enterprises did resist reforms. These trusts stressed the threat to

their own existence which took birth in measures favouring the competition of small enterprises. Moreover, big enterprises have lost the support of traditional lobbies since the last branch ministries were merged into a single Ministry of Industry in 1981. Ms.Szalai assumes that a new counter-attack of big enterprises would be all the more unlikely the more radical the reform turned out to be in the future.

A sound analysis of the second economy is given by István *Gábor R.* Let me only mention that the growth of the second economy appears to rely on a trade-off between an officially planned job, less intensive and with a lower income on the one hand, and on the other hand a "second" job where one works harder and one gets more money outside the plan (and sometimes outside the state sector). When, as in Hungary, manpower is in shortage, people are used to being hired twice, for a legal job and for a "second" one. The planned part of economic activity and the second economy then become so intertwined that it might be accurate to speak of a "perfectly mixed economy"; and the legalized underground sector now joining other allowed small business, they might be called together the "small economy"[1] more accurately than the second economy.

The last chapter, by Márton *Tardos*, elaborates on a wide reformist program based on reshaping the links between an increasingly indicative planning and the system of institutions. This system must become pluralist and must diversify; it must comprise various kinds of enterprises corresponding to different sets of property rights in the future. M.Tardos suggests bringing into the Hungarian experiment aspects of workers' self-management. He also advises creating new holdings which would share in the capital of State-owned enterprises and would be stimulated by their yield. These holdings would be allowed to found new enterprises or to close down old factories. The setting up of a network of decentralized commercial banks competing in credit supply would be the first step towards a genuine two-level banking system. The increase of Socialist entrepreneurship would help to tie together the patchwork of suggested reforms. The second stage which has developed since 1985 does not look so far from some of these expectations. Top managers are now elected by their employees, bonds are issued, experts are guessing on the pattern of future markets for labour and for capital (stock market and second hand market for material means of production), banking reform is on the tracks. The patchwork is all there, but it has still not been tied together: entrepreneurship and risk-taking are not yet the most common behaviour.

Concluding the book, X.Richet assesses the Hungarian path as being a one-way avenue. Of course, several hindrances prevent Hungary from becoming a genuine market economy including the role of the Party, the membership to the CMEA, individual behaviour—but if we can speak of a Hungarian model, it is neither the plan, nor the market, but something in between. A realistic, pragmatic and adjustable hybrid.

In my opinion, there was in France a basic need for knowledge about the Hungarian experiment. For a first hand knowledge gathered in Hungarian economists' writings. The need is now perfectly satisfied. Since then the economic reform has continued on its path. Indeed, a French review[2] in a recent issue, tried to update French literature on the second stage of Hungarian economic policy and reform. Inasmuch there is a gap between the reform rhetoric and what is actually happening, by the end of the eighties a new updated appraisal of the Hungarian path will be necessary. I hope it will be carried out in the form of a collective book written by Hungarian economists and reformers, and again translated into French. Let us hope that this is a true forecast.

W. ANDREFF

References

1. Chavance, B. (ed.): *Régulation, cycles et crises dans les économies socialistes.*

[1] As we used it in [6]

[2] A special issue "Réformes et politique économique en Hongrie: 1980-1985" of the *Revue d'Etudes Comparatives Est Ouest* [7] including papers by L.Csaba, L.Halpern, J.Koltay, I.Salgó and K.A.Soós.

Editions de la Maison des Sciences de l'Homme, Paris 1987.
2. Andreff, W.: *Redéploiement ou renouveau de l'économie hongroise? Point de vue d'un "outsider".* Revue d'Etudes comparatives Est-Ouest, 4. 1981.
3. Andreff, W.: The external constraint in the economic crisis of East European countries. In: Zazembka, P.—Ferguson, T. (eds): *Research in political economy.* Jai Press, Greenwich, Connecticut 1985.
4. Laki, M.: Central economic management and the enterprise crisis in Hungary. *Acta Oeconomica,* Vol. 35, Nos 1–2 (1985).
5. Papanek, G.: Hungarian enterprises surviving critical financial situations: a retrospective analysis. *Acta Oeconomica,* Vol. 37, Nos 3–4 (1986).
6. Andreff, W.: La "petit économie" hongroise. *Le Monde,* November 18, 1986.
7. *Réformes et politique économique en Hongrie: 1980–1985.* Revue d'Etudes Comparatives Est-Ouest, 2. 1986.

SOÓS, K.A.: *Terv, kampány, pénz-szabályozás és konjunktúraciklusok Magyarországon és Jugoszláviában* (Plan, campaign, money-regulation and business cycles in Hungary and Yugoslavia). Közgazdasági és Jogi Könyvkiadó–Kossuth Könyvkiadó, Budapest 1986. 533 p.

Introductory remarks, evaluation

The book of K.A. *Soós* is a monumental work. According to the description of its subject by the author it is "a cycle-oriented analysis of the economic mechanism and a mechanism-oriented analysis of the cycles" in the socialist—first of all the Hungarian and the Yugoslav—mechanisms.

In his research work—as Soós writes—the basic similarity in the cyclic fluctuations of the socialist economies prompted him to reconsider the ways of operation of these economic systems, that is in a wider sense, their economic mechanism[3]. He had to find those common elements in the economic mechanisms which are responsible for creating the cycles.

In the course of his investigations he has discovered some new or so far insufficiently stressed important elements in the operation of the socialist economy. Elements which play a significant part in all three types of existing socialism, i.e in the system of direct plan instructions, in the system following the "improvement" reforms, and in the system after the "true" reforms. These are: *campaigns as a means of mobilization; the instruments of the so-called semi-monetary restrictions and, linked to it, the role of the Financial Planner; the inelasticity of supply; and, finally, the lags due to the shortage economy.* The author has also created new elements in the theory of cycles. This has been achieved not only through the important part the abovementioned elements play in his explanation of cycles but also by openly raising and thoroughly investigating the question to what extent investment cycles of the Hungarian and

[3] Let us remember that the 1968 economic reform in Hungary was called "the new economic mechanism" and in this context we were speaking about the reform of the economic mechanism. L.Antal describes the concept of economic mechanism in a broad sense as follows: "I use the concept of economic mechanism or operation model of the economy ... in the original, broader sense. In addition to planning, the system of financial interests and regulation, and the institutional system of enterprise organization and control—which jointly represent the system of economic management—in my opinion it also includes the mechanism of top-level decision making, the informal relations among economic control organizations, social bodies and enterprises, as well as the actual division of decision possibilities among the various decision-making levels.

It implies furthermore the system of horizontal enterprise relations, the institution of the market, and the conditions of control and interests within the enterprise. A well defined system of interest and power relations, and, finally, automatisms and the nomrs of behaviour, reactions and adjustment—considerably influenced by these factors—are in the background of these, as part of the mechanism. In a given period the operation of an economy can be characterized by the (reproducing) elements of all these, showing relative stability."[1]

Yugoslav economy can be considered business cycles.

The analyses of Soós have been, in a narrow sense, based on the facts of the Hungarian cycle between 1968 and 1980, as well as on the cyclic fluctuations in Yugoslavia between 1955 and 1980.

In addition, he largely relies on the facts published in the book by Tamás *Bauer* [2]. For exploring the role of the Financial Planner he pursued some archival research, examining the practice of the National Bank of Hungary in the 1950s. With respect to Hungary and Yugoslavia he intensively studied the literature of the daily press and publications of the party. *His work is counterpart to the book of T.Bauer.* Carefulness, appreciation of the facts, endeavours to achieve the greatest possible probative force, even if they have required meticulous work, are similar features of both. Similar efforts at exploring the works so far written about their subject can be found in them. New concepts and theorems unfold from the innumerable data, quotations and concurrent presentations. New details of the micro- and macroeconomics of the socialist economic system appear in the vast volumes. These are present to such an extent that the title given by Soós to the first part of his book consisting of four parts is "Microeconomy", and the second part is entitled "Macroeconomic regulation: investment cycles". They are so powerfully presented that in the latest series of textbooks on political economy of the Budapest Karl Marx University of Economics—written in a new spirit—the volume entitled "The theory of socialist economy" describes, in its part on macroeconomic interrelations, the system and cycles of investment on the basis of the books of T.Bauer and K.A.Soós, and combines the cycle interpretations of the two authors. The part on microeconomics, however, contains less of their ideas. It also includes the concept of plan bargain invented by T.Bauer and the claim that, beside the breaking down of plans, the method of summing up the plans can also be found. On the other hand, e.g. the comprehensive analysis of Soós about the defects of economic control carried out through plan instructions is not included—whereas, in my opinion, it would deserve mentioning—and the Financial Planner and mobilization are also not dealt with. (See [3])

The book of K.A.Soós is a work difficult to read. This is due partly to his inductive approach, the rich material of facts and endless number of references, partly to the author's style of reasoning, of arranging and wording his ideas. He often gets so absorbed in his disputative method of thinking, that he fails to notice that there are too many twists in his train of thoughts and he deals the enemy too many blows. Another fault is frequent digressions from the subject. He is unable to resist the new ideas emerging again and again in the context of the subject just discussed. He himself never loses sight of the essentials of the "main" question and returns to it despite the twists, side-blows, and digressions, but one must be a resolute reader to be able to concentrate to the very end on what is actually the main issue.

The fact we have to put into the other plate of the balance is that Soós's inquiries are fascinating. *Why is it impossible to manage the economy merely by plan instructions? What is the function of money in the socialist economies, in what sense can we speak about commodity production? In what sense does a market exist, does it exist at all? Why do these economies impel themselves again and again until reaching sharp tensions? Why do the leaders forget the damages caused by earlier swings of economic fluctuation and the difficulties of turning back? Are the cycles of these economies investment cycles or of a more universal nature? Is it possible to eliminate shortage by the curbing of demand?*

Soós inquires in a lively manner. Why did this or that happen?—he asks. His curiosity makes him approach the subject, i.e. the "history" of the recent past and present as closely as possible. His book is an invaluable treasury of the facts of the Hungarian and Yugoslav economic mechanisms following the reform. (Such is also the book of T.Bauer with respect to the facts of the mechanism of the Hungarian economy prior to 1968 and of the other small CMEA countries governed by plan instructions, as well as those of the Soviet Union's mechanism.) Soós, too, consciously utilizes the advantages inherent in comparison: things which can only dimly be seen

in the economic operations of one country may sharply appear in that of another one. He respects the facts like Bauer, but has less respect for theories which are inveterate or in the process of becoming inveterate, and even less for his colleagues. *In certain questions he sharply takes issue precisely with T.Bauer, furthermore with János Kornai from the Hungarian economists, and from among the Yugoslavs primarily with Aleksander Bajt and Branko Horvat.*

Thus, it is not by chance that most of the questions selected for presentation in the following belong to the most controversial subjects in economic literature dealing with planned economies.

Review

(*Plan*) Soós is unable to abide by the subject he has originally set for himself, namely the socialist economy after the "true" reforms, since what has been said about the *economy managed by plan instructions* is considered by him inadequate and insufficient support. The system of planned economies is not identical with the system of the plan instructions—he claims in the criticism of Bauer's book—, for some elements of the market economy, as well as mechanisms of mobilization also play important parts in it. The elements of market economy—which might be called *horizontal* exchange relations—and mobilization are needed because an economy cannot be operated merely by instructions; in practice a command economy would be unable to function, and is a merely theoretical structure.

The author discusses nine—interdependent—defects of management by plan instructions, owing to which this mode of operation requires complementing.

1. The number of details significant for the economy exceeds that of the plan instructions, hence, more or less important details of the economic activities remain without regulation.

2. The various plan indicators of an enterprise may often be contradictory, owing to purely technical difficulties of planning, or to conflicting interests. Also the plans of different enterprises or sectors can be in contradiction with one another.

3. No appropriately formed incentives can rationally be connected to levels of fulfilment of the various indicators. In principle, for the sake of consistency of the national economic plan, 100 percent ought to be the fetish at the level of enterprise indicators, but in the case of underfulfilment this would cause immense damages.

4. Elaboration and subsequent modification of the plans is an excessively cumbersome and slow process, even for merely technical reasons.

5. The criteria of enterprise decisions induced by instructions are specifically distorting. (For instance, if the production target of nails is prescribed in terms of pieces, the enterprise will prefer to produce the smallest possible types, but if it is determined in weight, the greatest possible ones will be preferred.)

6. Owing to the efforts of enterprises to build up reserves, the plan must be tightened though it is rather difficult to find the right measure of doing so. The author claims that in the Stalin era the targets were in general too tight, and afterwards too loose.

7. Hence, deviations from the plans necessarily occur and it is difficult to handle them, owing to the problem described in item 4. In some areas shortages, in others surpluses may come about.

8. The supervisory authorities are able to fight against the enterprises' efforts at lowering the plan targets according to item 6 only by maintaining the "basis principle".[4] At enterprise level this results in the withholding of performance.

9. The enterprises are interested neither in too low, nor in too high performance. Thus, they avoid risks, their propensity to venturing is fairly poor.

(*Campaign*) Let us, for the time being, forget about the market, and, after the plan let us, as the author did, first deal with *mobilization*. As written by the author, mobilization or campaign—in contrast with the breaking down of plans and to the market—is not a specific mode of economic operation, but a phenomenon of the political sphere. The root

[4] Meaning that an increment over the base-year has always to be attained. Ed.note.

of economic mobilization is to make the national economic targets the objectives of society. The members of society are prompted not only by formal, codified tools of regulation, but also summoned and pushed in informal ways to pursue the targets—this is mobilization. The crucial link in the chain of mobilization are the enterprise managers. They bear the responsibility to state and party organs for observing the ever current watchwords and objectives of mobilization. Central management imparts its current preferences and the weight of the preferences to lower management by the aid of mobilization. The mechanisms of mobilization are suitable for mitigating the nine types of deficiency of plan-instruction management. Several aspects of this were discussed already in past decades by researchers of the socialist economy. Soós refers to the works of *Bendix, T.Berend, Berliner, Grossman, Kalinin, Kornai and Wiles.*

The merit of the book "Plan, campaign, money" lies in systematization and in that it separates the permanent elements of mobilization (e.g. improvement of plan discipline) from the variable ones. The campaigns are created by the latter, and it is to the credit of the author that he draws attention to the role played by campaigns in the economic mechanism. The word "campaign" in the title of the book is not by chance. In the opinion of Soós, for instance, the ascending line of investment cycles in the socialist economies cannot be understood without the concept of campaign. Every newspaper-reading citizen of the socialist countries knew about the campaigns even before the book of Soós had been published, as shortage was also well known by every consumer before Kornai's book [4]. The discovery of campaign as a political instrument, just as that of chronic shortage, belong to the types of discovery such as "the king is naked". We knew the phenomena but began to look consciously for their role in the theory of socialist economy only since the works dealing with them by Soós and Kornai had been published.

(Money, market, horizontal exchange relations) It is also not by chance that the word *money* can be found in the title. Here—concerning the discussion about the role of money or market, the characteristics of commodity production—the writer of the review is in a much more difficult position than she was in the case of planning or the campaign. The parts written about the role of money and the Financial Planner constitute a separate book within the book. The author deals with them on more than one hundred pages. He opposes the widespread opinion—stemming from Wlodimierz *Brus*—according to which the socialist economy can be divided in two separate spheres: in one of them (inter-enterprise relationships, relationships between the enterprises and the state) the role of money is passive, in the other one (the market of consumer goods and of labour) it is active. Soós finds no fundamental difference between the twoo spheres but only some in degree and fanatically searches for the signs of money's activity in the sphere where it is deemed passive. In the main line the discussion is related to chronology: the system of direct planning, the "improving" reforms, the system after the "true" reforms.

With regard to the system of direct planning he successively deals with the early decades in the history of the Soviet Union and closely examines the practice of the National Bank of Hungary pursued in the early 1950s. The role of money is discussed along two lines. On the one hand the author puts the question what money has to do here. He analyses the macrofunctions of money, its role in regulation; in other words, *why money has been maintained* and, linked to this, what the micro-sphere can begin with money. He sharply criticizes the theory of limitless supply of money, first of all the views of *Holzmann, Wiles* and *Kornai*. On the other line he joins the institutionalist school of thought earmarked by the names of *Berliner, Davies, Garvy, Grossman* and *Podolski*, asking what the *role of the Financial Planner* is. Soós deems the part played by financial institutions in the system of plan instructions more specific than the aforementioned authors do. He speaks not only about proliferation of the supervisory authorities, but postulates someone to be "in charge of thriftiness". The latter, though only having secondary power for assessing the views of profitability, could, in certain periods—called "semi-monetary restrictions" by Soós—keep the conductor's baton in his hands. In such periods the Financial Plan-

ner can strongly direct the economy in opposition to the natural aspects and, by obtaining campaign as a tool, he becomes the powerful protagonist of the restrictive period.

In the opinion of Soós, in the wake of the reforms aimed at "improvement", within the system which has even so far been a "heterogenous" one, the proportions have changed: the role of the horizontal exchange relations, of money and of the Financial Planner somewhat increased. This is, however, a final result which has come about by degradation of the earlier greater change. More radical changes of proportions can be experienced in the wake of the *"true" reforms*, in the Yugoslav economy subsequent to the reforms and in the Hungarian economy following the 1968 reform. The chief sign of the modified proportions in Soós's opinion is that the financial system accepts the financial consequences of the central instructions with diminishing elasticity and that—if with a number of exceptions and financial discriminations—some normative financial regulation does exist.

(Microeconomics?) In the author's opinion all the things said about plan, mobilization, horizontal exchange relations, money, bring about, in combination, a specific microeconomics. Unfortunately, it is not a systematic microeconomics. As a matter of fact, it is questionable whether the "heterogenous" economies built up of plans, mobilization, and market can have a microeconomics independent of the macroeconomics. As characterized by Soós, microeconomics contained in his book is but the arsenal of the means and the medium of implementing the intentions of planning. What are the means the centre uses for control and intervention and what are the outcomes of the intervention it may expect?—these are the questions which interest the author. His book contains as much of microeconomics as to provide sufficient basis for dealing with the cycles, he claims.

We do agree with this. Our objection is, however, that the parts of the micro-sphere discussed in his book are not sufficiently systematic. From part I, called microeconomics, important micro-interrelations have been left out and shifted to other parts, so that they are not emphasized in accordance with their importance. Such are: *lags because of shortage economy; rigidity, i.e. inelasticity of supply; the concept of "choice" of demand, and selecting its best parts by supply; finally, relative effectivity of the limits of resources.*

(Tensions, campaign, cycle) In his interpretation of cycles Soós lays great stress on the sharpening of tensions subsequent to passing through the points of equilibrium along the upward or downward curves of the cycle. Why does the acceleration or slowdown of growth not stop after passing through that point? Why does central management let the tensions, already perceived, sharpen further on, i.e. why is there a positive feedback?—this is one of his chief questions. In his opinion negative feedback, elimination of tensions needs no explanation. It is a "cosmic"—an anywhere and any time valid—law of complex systems that from time to time they lose their balance. And it is also a law of their regulation that their equilibrium has to be regained (restored)—this is called "negative feedback". What needs explanation in the investment cycle is the positive feedback, namely, why a "large" swing comes about instead of a little tilting over, why central economic management allows an excessive sharpening of the tensions—Soós writes.

He finds the reason to a minor part in the phenomenon of the so-called *lags due to shortage economy*, to the major part in the particularities of campaign as a means. Central economic management—as a result of lags caused by shortage economy—can influence the actual processes only with the delay caused by the long lead times customary in the economy. This is true in the case of regulating either demand or supply, both upward and downward. Upwards the time of delivery "forms a wall" against the intentions for a while, downwards the orders still to be fulfilled slow down the advancement. Such lags in the investment process caused by shortage economy in Hungary and Yugoslavia may be between six months and one year. The annual data reflect the rule in such a way that the investment performance always depends on the policy of the preceding year.

Delays of the shortage economy in itself do not explain the cycle, since central management—knowing the extent of delay—could, in principle, interfere with the pro-

cesses, so that sharp tensions could be avoided. The tool used by management for intervention, namely the campaign, makes the large swings almost inevitable. As described by Soós, the psychosis and peremptory nature of the campaign hinders the recognition of the danger brought about precisely by the policy pursued. It prevents the leaders from remembering and from taking into account that such policies had led in the past—perhaps even many times—to very unfavourable results. Owing to the delay caused by the shortage economy, initial favourable outcomes of the campaign only appear six months or a year after it had been started. These might be in the case of restraint a certain restoration of balance, or, if the objective has been growth, some acceleration. Central management becomes absorbed in the campaign and responds to these early results with further, more determined measures. This is the positive feedback which is demonstrated by the author with great plasticity, referring to the facts of the Hungarian economy in the 1970s.

He also calls attention to the fact that there are some experts in the planning and the financial staff who "remember" and who give us the warning that a psychosis linked either to growth or to restriction leads to evil effects. Their warning is, however, like water off the duck's back. The investment process of the planned economies proceeds with a blindness similar to the business cycles of the capitalist economies towards the peak or the trough. According to Soós, in the case of the planned economies blindness is caused by a psychological phenomenon, by "getting absorbed". In his opinion *"the fact that central management becomes absorbed in the specific psychosis of the campaign and loses its capacity of foresight, must not be considered more than a mistake difficult to avoid, and a powerful tendency"*. Thus, campaign as a means is not necessarily accompanied by zealotic faith. "The development of the Soviet Union after World War II, and that of Czechoslovakia in the 1970s, which were free from significant fluctuations of investment, show that finally such a mistake is avoidable"—says the author.(p.209)

In my opinion the discussions in "Plan, campaign, cycle" leave it uncleared, and do not even raise the question whether the "mistake" can be avoided by some kind of a moderate campaign or by dispensing with the means of a campaign. I would rather choose the latter. I believe—in contrast with the statements of Soós—that overdoing a campaign is a political, not a psychological phenomenon. Exaggeration follows from the fact that a campaign is a rough means of politics which is not suitable for fine tuning. Campaign is, by definition, zealotic faith. During the period of a campaign it is only allowed to pay attention to the goals of the campaign. The campaign promises that things will take a turn for the better, if we observe the currently prevailing economic guidelines, if we adjust our views "to the better". Time has come to make it clear: *if central management does not want tensions in the economy to sharpen from time to time, it must abandon this tool.* This is, of course, not at all simple, for it can renounce campaign both in favour of a strong-handed planning (see the Soviet or Czechoslovak instances quoted), and in favour of the market. In the former case, owing to the defects of planning found by Soós, other leaks will open. The latter path is untrodden with respect to investments and requires the solution of the hardest questions of the reform, namely, of capital flow and property.

(Negation of the theorem of "permanent over-investment" and "permanent excess-demand") In these questions Soós opposes Bauer and Kornai and tries to refute these precepts through several lines.

His argumentation easiest to follow—and nearest to the empirical level—is addressed to Bauer, linked to the descending curve and the trough of the investment cycle. In Bauer's opinion the tensions in the downward branch do not decline to zero and do not at all turn into the opposite direction. The slackening of tensions is not followed by a process in the opposite direction, sharpening the tensions (i.e. the cycle is not symmetrical), merely the slackening tensions give at a certain point free scope to the ascending trends, i.e. to the hunger for investment. *According to Soós, in contrast, the bottom turning point of the cycle is characterized not by a slight universal excess demand—as compared to the chronological average—but by excess demand linked up with lack of demand. In some areas excess demand, and in*

others a lack of demand can be found. In addition, the degree of the former can only be moderate, while the extent of the latter may cause some tension. The author thinks that the "inconveniences" caused by the lack of demand in the area of construction and the foreign trade in machinery with socialist countries, the tensions and unutilized capacities arising in these areas, force the cycle to turn upwards. Thus, in his opinion, the point is not only that the tensions of foreign trade and excess demand bring about a spirit of "Hurrah! We can grow again!" in the management, but tensions in the opposite direction become sensible, what is more, grow worrying.

Relying on the calculations of Tamás *Szira* and Éva *Ehrlich*, Soós attempts to refute the thesis of over-investment too, opposing the views of Tamás Bauer, János Kornai and Domenico Mario *Nuti*. I will not deal with this. But let us briefly touch upon the part of the discussion where he strives to answer the question *whether—under otherwise unchanged conditions—the shortage character of economy would cease by increasing the restriction of demand (i.e. whether the lasting shortage is the result of a permanently oversized demand).* His answer is no. He claims that in the planned economies in question supply is not only inelastic in its structure but also low in quantity (as compared to the available resources). In the given system it would be an absurdity to globally restrict demand to the level of this supply kept low in quantity. It would be absurd because, with a global restriction of demand, in the areas where chronic shortage is typical it would be mitigated, but in those where there was no shortage before the restriction a serious lack of demand would appear. In the considerations and experience of Soós, in the given system such a lack of demand would become unbearable before the shortage of the other areas would disappear. Thus, shortage is caused not by the great extent of permanent and general excess demand, but by the high degree of inelasticity in the mechanisms harmonizing demand and supply.

Concluding remarks

The book of K.A.Soós is a work built on its own laws. It is not an eclectic one. The author involves a lot of new elements in his explanation set forth about the planned economies. I have been striving to deal with these appropriately (though two important constituents, namely the semi-monetary restrictions and the business-cycle character of the investment cycles, were left out of the review). At the same time, he has thrown overboard many existing elements. Such are J.Kornai's and T.Bauer's concept of the investment continuation function, the concepts of soft budget constraint and paternalism introduced by J.Kornai, and the hunger for investments. The list can be continued by the marginal propensity to consumption applied by Aleksander Bajt to the socialist economy, the concept of capacity of the economy to absorb investments, which has been made famous by Branko Horvat, and so on. I have not delt with these, because it was no part of my intention to make justice. But I could not avoid to be seen from the review that the book "Plan, campaign, money" is sympathetic to me. My sympathy is due to the fact that in his discussions the author shows such readiness and liveliness of thought, such an iconoclastic impetus which, beyond him, can almost only be found in Hungarian economic literature in the works of Ferenc *Jánossy*. I believe that, as from Jánossy, we shall also learn for a long time from Soós, will again and again take down his book from the shelf and re-read some parts of it.

It would be nice to meet all this or a major part of it in cleared forms of micro- and macroeconomy, in purely theoretical works. To tell the truth, the book might already be more theoretical, better arranged, and cause less trouble for the reader. In this bulky work, at least three medium-size books are hidden. *It includes one book about money, one about the Yugoslav economy, and one about the Hungarian economy after 1968.* It would have been better to read about these subjects more clearly and separately. But let us not be insatiable. Let us rather be glad that, when

reading the book entitled "Plan, campaign, money", we can be present at the birth of thoughts.

J. SZABÓ

References

1. Antal, L.: *Gazdaságirányitási és pénzügyi rendszerünk a reform útján* (The Hungarian system of economic management and finances on the way of reforms). Közgazdasági és Jogi Könyvkiadó, Budapest 1985. p. 40.
2. Bauer, T.: *Tervgazdaság, beruházás, ciklusok* (Planned economy, investment, cycles). Közgazdasági és Jogi Könyvkiadó, Budapest 1981.
3. Hámori, B.: *A szocialista gazdaság elmélete* (Theory of the socialist economy). Közgazdasági és Jogi Könyvkiadó, Budapest 1985.
4. Kornai, J.: *Economics of shortage.* North Holland, Amsterdam—New York 1980.

SZALAI, J.: *Az egészségügy betegségei* (The diseases of public health). Közgazdasági és Jogi Könyvkiadó, Budapest 1968. 199 p.

Reviews and criticism of scientific books seldom begin with the evaluation of style. In the present case, however, we have to make an exception. The book of Júlia *Szalai* is prominent in affording good reading, and with its passionate tone well serves the aim of the author to address not only social scientists or the narrow group of health service employees but a wider audience of interested readers.

J.Szalai's diagnosis suggests that a real therapy can only be found if we go beyond the narrow sphere of public health and investigate the diseases of society. This is the only way for us to understand the pathogenesis of current troubles in public health.

The main message of the book, which is repeatedly demonstrated by the author from many aspects, can be summarized in the following theses:

— the health service is unable to come up to the letters and spirit of the law, i.e. to grant, without limitation, every Hungarian citizen medical attendance appropriate for his or her disease. (Such a promise is in itself irrealistic—a comment of the reviewers.) The difference between actual health provisions and the demand of those in want of them is an everyday phenomenon and a permanent source of tensions;

— shortage goes hand in hand with inequality; there are sharp differences in access to sanitary provision between particular social strata and—what is actually proved by the book—between types of settlements;

— the backwardness of the public health service can, of course, also be explained by the shortage of money. Like in the case of other areas of the non-productive sphere, owing to the *residual* character prevailing in distribution, never has enough money been allotted to hospitals, outpatients' dispensaries, instruments; the resources have become increasingly scanty, at certain places and times they even endanger maintaining the standards of the services;

— at the same time it would be a mistake to blame the shortage of development resources for everything; inadequate operation of the current decision making and allocation mechanisms are also responsible for the continued existence of tensions.

Thus, the book "The diseases of public health" on the one hand generalizes our experience while on the other hand, by presenting how this sphere is embedded in society, it highlights some interrelations which were suspected even so far. From the book we become acquainted with the history of public health in the last 40 years. The analysis briefly reaches back to earlier periods, too, but to understand the current situation, we have to consider the conclusions which can be drawn from the events after 1945. In this heroic period the health service was dedicated to fulfilling mission-like great tasks, primarily the fight against the most conspicuous diseases linked with pauperism, and the introduction of free sanitary provision. The public health policy of those years was crowned with success which at the same time seemed to justify the chosen path. Success was reflected in the swift improvement of the national health indicators. The author, however, calls our attention to the fact that the showy data are average figures with significant dispersion in the background which, for a

long time, nobody has taken notice of. (Generally speaking, the Hungarian professional apparatus of sanitation seems to be characterized by a certain lack of interest in information.

This undoubtedly has an unfavourable effect on the quality and efficiency of planning and decision making.)

The unquestionably significant public health results of the period were achieved by means of administrative regulation and basically in extensive ways, in areas where it was possible to make fast progress, by comparatively cheap treatments which could be used for mass therapy. Beside the appreciation of the achievements, the picture we get about the public health situation of the fifties is, however, not at all rosy. It is enough to mention the hostile attitude to physicians of the period, the forced interruption of professional continuity and traditions. The knowledge of these facts also helps understand the confusion of values in Hungary at present.

It also must not be left out of account that the approximate correspondence between the needs for and the performance of sanitation was also attributable to the circumstance that at that time only about half of the population was entitled to free medical treatment.

By the mid-1960s, following the establishment of the agricultural cooperatives, the number of entitled people—and, together with it, the demand for sanitary services –, suddenly and rocketingly increased. Again, lacking money, the task to fill the gap which opened between the health service and those to be attended had been imposed on organization and on the extensive deelopment of employment in the health service. Beside increasing the number of beds for patients without making investments, a great "feat" of organization was building up the network of *outpatients' clinics/dispensaries* in order to mitigate overcrowdedness in the hospitals. A great positive result of setting up these outpatients' facilities was that the population in the provinces could also obtain some form of specialized sanitary service (treatment) in a much more even distribution than provided by the hospitals. The original objective, however, has not been achieved: the outpatients' departments became close not to the hospitals but to the districts; they came to substitute for one another. Because of scarcity emerging in the one, the burden was shifted on to the other one. Simultaneously, tasks of the hospitals, where the signs of overcrowdedness were already visible, were further extended beyond medical attendance. As a result of insufficient services of social policy (e.g. shortage in the forms of care for the aged, or in institutions for rehabilitation), they had to perform other functions, too.

The tensions stemming from the inability to adjust became increasingly felt, but a rethinking of the situation of public health, defining new objectives and convincing society to accept them have not been put on the agenda. The trend of redistribution of the national income which was unfavourable for health services, furthermore the national programme of decentralization which turned to be realized in the form of recentralization at county level, have led to the growth of the already existing regional inequalities. The rapid pushing into the background of the "victims" of the concept of concentrated regional development, i.e. the so-called annexed or associated communities, is appalling. (Even though we think that the discussion and argumentation dealing with them is somewhat too long in comparison to the size of the work as a whole and the problems raised by it.)

None the less serious and accusing is the comparison of counties (for instance, a figure of really vital importance: with regard to the availability of beds for oncological treatment, a 17-fold difference had been recorded). Such a degree of institutionalized inequality in the opportunities of recovery may, with good reason, depress the public atmosphere. But do the social inequalities not appear in the same way in differences between chances of maintaining and recovering health? Do the chances depend on where one lives or, at least to the same degree, on the social stratum (group) one belongs to? The question is raised in "The diseases of public health" but we feel that no unambiguous answer is given.

From the mid-1960s on, the Hungarian public health service has reached more and more the situation which J. Szalai calls a "historical vacuum position". Namely, it has

come to face a structure of diseases which in the meantime essentially changed and, with its given institutional network, it is unable to appropriately respond to this challenge. The changed structure of diseases includes phenomena like the shifting ratios in morbidity owing to the growing average age, the radical reduction of infant mortality, and the spreading of the so-called adaptation disorders, diseases of organs of locomotion and psychiatric diseases.

In the seventies, we can see on the one hand a growing rigidity of the institutions of public health. On the other hand it can be found that the monetary funds available for the maintenance of sanitary establishments proved to be sufficient only for filling up ever fewer gaps. In the advanced countries an increasing share of the growing national income is spent on public health expenditures. In Hungary, on the contrary, the share of state expenditures on public health and medical provision has not changed in the last one-and-a-half decade; it has become stabilized around 3-3.5 percent.

In the middle part of the book a long chapter is dedicated to infrastructure and the new economic mechanism, and to the connections between the two. Though the economic reform has not directly affected public health, the changes which came to pass outside of public health, resulted in a "feedback", and their—mostly unfavourable—effects can be traced. The secondary position of the non-productive spheres seemed to have become permanent. In the allocation of the central monetary funds their typically residual position has remained unchanged. The trouble is not only the shortage of resources but also that spending the available budgets was and still is governed by much stricter rules than is in the case with productive units. The way how the author characterizes the situation is interesting. She says: "The unfavourable position of the non-productive sphere is caused by its two-faced structural condition. This means, on the one hand, that it stands outside of the economy (with regard to obtaining the bases and resources for autonomous action). On the other hand it means the constraint of participating in the economy (from the side of consumption)." (p. 91.) This is what she elsewhere calls "close dependence without direct protection".

This is the chapter where she also states that, owing to the ambiguous implementation of the reform and, later on, to the recentralizing efforts, inequalities of the infrastructure by regions and settlements have increased. In the background a "decentralization" can be found which has never been accompanied by autonomy. In support of this statement the authoress discusses in detail the councils' order of economic management introduced in 1971 and the national concept of developing the network of settlements formulated in the same year.

The development policy and regulation system strongly differentiating between settlement levels also resulted in an increasing concentration in allocating monetary funds to the health service.

The tension growing more marked between mass medical treatment and specialization is also linked to stronger concentration. Developing specialization is the condition necessary for inhibiting the growth of Hungary's backwardness in the level of medication, in scientific and technological development, in relation to the advanced countries. At that time the long-term development programme of the health service still set the very ambitious target of closing the technological gap.

Based on the facts presented earlier it is difficult to imagine that the two objectives—i.e. a high level of specialization and improved mass treatment available to everybody—can be simultaneously realized. In order to resolve these contradictions guidelines were born which aim at the elimination of the problem through the integration of sanitary services and by implementing progressive treatment of the patients. (Progressivity here means that, depending on his or her condition, the patient should obtain the proper level /institution/ of treatment.)

Being aware of the inequalities in the health service, J.Szalai strongly criticizes this concept, too. Summarizing wittily her message she says: "We can speak about progressiveness (i.e. gradualness) of medical attendance only after a progressive improvement of the conditions (i.e. democratic conditions, ad-

justing to people and patients and not directing them).

Almost everybody in Hungary knows a story about deficiencies of sanitary services, created primarily by some shortage; anger, repeated accusations are frequent phenomena. The condemnation of rewards ("conscience money") accepted for medical treatment, of money-grubbing and unscrupulous doctors, are subjects of everyday conversation, of the press and books. Even with regard to private practice many questions are unclear. On the other side, the measures against "defrauders of sick-pay" grow stricter; there are many who claim that the number of patients to be treated which has achieved a baffling extent (110-120 million per annum) is the result of gratuitous services, of "expecting everything from the state". Those who wantonly alarm the doctors on night duty, who use the ambulance cars for travelling, and the medicine hoarders are denounced on the same basis.

The list of charges against doctors and patients could equally be continued. These "distortions of behaviour" are mentioned in her book by J.Szalai but, luckily, she does not go into a detailed analysis of them. Thus, she consistently adheres to her concept, since the aforementioned phenomena are not causes but "merely" consequences. This deserves special emphasis because—also according to our experience—the management of the Hungarian health service, while evading the substance of the problems, is inclined to treat the "ethical situation" as a crucial issue. At least this can be gathered from several official instructions and guiding principles.

In the "Epilogue" new, convincing data bear witness to the inequalities of chances of health and recovery, in this case as reflected in morbidity and mortality statistics and in a sociological survey made in Zala county. We again come to be confronted with the existing, what is more, increasing differences even in this sphere between rural and urban inhabitants and/or between manual and intellectual workers—in both cases at the detriment of the former.

The leading message of the book, namely, the proving of the societal and social-political embedment of the health service, runs through the complete work. The idea can even be rendered topical: the Ministry of Social Affairs and Health is currently developing and organizing the comprehensive social programme of health preservation.

And, especially preventive medicine need not observe the borders between sectors.

The deteriorating Hungarian mortality statistics which is especially unfavourable in international comparison, indicates a serious trouble. In the early phase the worsening condition appears not in the form of diseases, however, the protection of health by society has to start already in this period. "The security of livelihood, of work and living conditions, a well balanced everyday life, all need protection and it is a question of social policy in the broadest sense as to whom, when, to what degree, at what cost and how society provides protection in all the several relations of life." (p. 178)

É.OZSVALD–A.KISS

MARER, P.: *East-West technology transfer. Study of Hungary, 1968–1984.* OECD, Paris 1986. 244.p.

This study on Hungary's economic performance, economic system, its record of technology acquisitions from the West and on the impacts of this technology transfer has recently been published by the OECD in the framework of a research series on East-West technology transfer. The study is based on a visibly broad research activity, gives a thorough analysis of the problems and is logically arranged. Namely, it is more-or-less the only way to explain the importance, the effects and, in general, the role of technology transfer in a country's economic performance through the analysis of its economic system and economic policy. And that is just what the author did.

The volume consists of six chapters. After *Chapter I* giving introduction and a summary of main findings, two chapters deal with the evolution of Hungarian economic reform between 1968-84, describe the functioning of the economic system in great detail, give an account of investment policy changes, development level and of economic policy in the

above mentioned period in general. According to the author, the economic reform, the so-called New Economic Mechanism (NEM) introduced in 1968 resulted in that "...today (1984) Hungary's economic system is approximately at a mid-point between a command centrally planned economy and an efficiently operating regulated market economy." (p.19)

In a regulated market economy the scope of planning mostly involves macroeconomic policy issues, its instruments are economic regulators, as for example prices, taxes, subsidies, exchange rates and credit policy, which are to help implement the plan but are not obligatory commands. The planning bureaucracy is smaller, the ownership and the regulatory functions of the state are separated, the industrial organization is flexible. The main result of the NEM is the abolishment of the compulsory plan instructions to enterprises and the introduction of a new regulatory mechanism. Nevertheless, the structure of economic institutions has not been changed, therefore the reform model is not wholly consistent.

This standing about between centrally planned and regulated market economy causes many difficulties because of regulators changed too frequently and not efficient enough—sometimes even counterproductive. The consequences are, among others, higher than normal inventory levels, investment projects running behind schedule, the absence of a real competition, the fragmentation of investment funds, etc.

In *Chapter III* the author reviews the economic policies and development of Hungary between 1968–1984. He adopts J.*Fekete*'s terms and divides this period into three phases: the "golden age" (1968–1973), the "age of illusions" (1974–78), and the "age of realism" (since 1979). In the first five years the development of the economy had been favourable, the NEM helped to release creative energies of many individuals and firms, mostly in agricultural and industrial cooperatives, and the external conditions had also been advantageous.

In the second period the first external shocks (the explosion of energy and raw material prices) came. Hungarian policy makers tried to insulate the economy from these shocks and accelerated the rate of growth, partly returned to traditional investment and trade policies, halting, and in some instances reversing the system reforms. These beliefs proved to be illusions—therefore the name, "age of illusions"—and among other things their most serious consequences were large balance-of-payments deficits in convertible currency relations, and a rapidly growing indebtedness. The age of realism followed 1978 because it was realized that the increasingly large deficits would make it impossible to meet the payments obligations. It was a close call in 1982 when the well-known events in Poland and the worsening of East-West relations triggered a liquidity crisis for Hungary.

The ensuing new policy of economic austerity even today affects the economic life of Hungary and more and more the standard of living. Investment spending and personal consumption have been restrained, the growth rate of GDP decreased. As a consequence, the Hungarian economy has practically stagnated in the 80s.

Chapter IV comes to the point of technology imports and the trade with Western countries. First, the author explains some problems with interpreting Hungarian statistical data of foreign trade (price differences, exchange rates etc.), thereafter shows us an abundant collection of data on the composition of Hungary's total trade and on the commodity structure of its trade with the West and the East, respectively. In the 70s the machinery imports from the West more than doubled in real terms, declining since then because of balance-of-payments problems. Anyway, its share in the trade with the East continues to be about double of its share in Western trade. In spite of that, the latter is relatively highly important because it embodies mainly the technology imported from the West. One of the two alternative OECD definitions of technology refers to capital goods only. The broader concept also includes certain R and D-intensive intermediate and consumer goods which could raise the technological level of production. These are labelled technology and technology-based products. The study follows both definitions but focuses its analysis on the first, narrower one. It is revealed that Hungary "...participates much more actively in the East-West division of labour than

do the other East European countries, but its participation is less pronounced in technology-related products. ... This confirms that Hungary imports relatively large quantities of raw materials and semi-manufactured products..." (p. 112)

A significant finding of the author is that the inclusion of components and spare parts in the import of transport machinery increases the share of this sector, in imports from the West to 10 percent of the total. This is especially interesting because Hungary is a major bus manufacturer, exporting its products to the CMEA (mostly the Soviet) market. "During 1970–80, 10 percent of its total technology imports (narrowly defined) from the West were destined to support this industry." (p. 116) It is very striking how small a sum is spent by Hungary on the so-called disembodied technology imports—licences, know-how, scientific-technical services, consulting,
designs, management contracts etc.—from the West. For example, the amount of Hungary's yearly average licence imports is easily surpassed by some larger private corporations in Western countries.

In the field of industrial cooperation with the West Hungary occupies a leading position among CMEA countries. Nevertheless, its importance is not so great—as the author states—because it "reflects primarily the sparseness and lack of importance of such agreements in the other countries rather than the overarching importance of such agreements for the Hungarian economy". (p. 126) But it should be noted that for the Hungarian economic policy this category has got a higher preference since 1984–85.

The next chapter attempts to analyse the relationship between intra-CMEA and East-West trade and its link-up with technology transfer. The author makes his analysis both at the macro and the micro levels. At the macro level there was a more or less favourable period for Hungary until 1975 because the growth rate of exports to CMEA countries was not or not very much higher than the rate of growth of imports from these countries. From the middle of the 70s the situation definitely changed and became disadvantageous for Hungary. Namely, it had to export more and more for the same volume of CMEA imports, its terms of trade continuously deteriorated. As a consequence, it was a factor in Hungary's convertible currency deficits with the West, too. But in a certain way it also influenced the technology transfer because Hungary has been compelled to devote about half of its hard currency imports to purchase raw materials and semimanufactures.

To make the reader acquainted with the problems at the micro level the author examines first the postwar period until 1968. In this period "... selected branches of the engineering industry were given high priority, under CMEA specialization programmes." (p. 139) These were: transport equipment (bus and diesel), machine tools, precision engineering, telecommunications and machinery for the food industry. They reflected the ambitious Soviet economic plans of the 60s.

After the introduction of the NEM the situation was not changed basically. "... Hungary's participation in CMEA ... speciali-zation ... was dominated by the establishment and implementation of six mammoth central development programmes (CDPs) and three further large state investment projects ..."—states the author. (p. 142) They differed from the earlier programmes in that the ones in the 60s were branch-specific while the new central programmes cut across branches. Their other important feature was the greater content of Western technology. The main CDPs were the following: the public vehicle (bus), the aluminium, the computer technology, the petrochemical and later in the 70s the electronics and the pharmaceutical, plant-protective chemicals and intermediary products CDPs. In addition to them a great deal of other large programmes were started involving considerable technology imports from the West in other industry branches, too.

The austerity measures since 1979 caused by the balance of payments difficulties led to new priorities, namely to large investment reductions and concentrating the remaining resources to energy and raw materials conserving programmes. As Hungary finances its convertible currency imports mainly by the export of agricultural products, it is an important part of this chapter that reviews the development policy of the agriculture. The case study of B'bolna Agricultural

Combinate well illustrates the advantageous effects of the imported Western technology on agricultural production, efficiency and competitiveness. The export problems of the Hungarian agriculture are mainly caused by the reduced demand on Western markets.

In *Chapter VI* attempts are made at assessing the impact of Western technology on the Hungarian economy. To the question "how much" the answer is relatively easy. "Since the early 1970s approximately 25 percent of total investment in machinery has originated in the West ... which share appears to have been largest ... among the CMEA countries"—says the author. (p. 176) Its channels are mostly embodied forms. The disembodied forms, as licences, cooperations etc., are relatively neglected which proves the autarkic tendencies of the country's R and D establishment—according to the author. Hungary's main trading partner, especially in technology intensive fields, is West-Germany, (40 percent of machinery comes from and about the same proportion of industrial cooperation agreements is with firms in West-Germany). The other leading partner countries are the most developed countries in Western Europe, the trade and cooperation with North American firms having lesser significance.

According to the author "Hungary's technological level ... can be called mediocre as compared with the other CMEA countries, but especially *vis-à-vis* the countries of Western Europe". (p. 225) But one of the main findings is that the shortcomings of the economic policy, the economic system also after the introduction of the reform very strongly limited the benefits of technology imports. Therefore, during the 70s the technology gap could not be significantly narrowed. "The most notable exception ... is the good technological performance of agriculture, a sector that has been able to identify, import, absorb, and disseminate ... technology it needed ... The significantly better performance in agriculture can be traced to the more consistent application there of the principles of the NEM, to the emergence of a functioning market mechanism helping to create competition between technology's suppliers and users, and the absence of too much government regulation."—according to the author (p. 226), who seems to forget in relation of agriculture the factor of costs. Namely, the spectacular technological successes of Hungarian agriculture required large sums of subventions making these good marks a bit dubious.

Summing up, the reviewer thinks that Mr. Marer has written a sound study not only about Hungary's technology imports but, we can say, on the whole economy of the country. His analysis is based on an enormous mass of data, and gives readers detailed background information on the factors influencing a country's technological development.

A. TÓTHFALUSI

TOLONEN, Y.: *On macroeconomic consequences of trade with centrally planned economies.* Turun Yliopiston Julkaisuja—Annales Universitatis Turkuensis B/176. Turku 1986. 142 p.

The analysis presented in the study is a highly successful product of theoretical work on a topic that, among the fields of research in international economics, has usually been treated empirically. This strong bias towards empirical thinking and methods in East-West trade economics is undoubtedly linked to the fact that relationships between centrally planned economies and market economies have constantly been in the focus of actual political and economic interest for the last 15 years. It should also be borne in mind that classical, neo-classical or modern international trade theories are not perfectly applicable to trade not only within the CMEA area but also between CMEA countries and market economies. As it is widely known these "market-oriented" trade theories are based on the more or less explicit assumption of free trade as far as comparative advantages and specialization structures are concerned. This assumption does not exclude the existence of protectionist trade practices and policies on the import side but it supposes a *generally competitive* economic environment within all or both of the partner economies and in trade between them. This would include—among other factors, of course—*multilateralism*.

The question on which Tolonen's interest is concentrated is how the macroecono-

mic behaviour of a special market economy differs from that of others if bilateral trade with a centrally planned economy plays an important role in her international economic relations. This more or less special market economy is Finland and her eminent trading partner is the Soviet Union. However, the study does not discuss concrete details of Finno-Soviet bilateral trade. Tolonen's work is essentially aimed at constructing a theoretical and analytical framework for further research on bilateral trade flows between market economies and centrally planned economies, and on the impacts of these flows on economic development in the market economies concerned.

The study has a clear and logical structure. The theoretical analysis itself (in *chapters III–VIII*) opens with some introductory remarks by the author which outline the development of the model of bilateral trade discussed in the first chapter; also, they present empirical evidence on the structure and the institutional background of East-West trade, examined in the second chapter. The consecutive chapters are based on five basic assumptions that determine the limits and the direction of development of the model. These assumptions include such Heckscher-Ohlin type conditions as the lack of capital flows or the limited number of countries involved. The model contains one centrally planned economy and two market economies. The latter trade with each other but only one of them exchanges goods with the centrally planned economy, thus the behaviour of the market economy "closed" towards the centrally planned one is similar to that of a control group in biological research. Thus it makes it possible to evaluate how "open economy macroeconomics" (in the Dornbusch sense) work when two types of openness are assumed. The theoretical analysis of the "Finnish-type openness" is an important contribution to modern West European macroeconomic theory.

Other important assumptions required for an understanding of the way the model can be made operative are: the centrally planned economy uses world market prices in its trade with the market economy i.e. prices used in trade between the market economies; the centrally planned economy balances its trade with the market economy by direct controls of export and/or import volumes by the trading authorities; the balancing of trade is done more rapidly between the centrally planned economy and the partner market economy than between the two market economies. Two out of these three assumptions are clearly new elements in "open economy" trade models.

The *third chapter* ("Short run determination of income with bilateral trade") analyses possible income effects of various demand disturbances or changes if it is assumed that a certain degree of non-substitution exists between goods imported from a centrally planned or a market economy by a market economy. The results contain an interesting phenomenon that might be called the extension of the home market. This means that the centrally planned economy may, in certain respects, be considered an extension of the home market of the "open" market economy, especially if bilateral imports replace domestic goods. The analysis presented in this chapter shows that this kind of structural shift in domestic demand does not affect aggregate income or trade balance at all. If there is a shift from multilateral to bilateral imports, the effect is similar to that of a shift from imports to domestic goods.

Favourable effects of Finno-Soviet trade on Finnish economic development in the mid-seventies created strong interest in the role bilateral trade with centrally planned economies can play in cushioning import price shocks—not only on the import but also on the export side.

The *fourth chapter* ("How does bilateral trade affect the consequences of import price shocks on market economies?") shows that restrictions in bilateral imports, due to trade policy reasons or price developments, influence the macroeconomic situation in the importer market economy through two channels. First, a change in the value of bilateral imports almost automatically leads to a corresponding change in bilateral exports, with a clear impact on growth perspectives. Second, this change in bilateral imports can modify multilateral terms of trade and elasticity of factor substitution in the market economy. If, for instance, there is a price increase in bilateral imports, and this leads to terms-of-trade improvement in multilateral exports, bilateral trade

can have a negative effect on real income in a market economy with elasticities of import demand and factor substitution smaller than unity. Tolonen makes clear, however, that " ...even to such a question as whether bilateral trade makes (...) an increase in real income smaller or larger, no unambiguos answer can be given as long as the elasticity of substitution between domestic and foreign production factors is smaller than unity in the market economy" (p. 73)

The *fifth chapter* brings the reader even nearer to the conceptual framework of Dornbusch (or Dornbusch-Fischer) macroeconomic analysis. The main question raised by the author here is how bilateral trade influences the efficiency of fiscal and monetary policies in the short run. If it is assumed that bilateral exports are constrained by bilateral imports and that these imports positively depend on income, while price adjustment is considered slow, are financial and monetary policies more effective, in the short run, with bilateral trade than in a multilateral situation? Bilateral trade also contains a mechanism which magnifies the effects of a disturbance in multilateral trade. A decrease, for instance, in multilateral exports leads to a decrease in income, to decreased bilateral imports and the outcome is decreased bilateral exports. So it is no exaggeration to conclude that bilateral trade cannot play the role of an anticyclical stabilizer in a market economy with bilateral and multilateral trade.

The *sixth chapter* ("How does bilateral trade affect the outcome of a devaluation in a market economy?) shows how useful Tolonen's three-country-model is to see the extent to which conclusions of modern monetary theories of open economies ought to be modified for a market economy with important bilateral trade. The effects of devaluation are quite clear if trade is supposed to consist of end products. If the price elasticity of bilateral imports in the market economy is smaller than the elasticity of multilateral imports, bilateral trade has a favourable effect on real income. This dependency on import elasticities of the outcome of the analysis is still present when intermediate goods are traded as well, but in this second hypothetical case the result of devaluation also depends on the degree of substitution of domestic inputs for imported inputs. The increase in bilateral exports after devaluation is greater if this substitution is limited. Tolonen's analysis presented in this chapter is in line with the famous Marshall-Lerner-Robinson thesis (or set of conditions) and can be evaluated as one of its most important special extensions.

The implications for macroeconomic policy of the three-country-model are perhaps slightly unproductive in the theoretical sense if it is assumed that bilateral trade does not affect prices. The seventh chapter introduces a general equilibrium model in which prices are completely flexible and output exogenous. Monetary adjustment process is created by imbalances between supply and demand. The effects of bilateral trade are not essentially different if the monetary adjustment process is still going on (i.e. multilateral trade is unbalanced) or if the adjustment is over with balanced multilateral trade. It is also shown that an increase of bilateral trade in a market economy may, with production capacity in full use, lead to a deterioration of the terms of trade and a fall in welfare in this market economy with important bilateral trade. This is partly because bilateral imports do not obviously develop according to demand elasticities in the market economy, and their structural changes follow structural shifts in the market economy's aggregate demand only with a considerable lag. The other reason is that bilateral trade can improve terms of trade and increase welfare in the market economy only if demand elasticities for the product of the market economy with bilateral trade are larger than one in absolute value in both market economies. This conclusion should be understood in the context of the analysis presented in the third chapter. Namely, that the effects of an increase in bilateral trade resemble those of a shift in demand from foreign to domestic goods in a two-country model consisting only of market economies.

The dynamics of the centrally planned economy's trade is explicitly dealt with only in the eighth chapter, at a point where Tolonen's development of his model is clearly approaching completion. This behaviour is essentially analysed in terms of an adjustment process in which quantitative changes in the ex-

ports or imports (but not both at the same time according to the model) of the centrally planned economy are made in order to restore trade balance. The adjustment process of the centrally planned economy has unambiguous impacts on exchange rate fluctuations in the market economy. If, in the short run, there is a shift increasing bilateral imports the exchange rate appreciates or remains unchanged, whereas an increase in the bilateral exports of the market economy leads to an exchange rate depreciation. Welfare effects of the centrally planned economy's adjustment are also quantifiable from the market economy's point of view. If, for instance, bilateral exports react to an increased import bill with a more or less considerable lag, this can temporarily have a positive impact on welfare.

Tolonen's study provides a very useful theoretical and model framework for a deeper macroeconomic analysis of market economies' interest in trade with centrally planned economies and thus it gives a good basis for evaluating export and structural change perspectives of centrally planned economies. At present, the practical importance of the implications of Tolonen's model is essentially limited to by far the most important bilateral trade flow in the world economy between a market economy and a centrally planned economy - namely, Finland's trade with the Soviet Union, given the fact that the smaller CMEA countries tend to multilateralize their trade with the West and also with their last bilateral trade partner, Finland. However, a modified version of the model could eventually be very valuable when analyzing macroeconomic behaviour in the open economies of Eastern Europe: namely, members of the bilateral intra-CMEA trading system which are, at the same time, strongly interested in developing their multilateral-type trade with the West. The Hungarian interest is quite special because of a possible extension or modification of the model. The open character of the Hungarian economy is strongly directed towards both the CMEA and the West, but this openness has completely different implications for her trade structure in the two directions. A country trying to implement an active exchange rate policy and interested in a fast structural change of its industry is obviously ready to increase its participation in the international division of labour. A model based on Tolonen's one but applicable to Hungary—according to Thomas Wolf a "modified planned economy"—would clearly be very helpful in evaluating the impacts on macroeconomic balance indicators of a further "balanced opening" of the national economy.

Á. TÖRÖK

BEREND, T.I.- RÁNKI, GY.: *Európa gazdasága a 19.században, (1780–1914)* (The economy of Europe in the 19th century (1780–1914)). Gondolat Kiadó, Budapest 1987. 703 p.

When I received this unequaled book for reviewing, nobody knew that after a few weeks György *Ránki* would no longer be among us. And that, consequently, the series of books which has been a rarity in both domestic and international scientific life, by which this pair of authors has, for decades, enriched the bodies of Hungarian and international scientific knowledge, would be interrupted. I can still hardly believe that Gy. Ránki, scientist, teacher and organizer of such outstanding talents, faculties and so great a stature is no longer among the living. His bold, pioneering ideas, however, which he has set forth in his works, lastly in this book, published in common with Iván T.*Berend*, will subsist further on.

Not only in the domestic, but "even in the international literature this book has been an unparalleled undertaking: it is not the parallel enumeration of the outlines of economic development in individual countries, nor a collection of mosaic-like studies of partial problems, but a monolythic synthesis showing the unity of last-century Europe's economic development, of its regional particularities and interactions", as Zsigmond Pál *Pach* wrote in his obituary about Gy. Ránki.

A work which had undertaken to draw up the synthesis of economic history of Europe cannot be found in either the Hungarian or the international literature. This book, however, starts with a synthetizing chapter.

In this chapter the authors, as in a preamble, outline the most important processes which characterize the "long" 19th century. Such are: demographic explosion and new migration; expanding world economic relations; development of technology which (as a motive power) caused revolutionary changes in production; revolution of transportation; expansion of world trade and capital exports; cyclic particularities of nineteenth-century growth of the world economy, and finally, the internationalization of the world economy and, at the same time, strengthening separation of independent national units. In its totality, this chapter demonstrates how Europe came to be the creator and, simultaneously, part of the modern world economy.

The introductory chapter concentrating on the above enumerated main processes is followed by a concrete presentation and pragmatic analysis of the socio-economic processes which came to pass primarily in the pioneer country (England). It is continued by those in the successful following countries or regions (France, the block of the West European small countries, Germany and Scandinavia), in the areas which only achieved half-success (Austria-Hungary, the Mediterranean region, the Russian empire), and in the Balkans where only failures took place.

The short but all the more terse concluding chapter organically fits into the analysis of countries and regions based on a rich material of facts and testifying to a wide knowledge of literature. Its title is "Summary and conclusions".

In the course of expounding the subject matter, the authors, in their whirling train of thoughts, also give an overview of the extremely variegated opinions to be found in the works dealing with economic history of the European countries (regions) and set forth their own standpoints.

Both the ways of approaching the analysed issues, as well as the applied methodology, are new. Regions beyond the large-territory and high-population countries of Europe are defined and dealt with by the pair of authors on the basis of kindred features exhibited by their development paths and being close to one another in respect of economic development level. (With regard to development levels and their changes the authors mainly rely on the computations of Paul *Bairoch*, professor of economic history at the University of Geneva, a gigantic work and highly appreciated by professional circles.) In presenting and analysing the various countries and/or regions the pair of authors apply the comparative method. They investigate and evaluate the motions and changing positions in the country or region in question by fitting them into the overall European framework. This comparative method renders it possible to clearly formulate, in the chapters discussing the particularities of the given country or region in detail, the most important interrelations and interactions, whereby the economy of the country of region appears as part of the economy of Europe.

The individual analysis of each successfully industrialized country and region in the 19th century demonstrates that the preconditions of industrialization were—almost everywhere—created by the development of agriculture and, within that, by the production and social (ownership) relations, i.e. by the changes which occurred in them. Employing new agrotechnology and cultivation methods resulted in an increased sustaining capacity of agriculture. Surplus products came into being, whereby agriculture became an exporting sector and worked as a pulling branch. On the other hand, the development of agriculture entailed a growing purchasing power and, in the wake of this, the internal market (which had been the basis of spreading industrialization) gradually widened. "Availability" of the factors of production needed for the spreading of new industries (partly of raw materials, partly of labour and capital) was built on the surpluses of agriculture—of course, not only on these. In addition, in several European countries it was precisely the "Verlag"-system, i.e. the peasants' work in home-industry and the complementary industrial activities in the framework of agriculture, which served as one of the foundations of successful industrialization. In fact, slow progress of the countries and/or regions which only reached half-success, or even met with failure in industrialization, the halt of development (especially in Russia and the Balkans) demonstrated that industrialization separated from the inter-

nal situation of agriculture could not—either then, or later on—be successful in the long run. What is more, the failure of the unsuccessful regions, lagging behind the all-European process of industrialization can, in essence, be explained by the backward relations of agriculture.

The concrete analysis convincingly points out the importance of exports, i.e. of an export-oriented development. The countries which proved to be successful were those which were able to spend their initial export revenues on internal development, which were capable of continuously and rapidly changing their export structure, adjusting to the conditions and price fluctuations dictated by the world market. Price changes in the world market were utilized by them to their own advantage. This demonstrates the importance of special export articles and/or quality which can meet special export demands and which can help achieve and maintain an outstanding market position. The book also convinces the reader that even if a country or region could very well adjust and adapt itself to the changing conditions of the world market in a given phase of its development, a lasting success could only be assured if this was accompanied by a continuous expansion of the domestic market, and also by developing the structure of demand in this market. Without that an export success, however big in the short run, proved to be only ephemeral.

A further turning point of success, half-success or failure was the revolution of transportation, mainly of land transport. This brought about the spreading of railways which were suitable for cheap mass transportation, the development of water transport (by steamships), big construction works for the regulation of riverways, and the building of canals. All that was followed by the discovery and spreading of the telegraph and, later on, the telephone.

In some regions the revolutionized transport and communications allowed, almost as a chain-reaction, smooth transport of agricultural surplus products and industrial mass products within the countries and abroad. In such areas the local markets came to be organized into national markets and could join into the world market, and the efforts at industrialization had been crowned with success. Where, in turn, (owing to diverse specific, individual causes), the new means and ways of transport had not grown into a countrywide network—nor could local markets be integrated into a united national market,—moreover, the application of the modern means of transport remained isolated, industrialization was accompanied by half-success or failure.

Half-success and failures were also interdependent with the role the state had played in the process of socio-economic changes. Where the government represented the interests of the rising bourgeoisie, the commercial, entrepreneurial and managerial groups, industrialization was successful. Where,—beside the subsistence of the "ancient" (feudal) ruling class—the powers of the upward striving new groups were able to influence the governments to support at least to some extent their interests too, a half-successful way of industrialization had been introduced. Conversely, in some countries the government protected and represented first of all the interests of the feudal ruling class, because the new groups were not yet sufficiently organized, or were weak and could not assert their interests. In such countries state power went astray in a forest of compromises and various group-interests and the governments proved to be unable to cope with the new challenges. In consequence, the endeavours to industrialize also failed.

The existence, coverage and appropriate operation of banks and other financial institutions significantly contributed to the success of industrialization. They collected the savings, and invested them in the new, modern activities, which flexibly changed their business policy and supported the new types of operation, ready to run financial risks. The lack of these institutions or their insufficiency played a part in half-success or failures.

The foregoing demonstrate that the authors have broken with the views which became widespread in literature both of international economy and economic history and which ascribe economic growth only to one or a few basic factors and causes. They even raise the question: "Can success or failure be the result of the availability or lack of the growth factors which can physically be measured and

therefore play a crucial part in the various growth theories—like labour, investment, availability of raw materials?" (p. 653) "Even a growing manpower cannot be decisive." "Success or failure can also not be traced back to the rate of accumulation"—they write. They consider raw material endowments and the possibilities of production and exports linked to them as undoubtedly important factors, but rather emphasize the negative side: "...not so much the favourable raw material endowments, than rather their lack proved to be decisive". (p. 654) However—they say—this can also not be the explanation of success or failure. "Instead of stressing the all-illuminating explanation of some particular theory or development model, or certain key factors", ldots "we call attention to the almost incomprehensible and mostly anyway non-mesurable totality of conditions. We also call attention to their development through historical processes, and to the influences exerted on them by fitting into the whole of the European international economic system" (p. 656)—the authors write.

The comparative survey conducted by the authors encompasses particular specific features of the European countries and of the regions built up by them, together with the most significant differences. This is the basis of the closing chapter of the book which rejects the interpretations derived from a single (or a few) causes not only with regard to the similarities but also to the differences between countries and regions. "The differences between the halfway or completely failing paths cannot be explained by a single cause, nor can the successful cases be traced back to a single dominant factor." (p. 662)

Putting aside here any firm standpoint in this very important and rather difficult question, I should like to note that rejection of an interpretation based on one or only a few reasons must not mean handling all the (detectable) elements as if they were equivalent. Namely, however variegated the economy of the European successful, halfway successful and failing regions is, a certain package of the dominant elements still emerges from the book by the pair of authors.

It is also true that human qualities play a significant part in this package. Such qualities are: the historically developed faculties, norms of behaviour, customs, culture, mentality and order of values of the industrial nations and groups of peoples. To put it in a simpler form, they are the quality factors of the labour force (also depending on education but reaching far beyond it). It is also true that a vast majority of human factors (though by far not all) belong to the "non-tangible" categories, still they might deserve more attention in this excellent book. The question as to how far human factors can be qualified as economic ones is, of course, disputable. But, whatever the answer to this question may be, regarding success or failure in industrialization the human factor is, in my opinion, by all means part of the "package of the dominant elements".

Reading precisely this book one cannot avoid seeing how strongly the processes which characterized the particular countries and regions in the last century have remained alive and active, and can again and again be discovered under the conditions of new socio-economic systems in a Europe which since has lived through two world wars. Ability to adjust and change in some countries and hesitation in others still exert their influence. This specific continuity which is powerful enough to transgress socio-economic systems is borne by the peoples of each country and region, together with their past. Why? Certainly also because it is much easier to change the operation forms of an economy than to change mentality, reactions and culture of people.

Should the author, who has so painfully lost his partner, happen to prepare a second edition of their work, I might take the liberty of calling his attention to a question which is, in my opinion, left open in the book: Apart from the results, i.e. success, half-succes or failure, have the countries and regions of Europe followed the same type of industrialization? Namely, the book approaches the types of industrialization from the aspect of the end-results. Whereas, if we examine them from the viewpoint of the actual process, even in the successful countries and regions different types of the industrialization process show up. For example, it seems that in England, as a pioneer country, industrialization was different from those of the other successful countries and

regions of Europe, from several important aspects. I only wish to point out two facts; one of them is also stressed in the book: "England was the only country in the economy of which agriculture had no longer been unequivocally dominant. In 1800 almost half of the population was already not working in agriculture ldots As a result of "enclosure", masses of people had been expelled from the land and by the end of the 18th century the peasantry, in the traditional sense, was non-existent in England"—we read in the book. (p. 97) Furthermore, England was the only country which started industrialization far before the epoch of railways. These two facts in themselves give a unique character to the English path of industrialization. The condition of industrialization in the countries following England with a time-lag were different also because—beyond the foregoing—England, as a pioneer, was able to become the "workshop of the world". The late-comers, in turn, necessarily had to face, in some way or another, the competition of England.

Thus, is it correct to say that similarity is a typical thing in the industrialization of England and the other countries following her successfully (or with half-success)? In certain aspects, of course, likeness can be found. Would it not be, however, necessary to stress the typical differences between the industrialization of England and the other countries? The presentation of such differences might also pertain to tracing the industrialization processes of Europe.

The book, written in an easily readable style deserves attention not only because, even while presenting an unparalleled rich material of knowledge, it does not become absorbed in the details but presents to the reader Europe as a whole and the 19th century in its totality. But several countries of the world have only recently, or even not yet, reached the development level at which they can start on the way leading to industrialization which will last a long historical period. Hence, experience of the predecessors (successes and half-successes, roundabouts, pitfalls and failures) may help them avoid deadlocks, unnecessary detours and wrong solutions.

Industrialization in Europe has been spreading throughout the continent in a radiating form and no late-comer could make himself independent of those ahead of him. England, which has been the country leading in development level throughout the whole period of industrialization had to yield her place, precisely at the end of the 19th century, to the United States of America which in the meantime had pulled ahead in respect of economic development. Today, however, the "England of Asia", i.e. Japan—also an insular country—takes over pioneership, creating a quite different model of industrialization. At present, on an other continent, Japan exerts a lasting radiating impact on the countries in its neighbourhood, so that it endangers the current superiority of the United States of America in an ever broadening sphere. The possibilities, world economic conditions and circumstances of Asian industrialization induced by Japan are, of course, very much different from those of Europe in the 19th century. Yet, acquaintance with the ways of industrialization of predecessors lying at large geographic distances from them may also be instructive. "Wise men learn from other men's mistakes"—says the proverb.

It may be considered a grimace of history and economic development that while internationalization and a more definite separation of the national states were joint characteristics of 19th-century Europe, now—at the end of the 20th century—the borders of the national states are softening and the establishment of a united European market economy (far exceeding the population of the United States of America) has come into the proximity of hardly a few years. Even for understanding this process we certainly need a comprehensive recognition and synthesis—as set forth in this book—of the past which is present and operative even in our days.

É. EHRLICH

BOOKS RECEIVED*

BRABANT, J.M.van:
Adjustment, structural change, and economic efficiency. Aspects of monetary cooperation in Eastern Europe. Cambridge University Press, Cambridge 1987. 480 p.

DASGUPTA, P.—STONEMAN, P. (eds):
Economic policy and technological performance. Cambridge University Press, Cambridge 1987. 243 p.

DORNBUSCH, R.—LAYARD, R. (eds):
The performance of the British economy. Clarendon Press, Oxford 1987. 271 p.

GÉCSEG, F.—PEÁK, I. (eds):
Conference on automata, languages and programming systems. Salgótarján/ Hungary May 19–22, 1986. Department of Mathematics, Karl Marx University of Economics, Budapest, 4/1986. 328 p.

GRANICK, D.:
Job rights in the Soviet Union: their consequences. Cambridge University Press, Cambridge 1987. 344 p.

MABRO, R. (ed.):
The 1986 oil price crisis. Economic effects and policy responses. Proceedings of the Eighth Oxford Energy Seminar (September 1986). Oxford University Press, Oxford 1988. 286 p.

MESZÉNA, GY. (ed.):
Papers on applications I. Department of Mathematics, Karl Marx University of Economics, Budapest 1/1987. 135 p.

SUZUKI, Y. (ed.):
The Japanese financial system. Clarendon Press, Oxford 1987. 358 p.

*We acknowledge the receipt of the enlisted books. No obligation to review them is involved.

AUTHORS

dr. Aladár SIPOS,
b. 1927. Academician. Director of the Institute of Economics, Hung. Acad. Sci., formerly sub-rector of the College of Politics of the Hungarian Socialist Workers' Party. Author of "Relations between enterprises in the agro-industrial sphere in Hungary" (Acta Oec. Vol. 31, Nos 1–2), "The impact of technical development on the agriculture of the highly developed capitalist countries" in Hungarian (1977) and several studies on different aspects of agro-industrial integration in Russian, German and Hungarian.

dr. Péter HALMAI,
b. 1953. Cand. of Econ. Sci. Assistant professor at the College of Politics of the Hungarian Socialist Workers' Party, senior scientific research worker at the Institute of Economics, Hung. Acad. Sci. Author of "Zwischebetriebliche Organisationen und wirtschaftlicher Mechanismus in der sozialistischen Landwirtschaft" (Annales, Budapest 1986 "Sind die ungarischen landwirtschaftlichen Grossbetriebe Unternehmungen?" (Annales, Budapest 1987), "Adjustment and vertical ties in market-oriented agriculture" (5th European Congress of Agricultural Economists, Balatonszéplak 1987) and co-author with A. Sipos of "Agricultural policy at the cross-roads" Budapest, under publication, in Hungarian.

dr. Ferenc FEKETE,
b. 1928. Doctor of Econ. Sci. Professor at the Karl Marx University of Economics, Budapest. Formerly Deputy Director at the Research Institute for Agrarian Economics, Editor-in-chief of "Közgazdasági Szemle". Author and co-author of several books and studies on agriculture in Hungarian.

dr. Teréz LAKY, see Vol. 32, Nos 1–2.

dr. Katalin BALÁZS,
b. 1954. Scientific research worker at the Institute of Sociology, Hung. Acad. Sci. Author of "Science for contract" (Valóság, 1985), "Tendencies in R+D in the 80ies" (Magyar Tudomány 1987) in Hungarian.

dr. Rudolf ANDORKA,
b. 1931. Cand. Professor and head of department of sociology, Karl Marx University of Economics, Budapest. Formerly head of department at the Central Statistical Office of Hungary. Author of "Determinants of fertility in advanced societies" London 1978, 431 p. Co-author with K. Zagórski of "Socio-occupational mobility in Hungary and Poland" Warsaw 1980, 173 p. and several books in Hungarian, among them "Changes in social mobility in Hungary" (Budapest 1982) "The number of children in developed countries" (Budapest 1987).

dr. Thomas A. WOLF.
Scientific research worker at the International Monetary Fund, Washington, D.C.

dr. János KOVÁCS,
b. 1926. Doct. of Econ. Sci. Head of department at the Institute of Economics, Hung. Acad. Sci. Author of "Labour planning and economic development strategy" In: Human resources employment and development. Vol. 2. pp. 395–404. (London 1983) and several studies and books in Hungarian, among them "Social reproduction and planning of manpower" Budapest 1980.

dr. Tamás TARJÁN,
b. 1949. Scientific research worker at the Institute of Economics, Hung. Acad. Sci. Formerly lecturer at the University in Oran (Algeria) in 1981–1984. Author of "On complexity of switching circuits" (Problems of Control and Information Theory, 1974), "Complexity of lattice-configuration" (Studia Sci. Math. Hungar., 1975), co-author with Katona of "Extremal problems with excluded subgraphs in n-cube" (Lecture Notes in Mathematics, 1983) and several studies in Hungarian.
dr. László SZAMUELY, see Vol. 36, Nos 3–4.
dr. András KÖVES, see Vol. 39, Nos 1–2.

TO BE PUBLISHED IN OUR NEXT ISSUE

T. ERDŐS: The Content of Monetary Regulation and its Troubles in Hungary
M. TARDOS: Economic Organisations and Ownership
M. DĄBROWSKI: The Economic Effectiveness of the Self-Managed Enterprise – A Review of the Theoretical Literature
A. HEGEDŰS: Theses on the Crisis of Ethics and the Economic Crisis
H.W. HOEN—H.-J.WAGENER: Hungary's Exports to the OECD: A Constant Market Shares Analysis
J. GÁCS: Changes in the Structure of Production and Foreign Trade of the Hungarian Industry in the Period of Restrictions (1978-1986)

A DEBATE ON THE CRISIS OF THE HUNGARIAN REFORM IN THE 1970s

I.T. BEREND: The Crisis of the Hungarian Reform in the 1970s
L. ANTAL: It Must Not Happen Again (Contribution to the Evaluation of the Anti-Reform of the Early 1970s)
L. SZAMUELY: Intentions and Constraints. Reflections on Reading I.T. Berend's Study
I.T. BEREND: In Agreement and at Issue

REVIEWS

M. SZÉNÁSI: A Dispute on the Changes in Property Rights

BOOK REVIEWS

BOOKS RECEIVED

Acta Oeconomica 39, 1988
Akadémiai Kiadó, Budapest

Acknowledgement: The American–Hungarian Soros Foundation has contributed to covering the expenses of this issue.

PRINTED IN HUNGARY

Akadémiai Kiadó és Nyomda Vállalat, Budapest

The **Association of Cultural Economics** is planning its **6th International Conference on Cultural Economics and Planning** in **June 8-10, 1990, Umea, Sweden.**

To request other details or to propose a paper, contact:

Dr. Abdul A. Khakee
Center of Regional Research
University of Umea
S-901 87 Umea, Sweden

ANNOUNCEMENT

Fifth Congress of the European Economic Association, August 31 - September 2, 1990, Lisboa, Portugal

Call for Papers

The **European Economic Association** will hold its fifth annual congress in Lisboa, Portugal, from Friday August 31 till Sunday September 2, 1990. Contributed papers in all areas of economics, including the history of economic thought and economic history, are actively solicited. Submissions should include two copies of the paper and of a one-page abstract, and must be sent before March 1st, 1990 to the Programme Chairman:

Professor Thorvaldur GYLFASON
Chairman, Programme Committee, EEA Conference
Faculty of Economics and Business Administration
University of Iceland
101 REYKJAVIK
ICELAND

ACTA OECONOMICA

A Magyar Tudományos Akadémia
idegen nyelvű közgazdaságtudományi folyóirata

Szerkesztőség: 1112 Budapest, Budaörsi út 45.
1502 Budapest Pf. 262.

Megjelenik évi 2 kötetben. Megrendelhető az Akadémiai Kiadónál (1363 Bp. Pf. 24.) a külföld részére a Kultura Külkereskedelmi Vállalatnál (1389 Budapest, Postafiók 149).

ACTA OECONOMICA

Журнал Академии наук Венгрии

Публикуется в двух томах в год.
Статьи публикуются на английском, русском и немецком языках.

Адрес редакции: H-1502 Budapest P.O.B. 262

Заказы принимает предприятие по внешней торговле Kultura (H-1389 Budapest, P.O.B. 149) или его заграничные агентуры.

ACTA OECONOMICA

Zeitschrift der Ungarischen Akademie der Wissenschaften

Aufsätze erscheinen in englischer, russischer und deutscher Sprache, in zwei Bänden pro Jahr.

Redaktion: H-1502 Budapest, P.O.B. 262

Bestellbar bei Kultura Außenhandelsunternehmen (H-1389 Budapest, P.O.B. 149) oder seinen Auslandsvertretungen.

Periodicals of the Hungarian Academy of Sciences are obtainable at the following addresses:

AUSTRALIA
C.B.D. LIBRARY AND SUBSCRIPTION SERVICE
Box 4886, G.P.O., *Sydney N.S.W. 2001*
COSMOS BOOKSHOP, 145 Ackland Street
St. Kilda (Melbourne), Victoria 3182

AUSTRIA
GLOBUS, Höchstädtplatz 3, *1206 Wien XX*

BELGIUM
OFFICE INTERNATIONAL DES PERIODIQUES
Avenue Louise, 485, *1050 Bruxelles*
E. STORY-SCIENTIA P.V.B.A.
P. van Duyseplein 8, *9000 Gent*

BULGARIA
HEMUS, Bulvar Ruszki 6, *Sofia*

CANADA
PANNONIA BOOKS, P.O. Box 1017
Postal Station "B", *Toronto, Ont. M5T 2T8*

CHINA
CNPICOR, Periodical Department, P.O. Box 50
Peking

CZECHOSLOVAKIA
MAD'ARSKA KULTURA, Národni třida 22
115 66 Praha
PNS DOVOZ TISKU, Vinohradská 46, *Praha 2*
PNS DOVOZ TLAČE, *Bratislava 2*

DENMARK
EJNAR MUNKSGAARD, 35, Nørre Søgade
1370 Copenhagen K

FEDERAL REPUBLIC OF GERMANY
KUNST UND WISSEN ERICH BIEBER
Postfach 46, *7000 Stuttgart 1*

FINLAND
AKATEEMINEN KIRJAKAUPPA, P.O. Box 128
00101 Helsinki 10

FRANCE
DAWSON-FRANCE S.A., B.P. 40, *91121 Palaiseau*
OFFICE INTERNATIONAL DE DOCUMENTATION ET LIBRAIRIE, 48 rue Gay-Lussac
75240 Paris, Cedex 05

GERMAN DEMOCRATIC REPUBLIC
HAUS DER UNGARISCHEN KULTUR
Karl Liebknecht-Straße 9, *DDR-102 Berlin*

GREAT BRITAIN
BLACKWELL'S PERIODICALS DIVISION
Hythe Bridge Street, *Oxford OX1 2ET*
BUMPUS, HALDANE AND MAXWELL LTD.
Cowper Works, *Olney, Bucks MK46 4BN*
COLLET'S HOLDINGS LTD., Denington Estate,
Wellingborough, Northants NN8 2QT
WM DAWSON AND SONS LTD., Cannon House
Folkstone, Kent CT19 5EE
H. K. LEWIS AND CO., 136 Gower Street
London WC1E 6BS

GREECE
KOSTARAKIS BROTHERS INTERNATIONAL BOOKSELLERS, 2 Hippokratous Street, *Athens-143*

HOLLAND
FAXON EUROPE, P.O. Box 167
1000 AD Amsterdam
MARTINUS NIJHOFF B. V.
Lange Voorhout 9–11, *Den Haag*
SWETS SUBSCRIPTION SERVICE
P.O. Box 830, 2160 Sz Lisse

INDIA
ALLIED PUBLISHING PVT. LTD.
750 Mount Road, *Madras 600002*
CENTRAL NEWS AGENCY PVT. LTD.
Connaught Circus, *New Delhi 110001*
INTERNATIONAL BOOK HOUSE PVT. LTD.
Madame Cama Road, *Bombay 400039*

ITALY
D. E. A., Via Lima 28, *00198 Roma*
INTERSCIENTIA, Via Mazzé 28, *10149 Torino*
LIBRERIA COMMISSIONARIA SANSONI
Via Lamarmora 45, *50121 Firenze*
SANTO VANASIA, Via M. Macchi 58
20124 Milano

JAPAN
KINOKUNIYA COMPANY LTD.
Journal Department, P.O. Box 55
Chitose, *Tokyo 156*
MARUZEN COMPANY LTD., Book Department
P.O. Box 5050 Tokyo International, *Tokyo 100-31*
NAUKA LTD., Import Department
2-30-19 Minami Ikebukuro, Toshima-ku, *Tokyo 171*

KOREA
CHULPANMUL, *Phenjan*

NORWAY
TANUM-TIDSKRIFT-SENTRALEN A.S.
Karl Johansgata 43, *1000 Oslo*

POLAND
WĘGIERSKI INSTYTUT KULTURY
Marszalkowska 80, *00-517 Warszawa*
CKP I W, ul. Towarowa 28, *00-958 Warszawa*

ROUMANIA
D. E. P., *Bucuresti*
ILEXIM, Calea Grivitei 64–66, *Bucuresti*

SOVIET UNION
SOYUZPECHAT — IMPORT, *Moscow*
and the post offices in each town
MEZHDUNARODNAYA KNIGA, *Moscow G-200*

SPAIN
DIAZ DE SANTOS Lagasca 95, *Madrid 6*

SWEDEN
ESSELTE TIDSKRIFTSCENTRALEN
Box 62, *101 20 Stockholm*

SWITZERLAND
KARGER LIBRI AG, Petersgraben 31, *4011 Basel*

USA
EBSCO SUBSCRIPTION SERVICES
P.O. Box 1943, *Birmingham, Alabama 35201*
F. W. FAXON COMPANY, INC.
15 Southwest Park, *Westwood Mass. 02090*
MAJOR SCIENTIFIC SUBSCRIPTIONS
1851 Diplomat, P.O. Box 819074,
Pallas, Tx. 75381-9074
READ-MORE PUBLICATIONS, INC.
140 Cedar Street, *New York, N. Y. 10006*

YUGOSLAVIA
JUGOSLOVENSKA KNJIGA, Terazije 27, *Beograd*
FORUM, Vojvode Mišića 1, *21000 Novi Sad*

HU—ISSN 0001—6373

Index: 26.033