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TAMÁS FÖLDI

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# MONETARY REGULATION AND ITS PERPLEXITIES IN HUNGARY*

T. ERDŐS

The basic idea of the article is that the introduction of a regulation based on monetary instruments is indispensable for the acceleration of structural changes. The author shows what the contents of monetary regulation in Hungary can be and how it compares with the monetarist and Keynesian theoretical systems. It examines the tasks related to the introduction of monetary regulation: interest rate policy, regulation of money supply and topical problems of developing the set of monetarist tools.

Today the statement that the regulation relying on taxation and on administrative bases has to be replaced by a regulation based on monetary means is already a commonplace. Without this no proper acceleration of the structural changes can be expected; at the same time, this can serve as an adequate background for giving preference to quality factors. It seems to me, however, that the content of a desirable monetary regulation under present Hungarian circumstances has not yet been clarified. There are several misunderstandings and such a kind of regulation has so far not actually come to the foreground. Also, we are maintaining a regulation which is still in its main part an administrative, and in the other part a fiscal one.

## Regulation based on monetary means – monetarism and Keynesianism

With respect to the misunderstandings I immediately have to call attention to a misbelief which is widespread in Hungary – namely that adopting monetary regulation means at the same time acceptance of the Friedmanist school's theses and refusal of the Keynesian theoretic system. In fact, regulation on a monetary basis does not mean identification with the monetarist school, and putting forward such a regulation in itself is not a position taken up in favour of Friedmanism and against Keynesianism. As much is, of course, true that regulation of the growing supply of money – to which monetarists attribute decisive significance – would also be of essential importance in Hungary. Even Keynesianists do not deny the importance of money supply, though in their opinion its importance varies, depending on the condition of business cycles in the national economy.

*Inaugural Academic lecture of the author, given on April 15, 1988.



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*Akadémiai Kiadó, Budapest*

Under Hungarian conditions, to introduce regulation on a monetary basis would in essence mean to place money – instead of its current secondary position – into a primary one and to build up economic practice upon the predominant position of money. This is reconciliable with the fact that we attribute *at least* such an importance to the Keynesian system as we do to the theses of monetarists. Seeing it from the view of our own economic practice, all Keynesianists are in fact monetarists, since, in opposition to our practice followed so far, Keynesianists also attribute decisive significance to money. The Nobel prize winner, Franco *Modigliani* once noted: "We are all monetarists." He added, "This is so because all, or at least most economists believe that money is a very important thing."

One of the most important features of monetarist theory, in opposition to Keynesianism, is that in the regulation of aggregate demand it prefers the regulation of money supply, rather than the use of fiscal tools. Formally, we take more or less the same standpoint with respect to the necessity of monetary regulation of the aggregate demand. Yet this does not mean simply adopting the theorems of the monetarist school! Keynesianists consider the magnitudes of budgetary revenues and expenditures, the ratio of the *whole* budget as compared to the GDP, and the balance of the budget to be important for the regulation of aggregate demand. We, in turn, emphasize our standpoint not to regulate aggregate demand by taxes which afflict the use of the production factors, because it is contradictory to enterprise autonomy, to the free combination of the productive factors, to material incentives, and to the prominence of quality factors, as well as to rapid restructuring, furthermore, to the improvement of efficiency. Neglecting the fiscal tools *in this sense* would be applauded by any Keynesianist. Employing budgetary tools may have good or bad results – the decisive question is which tools are used.

In the debate between monetarists and Keynesianists the central question is that of "activism"; namely, whether the state should pursue economic activities and whether it should take "discretionary" measures. The monetarist school – setting out from several theoretical considerations and relying on certain empirical facts – rejects state intervention. This is the basis of the charges against those who wish to strengthen monetary regulation in Hungary: they want to leave everything to the market, in the belief that the market will solve every problem. In our case monetary regulation does by no means suggest that central management shall be limited to merely regulating the supply of money. Let us set out from the supposition that in the case of monetary regulation money will get into a priority position and economic policy will rely on it. This is compatible with the economic activities of the state. Of course, the eventual results depend on the content of the state's economic activity and how it is realized. Economic processes can be regulated in such a way that the position of money is not violated. Keynesianists consider the formation of the balance of the central budget in the capitalist economy as an element of crucial importance within state intervention; along with an appropriate taxation system and a suitable structure of expenditures this can be compatible with the priority role of money. It may be taken for granted that a conscious

development of the budget balance is also going to be necessary in Hungary – in fact, it is required right now. In the same way, some other economic policy instruments, which are in compliance with the market and encourage the restructuring of production and foreign trade, are also necessary as well as compatible with regulation on a monetary basis. The shift from administrative state regulation to monetary regulation does not mean the rejection of economic activities of the state but ensuring that such activities are efficient. True, this also demands that state activities be prevented from becoming oversized since monetary regulation cannot exist alongside meticulous interventions, with unnecessarily increased bureaucracy which weighs on the economy and paralyses enterprise initiative. In the case of regulation on a monetary basis, the significance of processes depending on enterprise decisions is much higher than it is currently in Hungary; however, it does not mean the rejection of state activities in general, but the marking out of their due place that has to be aimed at.

The credit and interest rate policies have to be rendered an essential tool of central regulation. It is astonishing how many people deeply and sincerely consider that the hope for success of the interest rate policy indicates the increasing influence of the monetarist school. Here I need to make a few remarks.

– The monetarist school does not suggest an active interest rate policy. What is more, the leading theoretician of the school, Milton *Friedman,* deems the endeavours at regulating the interest rate to be harmful. Therefore, he rejects them. In fact, also the monetarists admit that interest rates are changing. However, these changes must not be the result of a deliberate interest rate policy conducted by the central bank, neither should they be – in their opinion – due to a 'rediscount rate' policy, or to some deliberate market intervention aimed at changing the interest rates. In the opinion of monetarists an active interest rate policy may cause false enterprise decisions and/or inflation. In the Keynesian system the interest rate policy plays a greater role than it does in the Friedmanistic approach, for Keynesian thinking agrees with activism. In the opinion of Keynesianists, apart from two specific situations (i.e. the cases of the "investment trap" and "liquidity trap"), interest rate policy might be successful and, by using it, aggregate demand can be boosted or curbed. Hence, if we consider interest rate policy as an important tool of monetary regulation, it does not mean that we take a stand in favour of the monetarist school, and against the Keynesian school.

– The argumentation according to which the ratio of the income from interest payments indicates whether or not monetary regulation has in reality a significant role, is false. In Hungary the proportion of incomes from interest is rather significant, even though up until now the strength of monetary regulation has been insignificant. From the outset, any regulation based on monetary tools requires a taxation and a pricing system which are in harmony with the profit motive and enterprise autonomy. In other words, monetary regulation can only assert itself on the basis of an economic mechanism that is entirely different from that which has so far been prevalent in Hungary. The former, but partly still existing, administrative and taxation-based regulation system is compatible with either significant or insignificant incomes from interest payments.

– If we succeed in moving towards the practice of regulation on a monetary basis, we shall approach not only the model described by the monetarist school, but the Keynesian one too. The Keynesian and the Friedmanist models are built on a market economy (albeit, on a capitalist-type market). We have to make our way towards a real market economy; it is precisely for this reason that, in practice, we shall proceed towards both the Keynesian and the monetarist models. It is, of course, not true that by developing a socialist market economy we are simply going to apply an economic policy recommended by the Keynesian, or the monetarist school. The Keynesian therapy is suitable only for the elimination of a non-structural economic crisis; while against the monetarist way of thinking – which is hostile to activism – indeed severe objections can be raised. Thus, we approach the Keynesian and the monetarist models inasmuch as they both attribute a role of primary importance to money – though not in the same way.

So far the progress towards regulation based on monetary tools has either been very slow, or has not even taken place; what is more, in certain respects, backward moves were made. Positive advances are very slow because, in general, it is still not the market and, along with it, money that determine company performance; subsidies continue to be used and they still play a significant role. The regulation of aggregate demand – including both investments and consumer goods – is, even today, done through taxation and with administrative methods rather than by monetary means. In this respect stagnation remains typical. The retreat is demonstrated by the mistrust in money, increasing along with the acceleration of inflation.

Here I cannot touch upon every problem linked to monetary regulation and upon all the important interrelations of the troubles emerging. The current debates concerning monetary regulation can be traced back to the general state of the new economic mechanism and, together with that, to the current situation of the interest in property (capital) and the ownership relations. Here I am going to deal with questions directly connected with the confidence shown towards money, without which no effective monetary regulation can even be imagined. I shall touch upon the questions linked directly to monetary regulation and upon those in which it is necessary to make steps in the very near future.

In order that regulation on a monetary basis should come up to the expectations linked to it, the following things are absolutely necessary:

a) an interest rate policy inducing the population and enterprises to save, and prompting the firms to weigh up the various investment opportunities;

b) a system of tools which can properly regulate the money supply, i.e. the nominal and real money balances;

c) a sophisticated application of that tool system in practice and, for the sake of so doing, a right recognition of the economy's demand for real balance; taking it flexibly into account, not only on an annual basis, but also in short periods of even a few weeks or few days;

d) creation of harmony between monetary regulation and the other elements of the regulation system. Whichever of the listed requirements we look at, grave problems

emerge in the context of each. In the following I attempt to deal with the most important ones.

## Chief problem of the interest rate policy

The average interest rate on the savings deposits of the population has been lower than the rate of inflation for ten years; also, interest policy in the enterprise sphere has only occasionally, and with very small influence, stimulated an assessment of investment possibilities from the point of view of actual effectiveness. In the enterprise sphere the interest rate has only very vaguely and accidentally been adjusted to the necessities determined by the average rate of profit, the tax on company profits, and the rate of inflation. The main characteristic of interest rate policy as a whole has been wilfulness.

In my opinion it is a serious problem that, since 1979, the average interest rate on the population's deposits has been lower than the inflation rate. This has an adverse influence on the development of the population's savings and its consequences are even more serious for the totality of the regulation system. Furthermore, the public atmosphere, the attitude of the population and the performance of labour, are seriously affected by this situation.

Of course, changing the saving habits of the population does not merely depend on the development of the interest rate. What is more, it is, in the main, not dependent on it. Yet, especially in the coming periods, we need to be particularly careful in actions regarding the policy adopted towards interest rates affecting savings by the population. Namely, in the next few years the expectations regarding inflation will have decisive significance. It is intolerable that throughout a longer period the rate of inflation should be higher than the average interest rate payable on the inhabitants' deposits, and that the inflation rate predicted by the government should also permanently and substantially exceed the average rate of interest. Efforts have to be made to avoid a situation in which the average net real interest rate on the population's deposits – i.e. the after-tax real interest rate – falls below zero percent.

– It is not satisfactory to use the excuse that even in capitalist countries the real rate of interest may sometimes be negative. Precisely now, when we are speaking in Hungary about developing a system of regulation on a monetary basis, an indispensable condition for doing so is to restore confidence in money in the sphere of both enterprises and the population. Therefore, in the next few years the maintenance of a positive – or at least a non-negative – net real interest rate is a very important requirement. In parallel with reducing the rate of inflation we must, as soon as possible, carry out a general increase of the average interest rate on the population's deposits. How can we expect the population to wholeheartedly put its shoulders to the wheels of the national economy in order to push it out of the mud at a time when wages are restricted by severe legal constraints? What incentive is there when difficulties appear in the supply of basic goods, so that the money available cannot be reasonably spent? What encouragement is there to save when

the purchasing power of the money deposited with the bank becomes eroded because of the negative real rate of interests? To compensate for the foreseeable rate of inflation by increasing the interest rates on deposits is an intermediate goal without which no progress can be expected.

– If the policy regarding interest payable to the population is not set right the whole system of monetary regulation will be built on sand. Money has to circulate in the sphere of inhabitants and enterprises. The money of the population can be invested in shares, bonds or other securities and the dividends or interest on these should increase the income of the population. If this kind of circulation comes up against obstacles, significant resources will remain idle. However, if we unblock this flow and the rate of the dividends is positive, even the real interest rate of the population's deposits can not stay negative for a long period.

It is true, though, that standing against the reappraisal of the interest rate policy affecting the population's savings there are some obstacles which are prominent and which seem to be invincible. Financial government bodies hint at the extremely low nominal interest rates of home-building credits, at the extent of the budgetary deficit, and at the need to reduce this deficit. Under the present circumstances, raising the interest rate payable on the inhabitants' deposits could only – or, in the main – be achieved by financing it from the budget; this would increase the deficit at a time when – both for internal and external balance requirements – it ought to diminish. Yet has the scope of movement for shaping the current balance of payments in fact narrowed down so extremely? To what extent can external debts be increased in the short run? Can the internal balance situation only be improved in parallel with decreasing the deficit of the budget? What level of budget deficit would be consistent with equilibrium? These question arise only if we are earnest about developing monetary regulation and treat confidence in money as one of the important issues upon which the success of economic stabilization may stand or fall. Alternatives to the decision depend for the most part on what we deem to be of primary importance, and what weight we attribute to considering the requirements of long-term development. Certainly, I would be less anxious if, though along with a larger deficit on the balance of payments, but based on a stronger position of money, and as a result of creating conditions to aid structural moves, structural changes would become faster. In the long run, the equilibrium of the balance of payments also depends on this.

With regard to the interest policy followed in the enterprise sphere, the situation is not much better. Yet at least here there are no obstacles to financing the real interest rate, which might be able to regulate monetary savings and the credit demand of the enterprises. Connected with the interest rate policy pursued in the enterprise sphere, the following remarks can be made:

– The connection between the generally achievable rate of return and the interest rate is very loose and can even be described as haphazard. In the case of a well-founded interest policy, the nominal interest rates are directly influenced by the rate of the general profit tax, the rate of inflation as it is developing with respect to the producer

prices, and by the extent of the average real after-tax profit rate realized by the enterprises in the given period. In practice the net after-tax real interest rate of enterprise deposits and credits ought to be adjusted in line with the latter factor. An exact coincidence is, of course, not possible but it is unfavourable if net interest rate and average net profit rate are detached from each other. In a properly operating market it is primarily market automatism that ensures that profit rate and interest rate do not diverge from one another. There is no such market in Hungary, and this is precisely why the development of the interest rates and, in the two-tier banking system, the rediscount rate, have extraordinary significance. Until now in Hungary the interest rates related to credits – both on capital investment and working capital – were too high or too low; at the same time, rates of interest paid on enterprise deposits – apart from 1988 – were usually too low; this stimulated the companies to apply for credits rather than to increase their deposits. Looking at the situation in 1988, it can be seen that the interest rates applied in the enterprise sphere are unrealistically high. Certainly, financial management is – albeit with good reason – aiming at financial restrictions, i.e. it is attempting to counterbalance the formerly too liberal credit policy. However, the 15 to 17 percent nominal interest rates on credit and the high refinancing interest rate, can hardly fit in with the expected and realizable net real profit rate of the general profit tax is 50 percent, the inflation rate of the producer prices remains below 0 percent and the net real profit rate can only be estimated at a mere three or four percent. The currently prevailing interest rates would be realistic if the average net real profit rate were to be at least eight percent.

– In Hungarian practice the system of sliding interest rates is unknown. This causes troubles in the cases of long-term securities, bonds or long-term credits. This is precisely because, after a longer period, the rate of inflation could change significantly. Furthermore, the general profit tax rate may also change, and the interest rate of bonds or long-term credits might excessively deviate from the profit rate even if, at the time of issuing the bond or placing the deposit, adjustment had been carried out. The system of calculating nominal interest at a fixed rate causes no serious trouble if the rate of inflation does not change frequently and to significant degrees, and if the rate of the general profit tax is fixed or changes only very slightly. In Hungary the situation is different, therefore the risk is too high. This state of affairs could be counterbalanced by a system of sliding interest rates. Such a system would be favourable for both the enterprise or institution which issues the bond and for those buying it. In this way the reliability and negotiability of the bonds would significantly increase.

I am convinced that, despite the vague and insufficient profit motive of companies, financial management is in no way released from its commitments to pursue a well-based interest policy and to prompt banks to follow the same interest policy. Unrealistic interest rates encourage enterprises to undertake improvident, ill-considered economic operations. If the interest rate is too low, – or, the real interest rate is perhaps negative, – it prompts enterprises, especially under our conditions, to rely too much on loans. In turn, an interest rate which is too high – given that applying for credit is practically unavoidable – produces, among other things, an incitation to raise prices. This generates

inflation or reduces the growth of supply, or it may do both at the same time. Unrealistic interest rates make the companies accustomed to unrealistic calculations. This is a major reason why, in the enterprises, the opportunity cost of utilizing or investing money is not subject to careful consideration.

In addition to all these points, matters are made worse by the fact that in the current situation (and, what is more, even in the next few years) a net increment of money supply can only be flowed to enterprises through the budget deficit, i.e. the whole of the enterprises can only obtain additional financial resources from the state budget. Appropriate allocation of these resources among the enterprises is impossible without interest rates being well adjusted to the profit rate. We may state that, beside implementing a reform process aimed at developing true market relations, it is immediately necessary to introduce an interest rate policy promoting well-founded economic calculations – or, if you like, this is also an important part of the reform process.

Up until the present time, a specific deficiency of the credit and interest rate policy has been the lack of negotiable government securities (e.g. treasury bills) for covering the deficits of the state budget. This, at the same time, could to a certain extent restrict state spending, and provide good investment opportunities for both the enterprises and the population. Good negotiability, however, can only be provided if there are attractive interest rates linked to the securities. Otherwise, rapid covering of the deficit can only be assured if the central bank buys the securities. Another important task of the negotiable government securities is to regulate the quantity of money by their sale and purchase. This, however, leads us further on to the system of tools for monetary regulation.

## The system of tools for monetary regulation

In the capitalist countries three main elements of the monetary tool-system based on a two-tier banking system are known. The first one is the setting of reserve requirement ratios and the second one, refinancing. Sometimes the two constituent elements of the latter, namely the central discount rate and the extent of lending (indicating the amount which the issuing bank is willing to lend), are mentioned separately. Finally, the third element consists of open market operations. The latter element, which has strongly increasing significance and is of crucial importance in the capitalist countries is, for the time being, missing from the arsenal of tools in Hungary. Here, since the two-tier banking system has been introduced, refinancing has been the decisive monetary tool; this is not merely by chance but because, owing to the lack of an advanced capital and security market, it is not possible to rely on open market transactions. The very rudimentary security market and the troubles appearing in the interest policy leave their mark also on the other elements available in the arsenal of monetary tools.

Flexibility and the ability to make rapid changes in the money supply are of crucial importance in monetary regulation. This cannot be realized by frequent changes in the

discount rate for it causes disturbances; on the contrary, in this area efforts aiming at relative stability have to be made. Frequent and significant changes in the required reserve ratios represent an excessively brutal way of intervention; stability in this sphere is even more important than in the discount rate. Nor is the change of the amount of central bank lending sufficiently effective from the viewpoint of monetary regulation. The truly appropriate flexible solution is to employ open market operations. The buying and selling of securities by the central bank simultaneously changes the interest rate (without modifying the discount rate). It also changes the reserves of the banks (without changing the required reserve ratio) exerts a powerful influence on the demand and supply of money, and affects the increase and reduction of the quantity of money supply. An outstanding advantage of the open market operations is their speed, since in the monetary sphere rapid changes may be needed week by week, or even day by day. In the computerized banking system of the United States a particular open market operation can be accomplished within half an hour following the decision.

The basic condition for successful transactions in the framework of open market operations and, indeed, for the whole system of monetary tools is, however, an advanced capital market and, along with it, a similar securities market. In the latter negotiable state securities play a very important part. Technical literature refers to them as "near-money" securities. Without a developed security market even the other tools of monetary regulation could only operate with some troubles. Adjustment to an occasional increase of the required reserve ratio can be made possible by selling government securities and filling up the reserves in this way. If they have plenty of negotiable securities in their portfolio, the commercial banks are not seriously afflicted by a restriction on refinancing. This is why the existence of an advanced capital and security market is of decisive significance. If, however, credit life is unregulated and the interest rates are unrealistic and disconnected from the rate of return, such markets cannot evolve.

## Professional aspects of monetary regulation

Even an existing refined system of tools, relying on the profit orientation of enterprises and including every important form of monetary regulation, will not guarantee that monetary regulation is adequate. Decisions properly adjusted to the money demand of the economy and which properly regulate the demand and supply of money are also needed. This belongs to the professional side of monetary regulation. In this context I want to raise three main problems: first, the problem of demand for money in the long run; second, the problem of short-term demand; and third, the question as to what monetary regulation should directly influence. Should it be the interest rate, the supply of money, or both? In Hungary, with regard to all of the three questions, serious want of experience exists. Some important interrelations have not even been noticed yet and, at the same time, the neglect of some others has already caused considerable troubles.

– As far as long-term demand for money is concerned, Friedman's "demand function for money" has to be considered very seriously. With this function he examines which factors determine the "demand for real balances". There is no place here to go into a detailed analysis and I will mention just some of the determining factors: e.g. the level of the nominal interest rate, the size of the per capita income, and the expected rate of inflation. The results of these which need to be reckoned are: a higher nominal interest rate and increasing rate of inflation reduce the demand for real balances, on the other hand, a higher per capita income increases the demand for money, though to a lesser extent than the actual growth of the real income; the final result is that the growth rate of the demand for nominal balances differs from the growth rate of the per capita nominal income and from the growth rate of the nominal national income on the average of the national economy. This is especially true when the interest rate and the rate of inflation are changing. The effect of these factors is to increase the velocity of money circulation. Neglecting the factors of Friedman's demand function for money may bring about a situation in which inflation grows more rapidly than it had originally been expected. It could also result in the emergence of disturbances in the money supply, or cause unexpected and greater changes in the interest rate – this will, consequently, disturb the reproduction processes. To assess long-term money demand raises special difficulties under our circumstances. In Hungary, profit- and cost-sensitiveness still have to be developed and the system of tools for monetary regulation are only now beginning to take shape. Here the responsibility of professional management is possibly higher than in those places where the system of monetary regulation is already developed and the general conditions of regulation are satisfactory.

– Short-term development of demand for money raises specific problems since, in the short run (even within one or two weeks), the trend of monetary policy may be quite different from that related to the annual level: it may be expansive at a time when, taking into account the year as a whole, policy should be restrictive. This is, in general, connected with the strongly varying short-term money demand of the economy and with circumstances characterizing certain sectors of it. Western economic literature often mentions the Christmas shopping campaign as an example, or periodic fluctuations owing to tax payments which, in certain periods, very much increase the population's demand for money. The greater demand of agrarian producers for money in springtime is also often mentioned. In addition to these, it is not rare for unforeseen changes to present themselves. In capitalist countries the bodies involved in financial management are usually engaged precisely in the tasks to be carried out in the short term. In the United States, for instance, where purchasing and selling securities in the framework of open market operations is an essential and important tool of monetary regulation, the so-called "defensive" operations account for the majority of transactions. The "dynamic" operations, on the other hand, show the general tendency of monetary policy, even though they represent only a few percent of the transactions. Hence, in the transactions of the central bank – pursued for the purposes of short-term changes – sometimes purchasing, sometimes selling the securities is dominant. The large number of open

market operations and the continuous buying and selling still result, on an annual level, in only small changes in the quantitity of money. Without this process – American literature calls it aptly "churning" – monetary regulation would be extremely rigid and might cause serious troubles. It is also possible, though more difficult, to apply "churning" in the framework of refinancing; in Hungary, however, hardly any sign of such processes has appeared. Early in 1988 it was precisely the absence of flexible short-term regulation that caused serious difficulties.

– The changes of the interest rate and the quantity of money are interconnected, i.e. they influence one another. One of the basic principles of monetary management is that the quantity of money and interest rates cannot be regulated at one and the same time. Therefore, management has to direct its efforts towards either control of the quantity of money or the control of the interest rates. In Hungary we are inclined to control everything: namely, efforts were and still are made to regulate both the interest rates and the quantity of money. This very soon results in a lack of equilibrium and raises, for example, the need to allocate credits. Hence, the interest rate loses its role of regulating the capital market. Of course, it would not be right to cherish illusions linked to monetary regulation. Even in the case of a highly developed and properly applied system of monetary tools it is not a simple task to keep the increasing money supply in the desired channel, and thus no accurate regulation can be expected. Yet, by proper regulation, the magnitude of money supply can be held between acceptable limits of error. In order to achieve this it is, however, necessary to bring about the economic conditions on which the monetary regulation is to be based, to develop the arsenal of monetary tools and to acquire the professional skills needed for pursuing that regulation.

## Monetary regulation and the reform process

The Hungarian economy is in an especially difficult situation. The problem is not only that we are increasingly falling behind the advanced western countries, and that several countries – earlier considered as developing ones – are leaving us behind. Added to these facts, our position is worsened by a heavy and, owing to the interest charges, increasing indebtedness. Under such conditions it is extremely important that in the very near future genuine restructuring should take place, and that high-quality performance should actually and generally enjoy priority. This will only be possible if the scope of movement for enterprises is radically increased and if central management unreservedly switches over to monetary regulation. Still, considering the actual changes which have taken place so far, it often seems as if we had plenty of time for deliberations and for making the necessary decisions. Yet it is precisely the time factor which is of greatest importance – there is no time to waste.

Few dispute the necessity of monetary regulation. However, it is still very far from being implemented. Certain elements of the system of tools needed for monetary regulation in the strict sense of the term are not in harmony with each other. What is

more, the system is incomplete. The main problem is that confidence in money is slight and, in addition, it is growing weaker; up to now economic policy has treated it as a factor of secondary importance, giving priority to the short-trem requirements of internal and external equilibrium. The principle of regulation on a monetary basis is also in contradiction with other elements of the prevailing regulation. There still are too many restrictions which constrain enterprise actions, and the sphere of administrative regulation is too wide. The conflict between the nature of monetary regulation and the prevalent regulation of wages and investments is conspicuous. Regulation of the latter is implemented decisively by administrative means and taxation, although these represent the majority of aggregate demand. The basic goal of monetary regulation should be precisely the regulation of aggregate demand. It is because administrative regulation is predominant and the regulation of aggregate demand on a monetary basis is pushed to the background – moreover application of the existing system of tools is also deficient – that the scope for the companies' manoeuvring is too narrow and the pace of restructuring unsatisfactory. However, if the requirement emerges that, beside strengthening monetary regulation, the constraints have to be released as soon as possible, it usually meets with refusal. The refusal is usually justified with reference to the general position of the economic mechanism, or even the situation in respect of the internal and external equilibrium. The best-known arguments are: the constraints cannot be released because there is no real market, and the latter does not exist because there is no external competition; or, an interest policy aimed at strengthening confidence in money cannot be implemented for, in order to improve external and internal equilibrium, the deficit of the state budget ought to be reduced, and this impedes the raising of nominal rates of interest on the population's deposits. Hence, the issue of confidence in money, as well as that of monetary regulation, remain at the same stage as they are today.

Another well-known argument states that it is not permissible to treat wages in the same way as other cost items because people's interest in property (capital) is unsolved, because the monopoly position of enterprises is too strong, because both internal and external competition are missing and because the proportion of subsidies is too high. In general, we are very strong in finding arguments for why it is not right to take some measure within a relatively short time, and why this or that decision is too risky; but we are very weak in explaining what has to be done in order to make progress within a short time. For instance, little is said about what has to be done in order that the enterprises' scope of manoeuvring should grow essentially wider as soon as possible. It is because only very little time is left that it is most important to determine the concrete measures which will allow rapid progress to be made.

I consider it essential to develop the arsenal of monetary tools and to make appropriate decisions related to the promotion of this development. I do not question the importance of creating interest in property (capital) and of changing the ownership relations, for I deem these issues just as important as anyone who is engaged in this fundamental part of the reform. Yet I am afraid that the solution of this range of problems requires many years and only gradual progress can be expected. However, we

can no longer wait for years for the acceleration of restructuring. Beside developing interest in property, the soonest possible evolvement of monetary regulation will also help – as a feedback – to strengthen that interest, and we shall be able to advance more rapidly. I dare take the risk of saying that acceleration of the reform process has to be started precisely by introducing monetary regulation. For the sake of rapid development of monetary regulation I consider the following steps to be most important:

– Restore confidence in money. This postulates a gradual but perceptible reduction of the rate of inflation and, at the same time, the formation of an average interest rate on inhabitants' deposits such that it will put an end to the situation in which real interest rates turn out to be negative. We must ensure that the average net after-tax interest rate should not be negative. Such efforts must not be subject to considerations about internal and external equilibrium; short-term equilibrium requirements should only come into account in the context of restoring the confidence shown towards money. Without this consideration, neither regulation on a monetary basis, nor long-term equilibrium can be brought about. It follows from all this that it is possible for the current balance of payments and the balance of the state budget, as well as the savings of the population and companies, to develop in some ways other than those the government currently deems necessary.

– The arsenal of monetary tools has to be supplemented by the tool of open market operations. This is only possible if the present unrealistic interest rate policy is replaced by an interest policy fitted to the average profit rate, if a reform of interest rates on household savings is implemented and if the elements of administrative and fiscal regulation – which violate the profit motivation of the companies – are eliminated. Gradual and perceptible reduction of the subsidies granted to some enterprises also belongs to this sphere. Together with these points and beside refinancing, in the regulation of money supply and within the framework of interest rate policy, we have to rely increasingly on the tool of open market operations. Obviously, for the time being, refinancing will have greater weight, since to develop a properly operating security market takes time.

– It is necessary to acquire the knowledge necessary for implementing monetary regulation. Taking into account the expected cost sensitivity of companies in Hungary, monetary regulation has to be directed towards the regulation of the supply of money, rather than to that of the interest rate. In such a position it is better if it is the rate of interest that adjusts itself to the changes of the money supply and, of course, to the money demand, than the other way round, the demand for and supply of money to the rate of interest. At the beginning there will surely be some errors in the changing of company interest rates, some disturbances in the adjustment may occur, and the interest rates will be subject to fluctuations. Nevertheless, gradual improvement can be expected. Yet the discount rate has, from the outset, to be adjusted to actual profitability – therefore it has to be regulated in any case. Furthermore, the interest rate applied to the population's savings is, in its present situation, untenable. Thus, reform of the interest policy is not contradictory to the theorem that regulation needs to aim directly at the

development of money supply. With regard to the latter, marked attention has to be paid to the short-term regulation of money supply, in conformity with periodical and sectoral changes of the demand for money.

– Based on the foregoing – and relying, of course, on a continuous strengthening of interest in property (capital) – a marked and rapid widening of the scope of enterprise manoeuvring is necessary. From among these the soonest possible elimination of the constraints on wage regulation and in the sphere of investments is of decisive significance. In practice, this means the abolition of administrative and fiscal wage controls and investment regulation. These are by no means in harmony with monetary regulation, which becomes meaningless and powerless if the former provisions remain valid. Moreover, the development of the monetary tool system is intended precisely for the purpose of abrogating the earlier valid or still predominant investment and wage regulations. Without doing so, the tax reform implemented so far (which is at present causing a lot of troubles) and, within it, the introduction of the personal income tax can be regarded as largely vain efforts. Finally, unless these goals are reached even the acceleration of restructuring cannot be hoped for.

* * *

The development of monetary regulation has several other consequences, too. I might mention for instance, the consequences for price policy and for the practice of price regulation. Also, there are the problems of harmonizing internal and external monetary processes, and making the total system of taxation compatible with the requirements of monetary regulation. This will, among other things, also have an impact on the formation of tax rates. The tasks to be solved are numerous and some of them can, realistically, only be solved after a longer period. In the framework of this inaugural lecture I am unable to present a satisfactory analysis of them. Instead, as a concluding statement, I would stress that well-considered and, at the same time, quick actions and decisions are needed. In monetary regulation a breakthrough has to be achieved within the shortest possible time. However, the only way to accomplish this is for economic management to accept – as a guiding principle – that the practice of economic policy must not focus on the views of short-term equilibrium. In fact, the assertion of the requirements of internal and external equilibrium is only right if it goes together with the development of a system of economic conditions which give free room to structural changes and which do not impede but support them. This is how the state of equilibrium can be improved, if not today, tomorrow, or even later on, to a satisfactory degree. It is precisely regulation on a monetary basis which is an important part of such a system of conditions.

# МОНЕТАРНОЕ РЕГУЛИРОВАНИЕ И СВЯЗАННЫЕ С ЭТИМ ПРОБЛЕМЫ В ВЕНГРИИ

Т. ЭРДЕШ

В первой части статьи автор анализирует содержание регулирования на монетарной основе, вводимого в венгерской экономике, и показывает его отношение к кейнсианству и монетаризму. Он подчеркивает, что система регулирования должна опираться на господствующую роль денег и что решающую важность имеет создание такой системы экономических предпосылок, которое сопровождается выдающейся ролью денег. Поскольку как кейнсианская, так и монетаристская система опирается на господствующую роль денег — только не в равной степени — введение регулирования на монетарной основе не означает одностороннего предпочтения монетаризма перед кейнсианством. Скорее речь идет о приближении к обеим школам, поскольку цель состоит в создании социалистической рыночной экономики и поскольку деньги из нынешней подчиненной позиции переходят к первостепенной позиции. Речь не может идти об одностороннем предпочтении монетаризма и потому, что никто не ставит под сомнение активность государства, а лишь ее конкретные способы и масштабы, и потому что никто не отвергает, в частности, активную политику процентных ставок.

В интересах введения регулирования на монетарной основе нельзя обойтись без восстановления доверия к деньгам и установления в интересах этого положительных реальных процентных ставок после выплаты налогов для сбережений населения. Дисконтные процентные ставки центрального банка должны соответствовать средней доле прибыли и одновременно с ней ставкам налогов с прибыли предприятий и предполагаемой доле инфляции. Вследствие задолженности пока следует стремиться к регулированию предложения денег вместо непосредственного регулирования процентных ставок коммерческих банков. Важно создание тех условий, которые сделают возможным применение открытых рыночных операций. Много задач, связанных с овладением профессиональных знаний, необходимых для монетарного регулирования.

Заключительная мысль статьи в том, что регулирование на монетарной основе — органическая часть общей реформы и его решительное проведение может ускорить весь процесс реформы.

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# ECONOMIC ORGANIZATIONS AND OWNERSHIP

M. TARDOS

The critical situation of the Hungarian economy, which has already lasted for a decade, is in a double relationship with the development of property rights in Hungary since World War II. The causes of the poor performance of the economy, of the closely related hunger for imports and the lag of export performance behind import demands cannot be found without an analysis of changes in the property rights.

## The critical situation of the Hungarian economy and the property rights

The process of establishing socialist property rights started in the late forties with the policy of nationalization, and ended with the collectivization of agriculture in the early sixties. The almost complete liquidation of capitalist private property and the radical suppression of small commodity production, – implemented in both the towns and the countryside – held out the promise that in a socialist society based on the dominance of uniform state property, the economy would not only rapidly develop but would also eliminate alienation and bring about a just distribution of incomes. In practice, however, the new system failed to produce the promised success. In the first period following the transformation the economy could only develop in an extensive way, by drawing in additional labour, steeply increasing accumulation and concentrating the means of production. Resources were not used efficiently. Though the importance of money did not diminish in accordance with earlier ideas, prices still did not play an active role in harmonizing demand and supply, and thus solvent demand frequently remained unsatisfied. Citizens could enjoy the results of their efforts only in a restricted sphere in spite of fast economic growth and full employment. The quantitative production drive and commodity shortages became characteristic features and substantially restricted the sovereignty of citizens, both as producers and consumers.

The situation continued to deteriorate when the extensive growth came to a halt between 1972 and 1978. The available labour, capital and mineral resources, as well as the additional raw material procurement possibilities offered by the CMEA-trade, were eventually exhausted. When it had become clear that the proposals aimed at the improvement of planning (e. g. [25]) were not producing the desired results, a reform of economy became necessary.*

*The exhaustion of productive forces and the dissatisfaction of the citizens were pointed out by György *Péter* in [19]. He was an advocate of reforms and his observations were also emphasized in the information issued to support the CC committee resolution of May, 1966. This presented details regarding the necessity of reform. [35]



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In the interest of more efficient management, the economic reform wanted to deal with the unsolved problem by making wide changes. It liquidated the two most important instruments of direct control: the mandatory plan targets and the central allocation of materials. Besides, albeit with smaller emphasis, it also proclaimed the necessity of developing trade, the price system and financial regulations; it also deemed it desirable to open the economy towards external markets, and wished to stimulate the strengthening of factory (workshop) democracy.

However, as is well known, the Hungarian economic reform only led to limited results. This unfavourable phenomenon is again related to the established property rights and to the power structure based upon it. This is the explanation for the compromises made in the course of preparing the reform and for the required revision which failed to come about. Thus, the resolutions of 1966–68 hardly touched upon the necessity for competition between state, cooperative and private properties in the economy. Questions related to the transformation of the organizational system and those affecting the system of property rights escaped attention – partly because the problem had not been recognized, partly for tactical reasons. As a matter of fact, some elements of the contradiction between the centralized organization relying on the dominance of uniform state property and the newly introduced decentralized decision-making system – that is, the pluralistic market – emerged even at that time. With regard to this, the debates preceding the reform are worth recalling.

Related to the questions concerning organizational decentralization, in 1966–68 it was obviously tactical consideration that led to the putting off of the solution – at that time a reform of property rights still counted as taboo. The article written by Kálmán *Szabó* and Miklós *Mandel* in 1966 [26] characterized the debate about the investment mechanism, which largely influenced questions of ownership, by describing two standpoints. The conservative group wanted to make available most of the investment funds, which served the development of existing firms, through the uniform banking system according to the national economic plan. This was to be on the condition that the enterprises undertake the fulfilment of higher tasks – also formulated in physical terms. Szabó and Mandel, who represented at that time the most market-oriented standpoint, formulated their demand by saying that enterprises should "decide on their own material responsibility on the rational combination of the available factors of production." In other words, they should manage them. However, they failed to clarify issues concerning the desirable mechanism of capital allocation, e. g. how should new capital be drawn in for the foundation of new firms, or for developments exceeding the resources held by the firm? Also, what was to happen to the capital accumulating at the enterprise but which could not be used there efficiently? Not only did their standpoint not advocate the market forms of capital allocation, they even thought that the enterprises' decision rights should be restricted. They said that ". . . all questions which determine the rate of growth of the economy, its stuctural changes, employment, the relation of productivity to the standard of living, the proportion of accumulation to consumption, the relations of the country with world economy. . . should be decided upon centrally." (ibid.).

Thus, even the then most consistent standpoint advocating market relations failed to speak about the necessity of a capital market, and found that the task of the government was not to influence the market to substitute it with something else. The reason for this fact must obviously be found in the concept which considered the appearance of a capital market – which is unfeasible without separated properties – to be incompatible with the image of socialism prevailing at that time.

Yet the success of the reform was mainly restricted not by the ideological treatment of socialist property rights, but by the contradiction between the power structure which had developed with nationalization and the changes pointing towards the market. The conflict became clear when, after liquidation of the mandatory planning, beside improvement of harmony between supply and demand and a slight increase of efficiency, some unexpected signs of spontaneous income differentiation also appeared. The relative growth of incomes of smaller firms and of those in the second economy was opposed to the efforts of managers of big firms to achieve a distinguished position. This strengthened the resistance of a part of the government administration opposed to the reform. Their anti-reform stance was supported by the fact that, following the intervention in Czechoslovakia on 21st August, 1968, the Warsaw Pact countries developed an antireform standpoint. The domestic economic situation, on the other hand, really required the solving of the above reviewed compromises of the 1966 party resolution. However, instead of further steps, the reform came to a halt in the seventies. Several problems, such as the regulation of wages and earnings – unsolved even today – and the problem of property rights, were removed from the agenda. The political leadership opted for the restriction of the reform, for the coexistence of the earlier developed centralized and hierarchical power structure and management without mandatory planning, namely, for the further restriction of the market instead of its development. The economic reform could not keep its promise because, due to internal and external pressures, politics flinched back from a consistent implementation of the reform and did not undertake the development of market management and a corresponding political structure.*

## The concept of property rights of the 1968 economic reform and the investment practice afterwards

In all certainty, the internal logic of the new economic mechanism (NEM) opened a wider scope for enterprise autonomy and the private sector than the actual practice demonstrated after 1968. There is every indication that those working out the NEM

*Regarding the restriction of the reform, for the opinion of Rezső *Nyers,* Secretary of the CC responsible for the introduction of the reform, see [18]. This problem is also dealt with, among other things, by Gábor *Révész* in [21].

intended to eliminate the monopolistic position of big firms, reduce the number and power of branch ministries exercising ownership rights over the enterprises, and moderate the political uncertainty of the private sector. However, they did not intend to create a capital market, nor to allow the contradiction between labour and capital within the firm to come to the surface. Finally, they were also far from considering the private sector, small ventures as economic actors and competitors of equal rank with the state and cooperative big firms. These new elements of the reform efforts of the eighties were not explicitly formulated even in the ideas of the most radical reformers of 1966–68.

György *Péter,* an outstanding precursor of the economic reforms, explained that traditional socialist management brings about a sellers' market. This hinders the freedom of citizens and efficient management. Interestingly, however, he clearly advocated centralization and central allocation of a significant part of enterprise incomes. He was against the regulation of wages depending on profit – as established in 1968 – yet he conceived a solution, within the centralized hierarchy, where the manager would handle conflicts – by state authorization – and the state would draw away the savings that could not be efficiently used in the firm by using its discretionary rights. Thus he did not think of acknowledging and institutionally regulating the conflicts between capital and labour within the enterprise. His concept relied on the assumption that the manager, acting on authorization received from the government, would rationally consider profit as the measure of success. Also by saving wage costs, he would use the receipts remaining with the firm in a result-centred way, yet he would not prevent the taxing away of possible surpluses [20].

Tibor *Liska,* who, in his "Critique and concept" [16], sharply criticized the cost-plus price system (from which practice did not deviate even after 1968) already in 1963, did not raise at that time the idea of an entrepreneurial market. In the article quoted he made, after sharp and justified remarks, a proposal that was difficult to make operative. He explained that it was necessary to perform input-output computations taking into into account world market prices, and the results had to be considered by the price formation. Concerning the creation of a market and the mobilization of entrepreneurs, he first mentioned this at the time of preparation of the reform in his "Oeconostat" [17]. This was distributed as a manuscript in the first years of the reform. This work was a great step forward because it called by name the three agents of a socialist market economy: political power, a banking system exercising ownership functions, and national economic entrepreneurs. Even then, there was no mention of the institution which was to play an important role in his later proposals – namely, the "fund for enterprise experiments", which would play the role of a capital market. In Liska's models however, the function of a capital market is fulfilled by this fund (which he calls a cash-desk). This is an institution comparable to a law court which follows ideal (social) interests, which has no direct interests attached to it, and which coordinates the activities of actors bidding for property. In this model the interests of entrepreneurs are not separated from those of non-entrepreneur citizens, nor are they institutionalized. Thus it also makes it difficult to make the ideal market concept operative [33].

Avoidance of open conflict between capital and labour, and the lack of labour and capital markets were also formulated in the May 1966 resolution of the Central Committee of the HSWP.* [35]

Accordingly, the regulation system of the new economic mechanism set out, in respect of investment financing, from the thesis that "it is expedient to relegate the investments related to the maintenance and minor expansion of fixed assets, to the autonomous management and decision scope of enterprises, and gradually implement them from the enterprises' own investment sources." Investment projects exceeding this – which would transform the structure – were to be financed in part by drawing in the firms' own financial resources but primarily by using money from the state budget and with bank loans. Both the budget allocation and the bank loans served partly "to make the investor materially interested in the rational use of means", and partly to ensure that the government or the economic control agency authorized by it "should exercise the rights of decision-making in the scope of major investment projects." The resolution considered projects such as the following: large individual projects in the non-productive sphere, the creation of new large enterprises and establishments, major expansions of big firms of national importance and/or the complete reconstruction of such firms [35]. It was this situation that brought about the well-known "forced ways" of wage control, and it had an unfavourable impact on capital management and investment.

The system developed after 1968 was unable to consistently assert the principles accepted in the guidelines, and it could not harmonize central decisions with the interests of enterprises [36]. With regard to investments, it proved difficult to distinguish the projects maintaining earlier levels of output from those carrying out structural transformations; although it was a constantly emphasized demand that the scope of state decisions should be radically narrowed, and market requirements as well the principle of returns should be asserted, three, conflicting, systems of criteria were declared. None of them broke the practice of the traditional socialist regulatory mechanism, according to which the central hierarchy develops the structure of development by drawing in the firm, by means of a so-called "scientific assessment." In this way the centre created the conditions for the implementation of projects deemed necessary by the central plan [34]. The three systems of investment criteria – of equally poor impact – were the following:

*This was in harmony with the views of W. *Brus*, a Polish economist popular also in Hungary. With reference to the writings of O. *Lange* and M. *Dobb*, Brus established that "the market mechanism is not suited for. . . selecting the main long-term and investment directions of the economy". From this he drew the conclusion that it was expedient if the centre "allocates the investment funds among the various branches through direct decisions". Accordingly, he approved that, in the interest of the "superiority" of the central plan (quotation marks by W. B.), the central level was obliged to apply a regulated market mechanism and narrow down the frameworks established with direct decisions by means of a series of indirect decisions ([9.] pp. 165, 170, 175).

– The firm should only undertake such investment which guarantees or increases the wages of the staff. This requirement demanded a very fast pay-off relative to international norms (one or two years), since wages could only be raised in this manner from the after-tax profit and after amortization of credits. In the case of a longer pay-off period the situation of the working collective would have deteriorated because of the investments.

– In principle, the Bank was only willing to finance developments if the expectable income of the firm – independent of the success of the investment project – was sufficient for paying back the credit in 4–8 years. This was big relative to the capital of firms and, in the case of development projects mainly financed with credits, a highly unrealistic demand.

– The National Planning Office and the branch ministries supported the projects only if the action corresponded with the 7–8 year pay-off period demanded by them – which in fact was more realistic by international standards.

Amidst these three, conflicting, systems of requirements related to development, the firms had two points in their favour: on the one hand there were some development programmes judged by the central hierarchy to be necessary; on the other hand, for these "necessary" programmes support could be received through price regulation, credit and budget preferences. Using these opportunities, some firms started significant projects and, true to earlier practice and in the interest of getting the support, they overestimated the income-producing ability of the projects.* Another group of firms gradually renounced development and made efforts to use the development fund that could be automatically put aside from their profits each year. This was done in such a way that the opportunities for raising the wages of employees were not restricted. The development-oriented firms and central organs not only joined hands in the interest of financing the planned projects**, but the firms actually got more favours for their implementation. The subsidies increased particularly fast between 1974–1978, but even after that their importance did not diminish.

The favours and later the delays (rescheduling) of credit amortizations had the effect of saving from bankruptcy the financially desoriented firms and those stimulated to make economically unfounded investments. This was in spite of the fact that a legal remedy for treating enterprise crises*** had existed since 1968.

Although the reform partially eliminated the quantitative drive under the command economy and also wasteful production independent of demand – i.e. production for the sake of production – the international contradictions of the management system did not help to create the foundations for efficient development. In an economy held together by

*"For the planned projects approved by central decision, central financial funds can be obtained – and also credits which almost certainly cannot be repaid." [36]

**". . . in the course of economy-wide planning. . . the branch control agencies were interested in the underplanning of the enterprises' own funds. . . while the National Planning Office. . . deliberately underestimated the development funds of enterprises. . ." [36] (See *Table 1*)

*** See the Order of the Minister of Finance No. 3/1968/I.20./PM.

**Table 1**
*The role of favours in the development resources*

| Year | Development fund (F) formed according to general rules | Favours increasing the F-fund | The F-fund-increasing impact of subsidies increasing price receipts | Total F-fund surplus | |
|---|---|---|---|---|---|
| | Billion forints | | | | Percent (4:1) |
| | 1 | 2 | 3 | 4 | 5 |
| 1971 | 58.0 | 4.7 | 12.2 | 16.9 | 29.3 |
| 1972 | 60.9 | 4.8 | 13.0 | 17.8 | 29.2 |
| 1973 | 66.4 | 5.6 | 14.5 | 20.1 | 30.3 |
| 1974 | 77.2 | 6.5 | 19.1 | 25.6 | 33.3 |
| 1975 | 85.9 | 7.4 | 23.4 | 30.8 | 35.8 |
| 1976 | 94.1 | 13.3 | 25.6 | 38.9 | 41.3 |
| 1977 | 107.5 | 15.9 | 30.8 | 46.7 | 43.5 |
| 1978 | 121.0 | 14.6 | 29.0 | 43.6 | 30.6 |

*Source:* Kevevári B.: A vállalkozás, tőkeáramlás általános kérdései (General questions of enterprise and capital flows). Manuscript. Ministry of Finance, Budapest 1981.

a network of central development targets, practice differed from the previous situation only in that it no longer encouraged the production of superfluous goods in the interest of plan fulfilment. Also, when firms bargained for their survival with the central agencies, the bargaining was not about plan targets and material allocations, but – neglecting economic (pay-off) criteria – it involved fighting for the means necessary for development and for favourable financial regulators [1, 7]. The cyclical development of investments continued to assume disturbing dimensions [27]. Because of the unrealistic financial conditions, enterprises should have abandoned their investment plans. However, the firms participating in the development programmes assumed they would get the support of the authorities and they frequently applied for credits which they could not possibly repay. Repayment was rendered impossible by the strict formal credit conditions, which held even in the case of successful development.

The firms left out of the development programmes – which were mainly smaller firms – could not generally count on credits, nor were they favoured in the bargaining over regulators [10]. A considerable number of them even restricted their relations with the banking system to a minimum. At the same time, they were also less dependent on the state budget. This does not unambiguously prove their efficiency, since it was easier for them than it was for the big firms to evade the pressure of official price control and income regulation. However, it is certain that the market neither forced the smaller units to genuinely more efficient management, nor encouraged more efficient development.

## Changes in the period of economic restictions

Though cyclically and with unsatisfactory efficiency, the economy continued to grow, until 1978, by drawing in external resources.

From 1979, the restoration of domestic and external financial equilibrium became the decisive task of economic management. Between 1978–1985 domestic absorption diminished: living standards stagnated, the real value of accumulation fell by 64 percent and the volume of investments by 15 percent. At the same time, other steps were taken to increase the economy's ability to adjust.

One of the most important steps was the expansion of the enterprise sector. One of its advantageous elements, albeit not unambiguous, was the transformation of the ownership of state enterprises in a great part of the market sphere.* In the new, market-oriented forms of enterprise the ownership rights are exercised by the collective of employees (enterprise council, general assembly, meeting of delegates). The problem related to the exercising of ownership rights by these bodies is that, independent of efficiency, they are interested in raising wages and, by holding capital together, in guaranteeing the workplace for the employees.

The measures which relate to economic associations, the foundation of subsidiaries, the issuing of securities, the reintroduction of commercial credit, current account credit and bills of exchange were important and progressive steps, as was the law on bankruptcy. Yet, however fast capital transactions other than credit have developed, for the time being they are unimportant. This is clearly illustrated by the proportion of the value of bonds and other securities issued in Hungary to the total value added. The ratio of Hungarian securities is clearly low by international comparison, even if the significant deviations in respect of proportions among countries are taken into account, including those between developed and developing countries.

The actions aimed at the development of a capital market were followed by the promising introduction of the two-tier banking system. These changes held out the hope that conditions would develop which would make money capable of integrating and directly regulating the competitive sphere of economy.

However, the impacts of the above changes, aimed at the development of the market, were not unambiguous. Most of the changes merely facilitated the transaction of a few measures which became topical in the period of stagnation [4], e. g. the foundation of a few new firms, the independence of some enterprise establishments, and joint development projects. The signs of structural transformation brought about by monetary considerations did not evolve. The development of efficient firms was partly hindered by the uncertainty surrounding the main economic regulators. A good example is the significant overvaluation of the forint currency in the seventies. When, after 1978, a moderate devaluation of the forint began, it was the difficulty of raising credits and the unexpected withdrawal of outstanding credits that disturbed enterprise management.

*The debates related to the introduction of the new forms of ownership can be studied in [24] .

**Table 2**
*Value of securities relative to value added, in Hungary and some other countries (GDP=100)*

| | Money market | Capital market, of which | | | | Grand total |
|---|---|---|---|---|---|---|
| | | Total | Treasury bills | Bonds | Shares | |
| *Developed industrial countries* | | | | | | |
| USA (1984) | 32 | 119 | 53 | 17 | 49 | 151 |
| Japan (1984) | 13 | 118 | 47 | 17 | 59 | 131 |
| Fed. Rep. of Germany (1984) | 14 | 104 | 47 | 41 | 16 | 118 |
| France (1984) | 6 | 34 | 20 | 5 | 9 | 40 |
| *Developing countries* | | | | | | |
| South-Korea (1984) | 19 | 22 | 6 | 8 | 8 | 41 |
| Malaysia (1984) | 21 | 96 | 44 | – | 52 | 117 |
| Brazil (1984) | 17 | 50 | 24 | 2 | 24 | 67 |
| India (1984) | 7 | 27 | 17 | 2 | 8 | 34 |
| *Market-oriented socialist countries* | | | | | | |
| China (1984) | – | 2 | 2 | – | – | 2 |
| Hungary (1986)* | –* | 4 | 1.1 | 1.4 | 1.5 | 4 |

*Source:* World Bank report on China, 1986. Hungarian data based on statistics of the National Bank of Hungary.
* In 1987 a two-tier banking system was introduced and thus the volume of securities increased.

These factors helped to cause a deterioration of the position of firms which became indebted, not because of their own fault, but as a consequence of the contradictions of the system of development credits already reviewed. The problems were also exacerbated by the fact that the financial authorities (the Price Office, the National Bank of Hungary, the state budget) continued to help the low-efficiency, loss-making firms or those struggling with liquidity problems. Thus, despite promises and pledges, money and the pressure of solvent demand have not become determinant in the life of enterprises. It is evident that even the activity of the new banks is not characterized by businesslike crediting. The functions of the new institutions of the capital market – and that includes the commercial banks – are far from being determinant in the Hungarian economy. More than 50 percent of the external sources of enterprise investments are even now financed by the State Development Institute. With the significant credits issued by it – financing mostly CMEA transactions or other preferred development projects – business viewpoints play, at most, a subordinate role. Nor do the new banks grant credit mainly on a business basis – i.e. by weighing up the time and safety of returns. The behaviour of the commercial banks is mainly determined by the fact that a significant part of the credit stock inherited is tied up with loss-making firms or those struggling with grave liquidity troubles, having lost their funds. If these credits were either not renewed by the banks, or

if they were withdrawn by using the appropriate legal procedures, the banks would weaken their own position on two counts. On the one hand, because of the many bankruptcies that would have to be initiated they would themselves run into losses. On the other hand, the bankruptcies would antagonise society and the political tensions thus arising would invoke the anger of state and party organs. It is no mere coincidence that after the entering into force, in September 1986, of the legal rules governing the liquidation and financial rehabilitation of firms: out of the formally loss-making 61 state and cooperative enterprises, liquidation procedures were initiated against only one big construction state enterprise, a small council-supervised enterprise and a cooperative. The losses of several big organizations were still settled by haggling over matters concerning regulators [11, 12].

Business-like credit financing was not only hindered by the fact that the faulty elements of the new regulations that "punished" changes did not break the way for the withdrawal of money from the loss-making sphere, but also because the central bank made the money necessary for financing the planned outlays (but not covered by revenues) automatically available to the state budget. This caused deficit financing and, consequently, the budget ran into debts. In order to avoid inflation it was then demanded that the banking sphere should diminish the quantity of money in the enterprise sphere. On the one hand, this meant that they undertook the impossible – the withdrawal of money already spent; on the other hand, the disturbance among enterprises was further increased.

## Creation of the capital and money markets as a precondition of enterprise autonomy

The economic situation which has developed since 1968 calls attention to the fact that the many-sided dependence of enterprise on the centralized hierarchy of party and government is much more resistant to enterprise autonomy and the market than was earlier assumed. The diversification of financial relations, the discriminatory method of firm-by-firm bargaining in relation to regulators and prices, the direct interest of enterprise collectives in immediate income as against the interests in long-term profit and the pay-off of capital, and the lack of interest in customers as shown by firms in monopolistic situations led to renewed disturbances which revive the old forms of central control.

To stop the continuous retrogression (i.e. return to the original state) and in order to make progress, development in three directions seems expedient:

– strengthening the autonomy of the actors in socialist market economy, and the creation of a capital market,

– simultaneously with the renunciation of interference in the details of management, there should be a shift towards a strong regulation of aggregate demand,

– liberalization of the use of incomes taxed with uniform conditions, and a renunciation of the detailed regulation of prices, wages and investment resources.

From the three factors mentioned only the reform of property rights and the creation

of a capital market will be discussed here. This discussion will be with relation to the so-called "competitive" sphere of the economy, excluding public services.*

It seems to be clear that the most important precondition for bringing about an efficient socialist market economy is the appearance of a large number of economic agents. In making their decisions, they should primarily take into account the future profit-making capacity of capital. Such change in the behaviour of economic agents cannot be expected to originate from simple government measures. For this it is first of all necessary that the private entrepreneurs already operating, and those intending to start operation, should receive a guaranty from the state that there is no intention to nationalize their property; there should also be a guaranty about the framework in which they can increase their property (taxes, among them inheritance taxes); they should be aware of what society considers acceptable and useful. The development of the private sector and its security – to which I shall refer later – is an important and determinant, but not sufficient condition of the market-oriented reforms.

Considerable changes are necessary in the socialist sector and in the operation of state and cooperative firms – other than those firms performing public services. Above all, administrative institutions and party organizations must renounce their powers of direct supervision and restrictive regulation. However, the autonomy of firms and their cost-sensitive management, oriented towards long-term profit, should be provided with solid foundations in other ways as well. This requires that in Hungarian society, ownership (property) should be interpreted in a novel manner, and that the organizational forms be newly regulated by law – in respect of both state and cooperative enterprises and private property.

*State property*

We have not succeeded in overcoming the problems related to management of state property. This is because the holders of property rights, i.e. the administrative organs, could not fulfil their business and ownership functions. The stand taken by the CC, HSWP in 1984, along with the ensuing government measures, attempted to reorganize the exercise of ownership rights in a significant part of the market sphere. A great step forward towards enterprise property was made; yet, because of the reservation of foundation rights, they only partially broke with state ownership. In practice, the property rights related to investment-strategy decisions, to the appointment of the manager etc. were handed over to the enterprise employees but the gains and risks involved were not transferred to them.

The one or two years which have passed since then are not enough for carrying out a comprehensive evaluation. However, the experience collected allows us to conclude that the new forms of enterprise management do not lead to the desired results. This is

*For the necessary financial changes see [31].

indicated by the fact that the beneficiaries themselves, the holders of the rights ceded, do not consider the changes to be substantial. Managers criticize the new forms of management because, while government interferences into the life of enterprises have not diminished, the frequently formal operation of the new enterprise management bodies makes rational management difficult.

In the interest of resolving the newly developed tensions it will be expedient to return to the earlier debate about the transformation of socialist state ownership [24]. At that time three trends could be discerned: self-management, corporations and state holdings as bearers of ownership.

The so-called "self-government" form introduced in 1984 in 1984 is nearest to the self-management solution. Consistent development of this form is a possible alternative for further progress, provided that restriction of the use of the ceded rights through informal political pressure comes to an end, and if economic units can everywhere secede from the big enterprises. It is then likely that the firm intending to become independent will use its assets more efficiently than the big state enterprise consisting of many establishments. The breaking-up of the big enterprises which now operate with the self-management form is all the more justified, as it is an important precondition for the success of this form that members should have an overview of the operation of the firm; this can be better secured in a smaller unit. In those areas where the new forms of enterprise self-management introduced in 1985–86 will remain, the collective should dispose of a much greater part of enterprise profits than at present: their share should increase from the present 10 percent to about 50 percent. At the same time, by completely abolishing the administrative supervision of firms, legal supervision by courts alone should be exercised. The application of the form of self-administration assumes that the enterprise collective successfully asserts its owns interests and that, consequently, this is also useful for society. This fact justifies increasing the direct interest of employees in the augmentation of property (wealth). In those firms operating in a form equivalent to complete self-management, direct material interest in augmenting the enterprise property should be extended, and this would justify a wide expansion of the practice which began with the introduction of property-notes.* The increased use of incomes not related to that part of the property engaged by property-notes for investments is sound and just. As a matter of fact, this property is not directly owned by the enterprise collective. It is thus justified to expect these firms to develop enterprise property at a higher rate than the rate of national capital increase.

However, the new forms of enterprise management, even if they are further improved, cannot be considered the only solution. It is also useful to take into account other forms of socialist ownership which are in conformity with the market. This is made necessary by the fact that enterprise employees are mainly interested in current income and thus

*The order of the Council of Ministers relating to the property-note can be found in the October 14, 1987 issue of *Magyar Közlöny*.

they do not make the effort to preserve and increase property – i.e. to assert the genuine interests of the owners.

As a continuation of the debate which has evolved since the sixties and seventies, two directions of proposals relating to interest in property have emerged.* One group of proposals recommends the measurement of property and a related interest in income [23], or a similar system where the ownership rights would be exercised by a property-supervising ministry. Others [2, 6, 14, 15, 20, 28] advocate, beside the self-managing firms and those supervised by the state, the spreading of firms which operate on the basis of direct interest in property (general partnerships, limited liability companies and joint stock companies) and economic competition among the various forms of enterprise. In my opinion the first solution – measurement of property and the incentives linked to it – is difficult to operate because of the unavoidable subjectivity of administrative organs in determining the capital value. I think that this solution is also unfortunate because it wants to assert interest in property merely in the scope of managers and the incentive system of the enterprise collective. Thus it does not open the way for capital flows and associations.

For handling the problem I consider the direction opposed by the second group as acceptable. As regards details I am now of the opinion – modifying my earlier standpoint – that market efficiency can only be secured if we do not make, or do not primarily make, artificially created property centres and holdings interested in increasing the market value of property. Instead, we should rally individual and social group interests behind the interest in increasing property. For making such a solution general, it is necessary to transform the status of state enterprises, and to apply across a broader field the law on economic associations – which is now under elaboration.

This law will provide the opportunity for the spreading of forms which best help the preservation and increase of property: deposit companies, general partnerships, limited liability companies and joint stock companies. Yet, in themselves, even these forms may become traps. If, namely, the shares remain in the hands of the Treasury – as happened when the basic capital of the new banks was issued – or if the shares remain in the hands of a closed group of joint stock companies (in addition, in those of the autonomous factories of an earlier state enterprise, as happened in the case of Medicor** the there is a great danger that we have done nothing else but adjusted the old practice of administrative ownership to the formal demands of a modern market system. It is also to be feared that the law on economic associations in itself can only slowly help the development of efficient management – i.e. if it only opens the way for new forms of

*These two directions do not include Tibor Liska's proposals on the entrepreneurial trust fund – which can hardly be called an owner and which would hand over capital to managers by way of an auction. His ideas are difficult to implement and – at least for the time being – cannot count on support either in government administration or in society at large [33].

**Company for the production of medical instruments – Ed. note.

association to the extent that free means originating in firms will be available. It is a precondition of successful management that enterprise property in the form of securities or else should fall into the hands of a large number of natural and legal persons who assert their property rights in their own interest. Thus they will sell and buy shares – that is, they will transact capital market operations. Beside citizens possessing shares such institutions may be the banks, which could transform a part of their credit stock into shares; on the other hand, they could be investment companies, which carry out capital transactions on behalf of the clients who commission them. Enterprises themselves may be owners of shares when they invest their property in the shares of other firms. The latter can happen – as is already appearing in the Hungarian practice – if investment outside a given firm is more promising, from the aspects of both safety and pay-off, than the use of capital within that firm itself.

The capital market may significantly expand if economic institutions of a new type also come about, or, if the existing ones are transformed into genuine business ventures. In this context I am thinking mainly of the insurance companies (which can be further decentralized), of the social insurance institutions, and of the pension funds. Secondly, I am considering capital foundations from the income of which the outlays of village, town and county self-governments and those of non-profit institutions (trade unions, universities, schools, hospitals etc.) could be financed.

In the course of transformation these institutions – now mostly dependent on the state budget – could become increasingly independent. In the not too remote past, each of these institutions ceded their possible surplus to the state budget, while their deficits were also covered by the budget. In the last two years the situation has changed as far as the insurance companies are concerned. Instead of the earlier monopolistic Állami Biztosító (State Insurance Co.) there are now four insurance companies, and their relationship with the budget has also changed. Yet, we can only count on their full autonomy – and competition among them – if their capital power increases, and if the security of their clients is guaranteed by this capital power and not by the expected balance between the gains and losses of their diverse activities. The strong dependence on the budget of the other institutions listed can be changed relatively easily. As a matter of fact, the national wealth operating in the form of state enterprises was formed from the incomes of citizens, and to small extent from the payments of those insured. If the state makes available this property to the above institutions for the purpose of buying securities, and they use it for capital investment, and for buying shares and managing them efficiently, then nothing has happened other than that the management of the national wealth of citizens has been transformed. This change, however, would not only significantly develop market management in Hungary – where the pluralistic ownership relations demanded by the market have been missing ever since the nationalization. For, without abolishing the established forms of self-management and cooperatives, it would also provide the possibility of transforming these into smaller units, as well as the change for the appearance of a large number of shareholders. These shareholders would indeed be interested in their property. An investment market, circulation of shares, and a stock

exchange would develop and these would finally open the way for a realistic valuation of capital. The change would also be an important step towards increasing the security of, and social control over, the organizations now dependent on the bureaucratic institutions of the state budget. In this way, citizens interested in local self-government and in the operation of the non-profit institutions may become capable themselves of controlling the institutions which provide social services.

The gradual creation of investment possibilities for the new and the potential market agents, and the opening of money limits that can be used for this purpose, offer two further advantages. On the one hand, through the planned determination of investment capital creation, financial policy will be able to regulate the rate of enterprise transformations and of capital market creation. For this purpose a separate organization ought to be brought about, subordinated to the National Assembly, which would take care – in harmony with the National Bank of Hungary and the Ministry of Finance – that the transformation of the firms and, in certain cases, the issue of bonds by them, should not get into conflict with the requirements of financial equilibrium. From this aspect it is important that existing firms can be transformed without administrative interference into those organizational forms which conform to market requirements (smaller self-managed firms, joint stock companies, limited liability companies, deposit companies etc.). The transformation of a large firm under administrative control, or of a self-managed one, into a new form (as listed above) could be stimulated by one of two means. It may be secured by a regulation according to which, at the law courts exercising legal supervision, a liquidation procedure can be intitiated if the firm becomes insolvent. It may also be asked that a firm operating under government administrative control, or which is self-managed, should be transformed if the profit of the firm is low and if the initiator promises a higher expected profit relative to the capital value. It would be good if the programme and reliability of the initiators were judged by the law court. The proposed method also has the advantage that the budget money, created in the interest of establishing the circulation of securities and made available to insurance companies and foundations, will be partially or entirely withdrawn from circulation after implementation of the investment. An adequate regulation is all the more possible as the money issued for the purchase of securities is covered by the property of the new enterprise. The latter is justly expected to pay a part of the sums received into the budget,.and/or to use further amounts for covering earlier debts of the firm, or to invest them into time-deposits which can only gradually be mobilized.*

Creation of the capital market is a promising action but not without dangers. It is well known that capital flows and a stock exchange are the least solid institutions of the market economy. Not only the Great Depression of 1929–33 but also the exchange crisis of 1987 produced justified aversion to every proposal involving capital speculation. Those opposed to the capital market may also refer to the fact that the success of the leading industrial countries is not determined by the capital market, and the institutionalized

*It was Ottó *Gadó* who called my attention to this possibility.

capital market has not even a determining role in several successful countries. The undoubted dangers may be countered by the following.

We may presume that it is true that a) control by detailed planning, by instruction and by calling firms to account does not produce adequate results; b) the firms functioning on commodity markets and striving for profit cannot become efficient without capital and labour markets; c) working collectives are not capable of efficiently managing capital. Therefore, the way out is the creation of a capital market operating with the participation of genuine business subjects – that is, natural and legal persons interested in the valuation of capital – in spite of all the dangers involved. This also means that, exceeding the experiments with the forms of cooperatives and self-management, a way must also be opened for the circulation of securities. There can be no denying that in successful market economies such economic agents operate who measure their results by the profit-earning capacity of property. Most of these ventures are private ones even in the closer sense of the word: a family or the association of a few owners. The fact that the more complicated forms of association also availing themselves of the securities are not everywhere determinant does not modify the basic principle, i.e. that management is centred on property. In Hungary's business life the viewpoints of property are not asserted. State and cooperative enterprises wish to increase the incomes of their employees (members). Private capital has been so suppressed, and members of society are so characterized by being centred on consumption, that for a breakthough it seems indispensable to widely open the joint-stock company form in order to stimulate investments and the stock market.

*Cooperative ownership*

Cooperative enterprises appeared in the capitalist economy almost 150 years ago as particular socialist organizations, or at least they followed social goals. According to their principles the rights over common property are collectively exercised by the members, while the cooperative cares for the employment of its members. The cooperatives stress the principle of solidarity: burdens are commonly borne by members and they share the gains equally.

Cooperatives operating in the Eastern-European economics departed from the original principles; the members became separated from their property and such cooperatives were created in which, from the outset, the members could not exercise their ownership rights. The members of cooperatives were thus reduced to an employees position, exercising their ownership rights merely when electing a chairman and when accepting the annual plan and the annual report at the general assembly – and frequently even then only formally. This practice accords few genuine rights to the membership. In reality, the bearers of cooperative ownership include the public administration, the national and county organs of cooperatives, the territorial (local) state and party organizations, and the banks.

In the case of agricultural cooperatives the interests and intentions of the territorial (local) state administration and self-government even more obviously restrict the ownerwhip rights of the members. [32]

This is why the transformation of cooperative ownership relations and the creation of interests related to increasing property are just as necessary as in the case of the state enterprises. For this transformation the experience of the western cooperative movement are insufficient. It has to be seen that the market economy is based, in every developed capitalist country, on private property. It is in this environment that the cooperatives – following social and also socialist objectives, but adjusting to market requirements – operate with more or less success. In Hungary, where the task is to bring about market relations, it may well be that cooperatives can become successful carriers of social progress if, for the time being, they follow fewer and more modest social and socialist principles than some western cooperatives do.

For the successful transformation of cooperatives probably the same conditions are needed that were outlined as development paths for the self-managed state enterprises:

– Restriction, through informal political pressure, of the cooperative ownership rights must be substantially reduced: the legal status and tasks of agricultural cooperatives have to be separated from those of the territorial self-management organs.

– The principles of cooperative democracy have to be asserted.

– The interest of members in capital has to be increased by moderating the ratio of indivisible property and by expanding the possibilities for the alienation of cooperative shares.

– Finally, cooperatives should also be given the chance to transform their form of ownership in conformity with the law on associations, if this corresponds to the interest of the members, or if their profitability does not attain the level proposed by the organisation initiating the transformation and judged reliable by the court of law.

*Private property, small ventures*

Only in recent years has it been recognised that in Hungary the economic activity of private citizens can be part of the economy not only in some particular fields where it is now tolerated. Many know that economic development is inconceivable without a considerable private sphere. Yet we are still far from acknowledging private activities. Statistics deliberately underestimate the role of private activities, remaining tacit about the fact that in recent years this is almost the only sphere of the economy which has performed dynamically. The political leadership still frequently watches private activity with suspicion. The Constitution itself does not mention management harming the interests of the community in general terms, it only assumes such in specific connection with private property. (Constitution of the Hungarian People's Republic § 12.)

The problems are not only of an ideological nature. Citizens are truly distrustful. Many of the opportunities offered by the new forms of enterprise have remained

unutilized. Under the impact of progressive taxes and discriminatory regulations enterpreneurs also feel the need to keep their incomes secret, and thus they undertake risks to a slight extent only.

In order to resolve this contradiction there is a need for a programme which solves three interrelated tasks, and these tasks deserve individual attention: on the one hand, a significant development of small ventures is needed, and these can function successfully only as private ventures. On the other hand, it is necessary that citizens increasingly save, and invest their savings. This is inconceivable without a liberal licensing of the activity of private capital and acknowledgement of returns to private capital. Finally, these conditions should be achieved in such a way that non-licensed activities and private activities which dodge taxes are suppressed.

For these changes the first condition is to ensure that the citizens have trust in a legal order which protects private property, helps to enrich the citizens, and equitably distributes social burdens. This is guaranteeed if the economy is guided by laws debated and enacted by Parliament. The citizen must know what economic conditions, administrative restrictions, taxes – within them inheritance taxes – he has to reckon with. The law has to make sure that the private investor undertakes risk only to the extent and value of the property (e. g. money) invested, whether he enters individual or joint ventures. Furthermore, a situation should be created in which the citizen trusts that the government will not and cannot retract its promises.

A relatively rapid breakthrough in the development of private activities is conceivable. Private securities can attain a significant share in the national wealth – even in the case of the increasing demand for investment – only if we continue to manage state and cooperative property inefficiently.

## Reform of property rights and the society

The outlined reform of organization and property rights is much more than a simple transformation of indirect management and the established order of the economy. The autonomous development of the new forms of enterprise and of cooperatives, the appearance of diverse groups of shareholders, and the growing security and weight of private property in the economy, may bring about substantial changes in the development of the country and the socialist economy.

The change must not be restricted to the promulgation of one or two new laws. It also demands a through revision of the legal status of state power, of enterprises and of citizens, as laid down in the Constitution. Revision of the forms of ownership, a new formulation of the role of capital, and the opening of market channels for the flow of capital are all important steps in this direction. If this is complemented by the development of a stronger representation of the interests of employees and various groups of society than is the case today, then we may already speak about a deep social transformation. The active participation of various social strata and groups in management and in the assertion of their interests, may be a major step not only on the road

from indirect economic control towards a genuine market regulated by law, but may also involve a breakthrough towards the evolution of socialist democracy.

The difficult tasks set by social development, which can only be assessed in a historical perspective, would be simpler to solve if the country did not have to struggle with the grave burden of foreign debts. It would also be easier if the shocks involved in transforming ownership relations and management did not come at a time when the possibilities of raising living standards are not only unfavourable in both the short and medium run but, worse still, the danger of decline has to be faced.

Because of these difficulties it is difficult to win the support even of those who can genuinely be relied on in these changes: namely, those who wish to get in exchange for their creative and efficient work rising living standards and a cultured way of life. This is because the fruits of the present sacrifices will only be born over a longer period. If, however, we think of the effects of the social transformation necessary for economic revival – which will restructure the power structure in size and depth – it is unlikely that such changes would have been considered without the pressure of acute economic tensions and crisis phenomena. Without a mess there would have been no way for surveying the ways leading out of the messs, and thus there would now be no chance for asserting the social goals of market and efficiency.

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## ХОЗЯЙСТВЕННЫЕ ОРГАНИЗАЦИИ И СОБСТВЕННОСТЬ

М. ТАРДОШ

Продолжающееся целое десятилетие кризисное состояние венгерской экономики имеет двойную связь с развитием в стране отношений собственности после войны.

По сути дела полная ликвидация капиталистической частной собственности и проведенное как в городе, так и в деревне коренное вытеснение рынка и мелкотоварного производства внушало уверенность в том, что в опирающемся на господство единой государственной собственности социалистическом обществе экономика будет не только быстро развиваться, но и создаст и справедливое распределение доходов и ликвидирует отчуждение. Однако на практике новый строй не принест обещанного успеха. В последовавший за преобразованиями первый период экономика была способна развиваться только по интенсивному пути, при мобилизации дополнительной рабочей силы, резким росте накоплений и сильной степени концентрации средств. Население, несмотря на быстрый экономический рост и полную занятость, лишь в ограниченной степени рользовалось плодами этих усилий. Погоня за количественным ростом произяодства и товарный дефицит стали особенностями экономики, что ограничивало суверенитет граждан государства как производителей и потребителей.

Когда же экстенсивное развитие затормозилось, стала необходимой хозяйственная реформа. Реформа, как известно, привела к ограниченным результатам, поскольку покоящаяся на сложившихся отношениях собственности структура власти препятствовала формированию плюралистической структуры принятия решений, требуемой рынком.

В статье рассматриваются возможности соответствующих требованиям рынка плюралистических отношений собственности и связанные с этим политические изменения.

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# THE ECONOMIC EFFECTIVENESS OF THE SELF-MANAGED ENTERPRISE – A REVIEW OF THE THEORETICAL LITERATURE

M. DĄBROWSKI

In this paper the main theoretical approaches to the problem of the conomic effectiveness of self-managed enterprises are presented. The analysis concentrates on four groups of problems: the consequences of the microeconomic objective function of the self-managed firm, the efficiency of management and the problem of professional competence, the consequences of non-exclusive and non-transferable property rights, the elasticity and mobility of structuring processes. Especially the points of view of the neoclassical school and of the property rights school were taken into consideration. The author also gives his opinion on the discussed questions.

## Introduction

A self-managed enterprise is a firm which is controlled by its workers. Three variants of the self-managed enterprise exist:

1. the self-managed enterprise which is formally either the property of the state (Poland) or what is called social property (Yugoslavia); workers are not the owners;

2. the self-managed enterprise which is the collective property of its staff, although particular workers do not have individual shares (the Israeli kibbutz)

3. the self-managed enterprise which is the collective property of its staff, with individual shares belonging to particular workers (cooperatives, workers' companies).

Apart from works on the theory of cooperatives, a theory which has over one hundred years' tradition, interest in the economic behaviour of self-managed enterprises dates from 1958, when Benjamin *Ward* published his article "The firm in Illyria: market syndicalism" [1]. This article is a typical example of the application of neoclassical theory to the analysis of the micro-economic behaviour of the firm.

In the following years other economists used various methodologies and represented various attitudes as to the merits of the concept. A discussion about the rationality of the self-managed enterprise and the self-managed economy in comparison to private enterprise and the capitalist economy began. The majority of those who criticized self-management did not have any doubts as to its superiority over the traditional socialist economy. This is particulary characteristic of the property rights school. (See e. g.: [2].) By detailed comparison of different variants of the socialist economy it can be proved that self-managed enterprise is economically the most efficient and socially the

most desirable model of a non-private firm.* Unfortunately, this interesting approach rarely appears in economic literature.

Objections concerning the supposedly lower economic efficiency of self-managed firms in comparison to private firms are of a different nature. The four main groups of arguments address the following problems:

1. the consequences of a different objective function in the self-managed firm (income per capita) in comparison to the objective function of the private firm (profit rate);
2. the characteristics of collective decision-making by self-management organs and the participation of non-professionals in decision-making;
3. non-exclusive and non-transferable property rights in the self-managed enterprise;
4. insufficient flexibility and mobility of structural changes in the self-managed economy.

## Consequences of the microeconomic objective function

This trend, the earliest and the most popular of arguments in the discussion concerning the rationality of the self-managed economy, was particularly characteristic for the neoclassical school. Ward, the pioneer of this problem, assumed that employees were interested in maximizing wages and profits per capita (equal to income per capita). [4]

A similar assumption was made by Evsey D. *Domar* in his analysis of cooperative farms' behaviour. [5] Domar described the objective function of the cooperative as maximization of the dividend per labour unit, or dividend rate, with the restriction that this assumption holds true only for short-run analysis. Similar statements were made by J. E. *Meade* [6] and, with some restrictions, by S. *Parrinello* [7] and Jaroslav *Vanek* [8].

Income per worker as the objective function in a self-managed enterprise is also assumed by the majority of Yugoslavian economists. As a consequence, the whole financial system of the Yugoslav economy has been based on the category of income [9].

In Poland as well many authors consider income per worker (or net output per worker) as an economic category adequate for the self-managed enterprise or even for socialist enterprises in general. I have in mind works by Jan *Mujzel* [10], Urszula *Wojciechowska* [11], Jan *Lipinski*[12], and Stefan *Krajewski* [13].

What are the consequences of such an assumption about the objective function of the self-managed enterprise? These authors' primary concern is a tendency towards lower output. Two particular problems are predicted: 1. the different reaction of a self-managed enterprise (in comparison to a private enterprise) to price changes; and 2. a lower optimal production level with a given assets level (again in comparison to a private enterprise).

The first objection is derived from Ward's model of the "Illyrian firm", in which the firm reacts to a price change by changing its output in the opposite direction. This is the

*A more detailed analysis on this subject is contained in [3].

result of a negatively sloped supply curve. [14]* This means that in the self-managed firm a price increase will result in decreased supply, and not increased supply as in the capitalist firm. However, if the negative price flexibility of supply is higher than the negative price flexibility of demand, it will not be possible to achieve equilibrium and the economy will remain unstable.

The actual experience of Yugoslav enterprises as well as of self-managed firms and cooperatives in other countries does not confirm the above conclusion. Why is this so? Ward was inclined to explain this by the fact of state intervention, which modifies the natural goal of the Illyrian firm: [op. cit. pp. 575–576].

It seems, however, that his conclusions were affected by the excessive simplifications of his model. He analysed a case with a one-factor production function (labour), where a given worker has stable productivity, and with a firm which manufactures only one product and pays only one tax (a capital charge), functioning in a neoclassical environment (perfectly competitive market). The real environment and operating conditions of a firm are much more complex. Ward did not consider a situation in which the firm produces many products, nor did he take into consideration the danger of outside competition or the workers' interest in retaining their position.** Furthermore, this is a short-run, static analysis which does not take into account the enterprise's development [17].

Ward himself, extending his analysis and discussion from a one-factor to a two-factor production function (including material input), modifies his earlier conclusions. He admits that in this case the probability of a positively sloped supply curve is high. This depends on the share of labour in total inputs. The higher this share, the bigger the probability of a negatively sloped supply curve of a flexibility such that would result in economic instability.

Economists discussing, as Ward did, the problem of a negative reaction to price increases have tried to solve it in two ways: either by einriching Ward's simplified model with two elements which bring it closer to reality, or by questioning the assumption that income per worker would be the sole and universal objective function in a self-managed enterprise. Domar is a typical representative of the former trend. In the first part of his work on the economic behaviour of agricultural cooperatives (an ideal model of the Soviet kolkhoz in a hypothetical market environment [18]) he repeats Ward's reasoning, arriving at similar conclusions. Later on, however, he alters Ward's assumption concerning the ideal divisibility of labour inputs and the possibility of their change as a result of changes in prices or in the capital charge in order to maximize the dividend rate. In Domar's opinion the self-managed enterprise will be rather reluctant both to hire new workers and to dismiss present employees. Instead, it will react by adapting to some extent the intensity with which its members work. (Remember that Ward assumed constant labour output per worker.) Thus, supplementing Ward's "pure" model with a

*W. *Kamiński* points to the possibility of the appearance of a similar behaviour [5].

**This factor is mentioned by T. *Eger* and P. *Weise* [16].

labour supply curve, and discussing possible variants of this curve, Domar comes to the conclusion that in each case the reaction of the cooperative to a price increase will be positive.

A similar modification is introduced to the model of the Illyrian firm by Parrinello. He states that workers are reluctant to change firms and reluctant to dismiss their co-workers. They also do not want to hire new workers because these new workers could cause changes in the collective preferences in an undesirable direction. Unlike Domar, Parrinello not only enriches Ward's model, he modifies the objective function of the self-managed enterprise, introducing kinds of risk: the risk of dismissal and the risk of hiring new workers. The higher the risk factor, the more undefined is the objective function. However, the general orientation of the Illyrian firm is preserved [19].

The theme of risk connected with increased employment in the self-managed firm is developed by Eirik G. *Furubotn.* He questions the assumption of the homogeneity of interests and of individual goals of particular workers. Differences can concern such matters as risk preference, length of planning horizon, attitude towards newly hired workers, and attitude towards work discipline. He also assumes that the group of workers controlling the firm in the first period will wish to preserve their dominant position in the following periods. Therefore he rejects the hypothesis about the maximization of income per worker in favour of a hypothesis that predicts maximization of a multi-factor welfare function [20].

Vanek accepts maximization of income per worker only as a short-run staff goal. The long-run goal will be preservation of work positions, improvement of qualifications, work safety, and shortening of work-time. In the name of these goals the worker collective will spend part of its income on the development of the enterprise. This will counteract the regressive output tendencies [21].

The Yugoslav economist Branko *Horvat* modifies the theory of the Illyrian firm in still another way. On the basis of the experience of Yugoslavian enterprises Horvat introduces a new category to the model – the category of desired personal income. This is the level of income per worker which is the object of workers' aspirations at the beginning of the planning period. It consists of the level of personal income achieved in the previous year (or some other income norm) plus the expected increase in the year planned for. Thus the desired income is a function of several factors, including expected turnover, the level of personal incomes in other firms, the level of income gained in a given firm in previous years, labour productivity, the inflation rate, and tax policy. This is the obligatory goal for management, so it plays a role similar to that of the wage rate in a capitalist firm. At a given level of desired personal income a self-managed enterprise aims at maximization of surplus over the income aspirations of its staff. This is similar to the behaviour of a capitalist firm maximizing profit, so there is no problem of different behaviour of a self-managed firm in respect to decisions concerning output and employment, allocation of production factors, etc. [22].

Another objection concerning the self-managed enterprise is connected with its optimum output, expected to be lower at a given state of assets than in private firms [23].

As in the previous case, the primary reason is the different objective function and the different character of workers' payments. This payment is not, as in a private firm, a component of costs, given from outside by the labour market, but rather the income of a co-entrepreneur, and so subject to maximization. A self-managed enterprise will increase its output (and employment) to the point at which marginal income per worker will be equal to average income per worker, which means the point where the average income per worker reaches its maximum. A private enterprise is inclined to increase output further, to the point where marginal income per worker is equal to the average wage.

The shape of the income supply curve is of key importance in this analysis. The neo-classical school assumes that the income per worker function is non-linear and that it declines, from a certain point, corresponding with a U-shaped cost curve. It is doubtful, however, that this reflects the realities of the contemporary market economy. In the thirties Michal *Kalecki* was already questioning the validity of the assumption of increasing marginal costs for modern industry. He believed that this assumption was based on observation of agricultural processes. In Kalecki's opinion the marginal cost curve will remain horizontal for a considerably long period and will begin to rise rapidly when approaching the total technical exploitation of a plant's assets. So a high degree of exploitation of production capacity is not possible for other reasons [24].

Harold *Lydall* in his theoretical model of the self-managed economy [25] also considers a U-shaped cost curve as one possible variant, as well as a curve which declines to a certain point and then stabilizes, and a curve which declines infinitely. In practice, both a self-managed firm and a capitalist firm, with U-shaped cost curves, will produce less than the production level with the lowest average cost, due to physical demand constraints.

Here we arrive at the second important objection to the conclusions of neoclassical analysis: competitive imperfections in the modern market economy cause enterprises to react to demand changes mainly by adjustments of quantity and assortment rather than by price. The differences between a self-managed and a private firm at the optimum point are of little inportance, since neither of them reaches this point.

The neoclassical analysis of the optimum production problem does not take into account many other factors which can modify its conclusions considerably. These include:

1. a different share of labour input in total input; Ward himself believed that in the case of enterprises with a high degree of automation of the production process, in which labour did not constitute the main variable input in a short-run production function, optimum production is defined by the equilibrium conditions characteristic of a private firm; [26]
2. the danger of competition, which prompts a policy of production expansion;
3. the development ambition of staff and management [27].

It should also be mentioned that the state may influence the microeconomic choices of the self-managed firm. In Ward's model of the Illyrian firm capital charge plays the role of the state instrument which influences output. Increase of the capital charge results in

an increase of the optimum production level in the self-managed enterprise, while in the capitalist firm there is no such reaction [28]. In practice a similar role can be played by different rent payments and by taxation of non-labour input, which is a constant or quasi-constant.

Moving from the analysis of an enterprise with given assets to the analysis of methods of increasing production, we can see another aspect of this problem. One could expect that a given output level will be reached by a self-managed enterprise with a bigger capital input and a smaller labour input than by a private enterprise. The majority of theoreticians share this opinion [29]. There have been attempts at empirical verification of this theory in the Yugoslav economy, clouded, however, by some doubts of a methodological nature [30].

The reason for the choice of more capital-intensive and labour-saving methods of increasing production is that the level of income per worker in a self-managed firm is higher (since it contains the profit rate as well) than the wage rate in a private firm. Vanek tries to prove that in conditions of ideal competition (identical technology, free entrance into the market) Ward's Illyrian firm will reach Pareto's optimum, since factor input will be equal to the marginal productivity of the factors (as in a capitalist firm) [31]. Thus, in the long-run there is no problem of non-optimal allocation of production factors.

Lydall questions the assumption that a capitalist firm pays a constant wage independent of output. In reality the average wage has a tendency to increase when the firm's output is larger [32]. If Lydall's observation is valid, earlier conclusions would have to be changed. There would still be less difference between the behaviour of a self-managed firm in comparison to a private firm.

Some elements should be added to the above analysis: the effects of inter-branch flows (preference for capital-intensive techniques will probably result in increased demand for capital goods and, consequently, in supply and allocation effects in this sector [33]) and the effects of input taxation.

The usefulness of the neo-classical approach to the analysis of the modern economy has often been questioned, notably in János *Kornai*'s work "Anti-equilibrium" [34]. In the case of the self-managed economy [35] these reservations concern too idealistic assumptions, including those about ideal competition, the shape of cost, income and demand curves, homogeneity of product, limited number of production factors, homogeneity, ideal divisibility, and elasticity of labour, spending all economic surplus on personal income, and full transparency of the market. The enterprise is analysed separately, without any connection to other economic actors, without taking outside competition into consideration. Simple summing of the individual behaviours of model enterprises, without accounting for their mutual connections, for interbranch flows, for competition, etc., and on this basis drawing conclusions about the functioning of the self-managed economy is too simplified a methodology to sustain confrontation with practice. Furthermore, neoclassical analysis has a static character and is based on the

assumption of the maximizing behaviour and hedonistic motivation of economic actors. It does not take into account the achievements of modern psychology, sociology, nor organization and management, such as the theory of limited rationality [36].

## The efficiency of management and the problem of professional competence

There are many possible objections to the method of collective decision-making, including the long time necessary for taking a decision, the necessity of frequent compromises [37], the possibility of conflicts, and participation in decision-making by people without sufficient professional knowledge [38]. Consequently, self-managed or participation enterprises are expected to have lower abilities to react to changes in the environment [39].

However, empirical research concerning workers' participation in management in the Federal Republic of Germany (with all the restrictions stemming from differences between self-management and participation) have proved the contrary – the higher the level of workers' participation in managing the enterprise, the more efficient the decisions taken. [40] Nor does the super-democratic decision-making method of the Israeli kibbutz have a negative influence on efficient functioning [41].

Why such a big discrepancy between expectations and reality? The main reason lies in the myth of one-man management in other types of enterprises. One-man management can only function in relatively small economic units, where the manager has full information about the firm and, at the same time, has full decision-making competence both in current and in strategic problems. These conditions only hold for a small private firm managed directly by the owner, in which there is no trade union.

In other cases, for strategic decisions the director of the firm has to get the approval of the owner, the general shareholders' meeting (or the supervisory board), or the state administrative organs (in the case of the state enterprise). In addition, he must consider the interest of the staff as a whole and of particular groups in it, as well as the opinions of lower and middle management, if he does not want to have conflicts inside the firm. Participation and, even more strongly, self-management create the necessity of cooperation: already in the early stages of decision-making variants which will be accepted by the workers are chosen. All efforts in the decision-making process are concentrated on finding a variant that can be accepted by all the interested parties, rather than on carrying through an arbitrary resolution.

The real advantage of a self-managed model, as opposed to other types of enterprises, is cancellation of the employer-employee dichotomy. The workers are, at least formally, co-entrepreneurs. The conditions for avoiding employer-employee conflicts and for reducing supervisory costs have arisen [42].

The objection regarding the professional incompetence of the members of the self-management organ is relatively easy to confute. First, it omits the division of

enterprise decisions into strategic and current. The latter are not the subject of collective voting in any real self-managed firm, not even in the Israeli kibbutz. Only strategic decisions are made by the staff or its organs. Here there is a certain analogy to shareholders in a joint-stock company, who do not need to be professionals and who do not know the company from the inside. Nevertheless, they can take good care of their interests, which are strictly connected with the firm's prosperity. Second, one must take into account the growing level of education of contemporary staffs, not only the technical and economic specialists, but also the physical (manual) workers. Third, the strategic management abilities of a firm can be enhanced by the practice of performing self-management functions. This has been proved by the experiences of labour-management organs in Yugoslavia and Poland, or by the system of management rotation in Israeli kibbutzes [43]. Fourth, there is always the possibility of using the professional expertise of experts or of consultative bodies, both inside and outside the enterprise.

## Consequences of non-exclusive and non-transferable property rights

At the turn of the sixties and the seventies the problem of economic efficiency of the self-managed firm was also studied by the property rights school. (See works by S. *Pejovich,* Furubotn, and later works by H. G. *Nutzinger,* H. *Leipold,* T. Eger and P. Weise, and others.) The main field of interest of this group of economists is the behaviour of self-managed firms in the process of income distribution and innovation and development behaviour. I will concentrate on the first problem.

Svetozar Pejovich begins with the limited property rights of a self-managed firm of the Yugoslavian type [44]. The workers have the right to use the firm's capital, but this is limited to the period of their employment in the enterprise. Discussing the distribution of economic surplus, they have the following alternative solutions:

1. Increasing the firm's capital, which means investment in the non-owned assets. Here profit is limited to the possibility of participation in the increased future income, up to the time of leaving the firm. Once means are invested, workers cannot withdraw them and allocate them outside the enterprise.

2. Investing in private capital (owned assets), e.g. in individual savings deposits, purchase of bonds or shares, or establishing a private enterprise. In this case, in the future the worker will be able to count upon not only increased outcome (without the restrictions connected with a possible change of employment) but also on the possibility of full control of the invested capital.

In view of the above the worker is faced with the following alternative methods of increasing his own capital: either by a rent received during a given period (without return of the capital) or by a savings deposit. If both variants are to be equally attractive, the rent must be higher than the rate of interest on the savings deposit. At an interest rate of 5 percent the equivalent rent must be 23 percent for a five-year period, 19 percent for a

six-year period, 13 percent for a ten-year period, 9 percent for a fifteen-year period, etc. The longer the period the smaller discrepancy between the two values.

The above model has certain micro- and macroeconomic consequences. The second investment variant will be more attractive to workers. They will aim at increasing individual earnings to be able to finance not only their current consumption but also their individual accumulation. At the same time they will limit the accumulation of the enterprise. This will result in the stagnation of the self-managed enterprise and in the rapid development of the private sector and, consequently, in the gradual elimination of self-managed enterprises from the economy.

In the opinion of the property rights school some remedy to this may be provided by outside credits. Eger and Weise [45] cite Vanek's opinion that outside financing can resolve the investment problems of self-managed enterprises. In their own opinions they are more cautious. They consider that outside financing makes it possible to increase employees' future consumption without limiting present consumption. Furthermore, outside financing mitigates conflicts between the old staff and new employees, since the latter not only profit by the effects of investment, but also participate in its repayment. The credit cost counteracts the decrease in output (since it is not part of fixed costs).

Eger and Weise discuss various suggestions concerning stimuli for accumulation of enterprise capital, including periodic participation of workers in profits from investments (this to include workers who have left the enterprise). In the second type of a self-managed enterprise (group ownership without individual shares) the problem of choice, as discussed by Pejovich, is still real. It disappears in the third type (cooperative or workers' company). However, there are other problems here, such as the current evaluation of workers' shares and the method of transferring shares to the next generation of workers.

It appears, however, that the character of property rights is not the only factor determining the workers' attitude towards the distribution of surplus. Several other conditions, both inside and outside the firm, must be considered. The most important of these are:

1. the social structure and stability of the staff;
2. the enterprise's ability to accumulate and develop (e.g. the possibility of unrestricted diversification of product structure, the freedom to choose the directions of the firm's development, chances of attractive allocation of free capital outside the enterprise);
3. the functioning of the market (e.g. the level of competition);
4. the state of economic equilibrium (e.g. equilibrium of the labour market, the level of inflation);
5. the direction and stability of the state's economic policy;
6. state instruments for influencing the firm's activity;
7. social and political conditions.

The property rights school made an effort at breaking some of the restrictions and simplifications of the neoclassical school. Their approach is more dynamic than that of

Ward, Domar, and Vanek, and at the same time it addresses much more important problems. These authors also analyse only the individual enterprise, but do not take into consideration several important conditions and motivations of economic behaviour. Thus they continue the "maximizing" philosophy.

## The elasticity and mobility of structural changes

Attempts at a macrosystem approach to the self-managed economy are relatively new. The widely known "General theory of labour-managed market economies", published by Vanek in 1970, can be considered the first work in this trend. Unfortunately, Vanek's model of the self-managed economy to a great extent has a postulative, unrealistic, and static character. Similar objections can also be made to the postulative models of the self-managed economy worked out by representatives of the so-called third road, e.g. Ota *Sik* [46] and Radoslav *Selucky* [47]. Nevertheless, these models were an important contribution to the recognition of important structural barriers and imperfections of market mechanisms in an economy where self-managed enterprises prevail.

Macrosystem problems were also studied by some theoreticians who represent an approach similar to that of the property rights school, including Leipold, and Eger and Weise. In recent years there are more works on this subject, representing different ideologies and methodologies.

The analysis of the economy dominated by self-managed enterprises may concern various problems: the functioning of market mechanisms (in the products, labour, and capital markets), structural changes, coexistence with other types of enterprises, and state policy towards self-managed enterprises. In this paper I will limit myself to the problem of the dynamics and elasticity of structural changes, and to the possibility of a functioning capital market in the self-managed economy.

New firms play an important part in the activation of competition. They also counteract monopolisation and promote technical progress [48] and optimal allocation of labour. Therefore, the ability to create new economic units is one of the main criteria of system efficiency.

The greatest freedom in this field is found in the contemporary capitalist economy. Different forms of private firms, companies, and cooperatives may be created. State organs; territorial self-governing organs, other organizations and public institutions also have the right to establish enterprises. This freedom results from the liberal system of property rights [49].

The elasticity of structural changes in the self-managed economy depends on the form of ownership. In the first variant of the self-managed enterprise (the Yugoslav type) only a state organ (central or local) can establish an enterprise. Individual persons will not be interested in establishing self-managed enterprises, which are state (social) property, or at most their interest will be very limited (depending on the possibility of forming private firms). In general, it seems that state organs can in no case replace the spontaneous

creative initiative of economic actors interested in profits, and this includes taking the economic responsibility for the decision to establish an enterprise.

The barriers discussed above can be overcome (at least to a certain extent) in the second and third type of ownership, where spontaneous creative initiative resulting in profits to individual persons is possible. However, it is difficult to determine whether or not in the liberal system of property rights the individual persons would not be more interested in establishing family firms or typical capitalist companies than in cooperatives or workers' companies. For some persons lack of capital would be a barrier in creating a self-managed firm. Some kind of assistance in the form of a credit from a state agency or from a bank would be necessary in order to collect the initial capital [50].

The establishment of new enterprises by the self-managed firm itself is also possible (independent of the ownership variant). However, the "derived" enterprise becomes a kind of "vassal" for the establishing firm, and therefore cannot keep the status of a self-managed enterprise. Its staff can only partially participate in management.

The establishment of new enterprises is closely linked to the functioning of the capital market, i.e. to a mechanism of horizontal flow of economic surplus from the place of its creation to the place where it will be most effectively used in the development process. [51] In the self-managed economy the following forms of market capital flow are possible:

1. interbranch flow of capital within the frameworks of already existing enterprises (free diversification of production);
2. bank deposits and credits;
3. mutual crediting among enterprises (in the form of commercial credit, joint ventures, or bonds);
4. formation of "derived" enterprises (i.e. companies established by self-managed enterprises);
5. limited stock-market for self-managed firms (bonds, promissory notes, shares in "derived" enterprises, etc.).

The question of participation of physical persons and other subjects (non-self-managed enterprises, banks, etc.) in the stock market remains open. There seems to be no obstacle to the free participation of all economic actors in credit transactions (bank deposits, mutual crediting, and the turnover (circulation) of credit papers).

The problem becomes more complicated with regard to shares turnover. Free turnover of shares in "derived" enterprises seems possible. However, the ownership of self-managed enterprises in the first and second variants could not be the subject of market transactions due to its indivisibility (in both variants) and due to its state or quasi-state character (in the first variant).

In the workers' company (the third variant) workers' shares could theoretically be the subject of market transactions, but a decision on purchase or sale of a share would be the same as a decision on accepting employment or leaving the firm. It is difficult to imagine a situation where the purchase of a share, i.e. the hiring of a new worker, could be accomplished without the acceptance of the firm's self-management organs. Therefore,

there is no possibility of anonymous shares or of a stock market in the form in which it functions in the modern capitalist economy.

The problem of the valuation of workers' shares arises. This can be either market or nominal valuation. In the case of an efficient firm the market value could be so high that it might constitute a real barrier for new employees. [52] The basic entrance criterion would become the financial standing of the potential worker and not his qualifications, abilities, or expected efficiency.

Use of a nominal valuation (especially in the case of a low one) decreases the financial barrier to entering the firm. It does not, however, even with applied inflation revaluation, account for the results of earlier decisions concerning accumulation, development, innovations, market position, and firm performance. The share, then, does not play the role of an institution "enfranchising" the worker, it does not counteract consumption tendencies, nor does it stimulate investment in firm property (unless these investments are financed by the emission of new shares). It becomes a kind of security deposit, which the worker can lose if the firm goes bankrupt. At the same time the financial importance of the share decreases gradually with the growth of the indivisible funds of the firm.

The above analysis suggests three conclusions:

1. The self-managed firm described by the third ownership variant (workers' companies) cannot be the only form of enterprise in the national economy due to the financial barriers of entering such a firm.

2. The credit market can function in the self-managed economy to a similar extent and in similar forms as in the capitalist economy.

3. The market for property shares can function in the self-managed economy to a considerably lesser extent than in the capitalist economy.

What are the consequences of the third conclusion for the self-managed economy? The share market in the capitalist economy has three important functions:

1. It enables a free flow of capital to the place where it can be used most effectively.

2. It enables market valuation of the expected effects of present economic decisions of the company.

3. It is an indirect mechanism of shareholders' control of the efficiency of the managers' work. [53]

The first function could be performed in the self-managed economy by the credit market, by interbranch flow of capital inside the enterprise, and by those forms of stock market which are not in conflict with the self-managed model of the firm. A similar hypothesis can be applied to the second function. It appears that the credit market could constitute a sufficient valuation and control mechanism for the self-managed firm. However, we do not have enough empirical experiences to draw final conclusions. The function of controlling the managers can be realized in another way – by direct observation of their daily work. This method of control is not possible for shareholders of a capitalist company not employed in the firm.

## Conclusions

I have already indicated my reservations concerning the practical importance of problems discussed by the representatives of the neoclassical school and concerning the methodology of this approach. I have also shown that it is relatively easy to eliminate doubts concerning the efficiency of collective decision-making by the supposedly professionally incompetent employees.

In my opinion the problems addressed by the property rights school and the representatives of the macrosystem approach are of much greater importance, especially in such questions as income distribution, the intensity of different kinds of competition, the elasticity and mobility of structural changes, and the role of state regulatory policy. These problems should be studied further.

Until now there have been no definitive arguments for the inferior efficiency of the self-managed economy. Theoretically, there still is a chance that self-managed firms can function as efficiently as private firms, given an appropriate state regulatory policy. Certain positive practical experience (i.e. the Israeli kibbutz, the Mondragon cooperative system in Spain, and various workers' companies in Western countries) seem to affirm the value of further studies.

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## ЭКОНОМИЧЕСКАЯ ЭФФЕКТИВНОСТЬ САМОУПРАВЛЕНЧЕСКОГО ПРЕДПРИЯТИЯ ТЕОРЕТИЧЕСКИЙ ПОДХОД В ЭКОНОМИЧЕСКОЙ ЛИТЕРАТУРЕ

М. ДОМБРОВСКИЙ

В статье представлены основные теоретические направления в области исследований экономической эффективности самоуправленческого предприятия. В частности, рассмотрены взгляды представителей неоклассического подхода (Б. Уорд, Э. Д. Домар, Я. Ванек, Б. Хорват и другие), а также представителей «школы прав собственности» (С. Пеёвич, Э. Г. Фуруботн и др.). Наряду с теоретическими позициями статья содержит также собственные комментарии и оценки автора.

Существуют три варианта самоуправленческого предприятия:

1) предприятие, являющееся государственной собственностью (пример Польши) или общественной собственностью (Югославия).

2) предприятие, являющееся групповой собственностью трудового коллектива, но без индивидуальных взносов рабочих (пример израильских кибуцов);

3) предприятие, являющееся групповой собственностью трудового коллектива, с индивидуальными взносами рабочих (кооперативы с тождественностью членства и занятости, акционерные общества рабочих).

Автор принимает во внимание все эти варианты самоуправленческих предприятий. Дискуссия сосредотачивается на четырёх группах вопросов:

1) последствиях функции цели самоуправленческого предприятия (доход на одного занятого) в сравнении с функцией цели частного предприятия (норма прибыли);

2) характеристике коллективного порядка принятия решений самоуправленческими органами и участия непрофессионалов в управлении предприятием;

3) последствиях неполных прав собственности рабочих в самоуправленческом предприятии;

4) недостаточной гибкости и свободы структурных процессов (в том числе создания новых предприятий).

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# THESES ON THE CRISIS OF ETHICS AND THE ECONOMIC CRISIS

A. HEGEDŰS

Significant groups of people frequently act contrary to their interests instead of in conformity with them. For understanding such situations it is useful to include the analysis of ethics. In modern societies – thus also in those of the Central–Eastern-European type – conflicting or, at least in essential features, greatly differing ethics live side by side.

The power élite refers to the ethics of socialist egalitarianism as a tradition. Later a new kind of inequality and with this a hierarchy began to develop. For its ordering principle there served a system of bureaucracy and of privileges granted to a group of intellectuals important from the viewpoint of politics. This socialist bureaucratic ethics has been pushed into crisis by the economic crisis of the last decade, in the meantime, protestant ethics continues to exist in socialist societies.

It is the ethics of socialist humanism that transcends the capitalist (protestant) and the bureaucratic socialist ethics – the tragic hedonistic ethics is a retreat and not transcending. The substance of the new ethics is that, after the creation of material existence, people spend their energy on self-accomplishment, learning and the enrichment of human relations. In the present-day Hungarian society the development of a humanistic socialist ethics can be observed in marginal groups.

> "Research has always been aimed at discovering which mode of ownership brings about the best citizens." (K. Marx: The precapitalist forms of ownership.)*

Economic "interest" has long been seen as a subject of mystification in Hungarian economics. Books and articles treating widely different subjects portray interest as the "motive of all practical activity, work included", and as the "ordering principle of the satisfaction of needs". The analysis of interest relations is considered by many as a most important task, not only of economics, but of sociology as well. (See, for example, the investigations carried out by Lajos *Héthy* and Csaba *Makó* at the Rába Factory of Győr in the early 1970s.) [2]

It cannot be said that the pedestalling of interest is a product of retrograde thinking, since it was made into a "watchword" exactly by those proreform economists who wanted to oppose certain conservative views. These views held that in socialist society the striving after common objectives will gradually become the primary motivation of conscious activity.

*Based on the Hungarian edition [1].

## The deadend of interest orientation

It seems we can choose between no more than two different approaches: the motivation of economic activity is

– either a relatively independent, particular interest,

– or the common objective or "social ideal" formulated in various documents.

If, in fact, only these two different approaches existed, the first one should be opted for, since it is nearer reality.

However, on a closer examination of that "relatively independent" particular interest, and of the economic activity it is supposed to motivate, it comes as something of a surprise to find so many groups of society not acting according to their interests, i.e. not acting according to what we assume their interests to be. Often people behave expressly in a way contrary to them. This is not only because they do not know the system of relations in which their "interests" or "interest relations" are comprised (which is, of course, often the case), but first of all because they do not acknowledge their interests to be those that we assume them to be.

In any case – its ties with the reformist thinking notwithstanding – the stress laid upon interest in Marxist social science reasoning implies a few important orthodox elements, inasmuch as it supports:

– the stand taken on the indisputable primacy of economy, which may today be looked upon as outworn,

– and also the assumption that social events take place, at least in the final account, in conformity with objective laws similar to the laws of nature – as it was so rigidly put by *Engels.*

## Ethos as a connecting link

The medium of social awareness, in which interest is shaped in the thought of the different groups of society, can be best described by the concept of ethos. This is a specific composition of elements of awareness belonging to a given milieu (Durkheim), such as

– ethic disposition

– aesthetic quality fitted into the mode of life

– views about the correct way of living.

In modern societies, directly opposed or at least essentially different types of ethos may coexist, whereas in archaic societies ethos was different among different types of communities, and this was generally accepted. In this respect, the socialist or, more exactly, the Eastern European type of societies follow the "modern" example, even though official ideology proclaims the prevalence of an artificially fabricated "socialist ethos" – or at least its necessity.

Although the development of the various types of ethos is usually tied to the

emergence of certain classes or groups of society, their influence does not remain within those bounds, but goes so far beyond them that it renders their class character doubtful. This phenomenon is especially conspicuous in the socialist states of Central-Eastern Europe, in which the historically developed class structure was forcefully destroyed within a relatively short period, and a new structure has only recently begun to emerge. (The term Central-Eastern Europe, which historians now use with increasing frequency, is meant here to cover those of the socialist countries which have traditional ties with Central Europe and thereby with the West, i.e. beside Hungary also Czechoslovakia, Poland, and the GDR).

## Ethos and economy

Although the development of the different types of ethos are not simply attributable to economic conditions (since on identical levels of economic development different types of ethos may emerge, depending on the given milieu, e.g. geographical conditions, religious and cultural traditions) the mode and level of development of a given economy are among the determinant (challenging) factors of all kinds of ethos, diverse as they may be. The decisive factors are, however, the forms of ownership and the related chances of sharing in these. These may be manifold, even on the same economic level, and may depend on a number of other factors. This is the domain which most directly shapes ethos: the emergence of new ones and the failure of old ones.

At the same time, the quality of the economic activity of the different social groups is largely determined by the ethos prevailing among their members. Economic and interest relations as given social conditions, get their specific interpretation within the realm of ethos and it is also there that the motives of the different economic activities develop.

It follows that whoever wants to understand economic activity and the motives of production (services) and consumption must reveal and consider the formation and effect-mechanisms of the most important types of ethos established in society.

In this article I shall make a first and, of course, very modest attempt at this.

## From socialist egalitarianism to the socialist-type bureaucratic ethos

In today's socialist societies – i.e. those of the Eastern European type – the power-holding élite refers to the ethos of socialist egalitarianism as a tradition, which for most of them is a historical reality or perhaps a family tradition.

Reference to the past is not without a historical basis. From the mid-19th century, a new ethos emerged: socialist egalitarianism spread among those intellectuals who sympathized with workers, peasants and, in general, the suppressed elements of the Eastern European states. In the emergence of this ethos the following elements played significant roles:

– the flagrant contradictions of early capitalism
– socialist Utopian theories
– Marxist and anarchist ideas.

The adherents to this ethos were gradually divided in the 20th century by politics: a life-and-death struggle began between socialists and communists, and intellectuals were driven to a marginal position. All this, however, took place in the political field, whereas ethos, as an undercurrent deep below the wind-tossed waves of the surface, was to remain unchanged for quite a time.

From the large mass of the adherents to the egalitarian ethos certain groups broke away around the turn of the century; they confessed "new beliefs", or at least new life-principles, but they were never quite separated from their original roots and kept referring to them, regardless of whether they were

– communist militants,
– trade union officials,
– or professional social democrat politicians.

Proclaiming the continuity of values, they used political arguments in trying to win over those devoted to the old faith.

This was the situation that radically changed when the Eastern European type of socialism came into being. Although in the beginning it seemed that the ethos of socialist egalitarianism might conquer the whole society: a series of forceful measures were taken seemingly to implement those principles (confiscation of property, nationalizations, equalization of incomes, etc.). After a time, however, these processes stopped and a new kind of unequal hiearchy began to develop. The underlying principle of this hierarchy was provided by the bureaucratic relations of sub- and superordination as well as a system of privileges granted to certain – politically important – groups of intellectuals.

The fanatics of the socialist egalitarian ethos

– either joined the newly established power and institutional system and became the subjects or objects of a new ethos: the socialist kind of bureaucratic ethos, which justified the newly developed relations of inequality,
– or they kept their "old faith" and were driven to a marginal position, from where they bitterly criticized the system which they had so enthusiastically helped to create.

The literature of the bureaucratic ethos grew constantly and, frequent confusions and necessary inconsistencies between different approaches notwithstanding, the sub-culture that developed in the various bureaucratic institutions, and the behaviour norms of the participants, are quite realistically described and reflected in it. After all, a system of values can be made out which predominates in this sphere in respect of valuations and of beliefs concerning social reality.

At a general level, the bureaucratic ethos and its underlying system of values can be taken as a category valid for the bureaucratic institutions of societies passing through different historical periods: the Asian mode of production, feudal absolutism, modern industrial societies, etc. Besides, the specific bureaucratic ethos of each mode of production (socio-economic formations) can be operated as specific concepts. Thus can

be interpreted the specific traits of the ethos of socialist bureaucracy. These distinguish this sphere of phenomena from the situation and system of values of the administrative and economic bureaucracy of the modern capitalist industrial societies, which fulfil a historical function very similar to the former.

– The former represents power in a monolithic position, in which bureaucrats control bureaucrats; thus, bureaucratic power may attain a ruling position. Thus, for example, it can easily make its own particular interest seem general, and pose as the servant of society. The latter functions within the framework of a pluralistic power and institutional system and its particular interests are not hidden from society.

– The former is permeated by Marxism–Leninism (as the dominant ideology) reformulated in the Stalinist spirit. This provides the ideological background of the bureaucratic ethos. Also, it accounts in no small part for the conservatism of socialist bureaucracy, which is by no means characteristic of the similarly bureaucratic economic management of the West. In the latter, namely, ideology is also pluralistic.

– The activity of the former has no efficient control mechanism, whereas the latter is subject to relatively strong control. (Economic bureaucracy is under the control of the market, shareholders and trade unions; administrative bureaucracy is under political control deriving from parliamentarism; both bureaucracies are exposed to relatively wide publicity.)

It is ascribable to these differences that, as regards efficiency, the socialist economic bureaucracy (here, the reference is directed primarily towards managers of large enterprises) remains behind its Western counterpart.

In the present new reform period in Hungary, when small and medium enterprises flourish and a great number of large enterprises find themselves in a desperate situation, Marx's statement – formulated in quite different conditions – comes to mind: "life begins where bureaucracy ends". It may seem an exaggeration, yet it is largely true that the economic crisis has also plunged the socialist bureaucratic ethos into a crisis; along with this also the principle which served to justify the new inequality structure. This said that income must be distributed in accordance with the extent of the responsibility borne by individuals taking different positions in the hierarchic order. The greater responsibility assumed to be borne at the top levels of the hierarchy is usually non-existent under the given circumstances – on the contrary, it turns into general irresponsibility.

## Survival of the Protestant ethos in the socialist societies

This ethos is, fortunately, present in Hungarian society. It may be criticized, of course, on the basis of the socialist values. However, its essentially valuable contribution to society is undeniable. Yet the Protestant ethos is thwarted in its fulfilment by the narrow space allowed for bourgeois private property. Even if talent and industry combine, there is still no competition. This is because a monopolistic situation has

established itself as a consequence of the shortage economy, and thus difficulties are soon encountered by this particular ethos.

In spite of the obstacles regarded as quasi-natural in a socialist society, the new phase of the Hungarian reform may enlarge the sphere of those who can live only under the rules of this ethos.

## The tragic-hedonistic ethos

I use the term tragic-hedonistic instead of hedonistic in order to make a sharp difference between this ethos – rapidly spreading nowadays – and its classic precedent.

Athens' hedonists and their Roman followers freely chose "carpe diem" for their life-principle. Their choice was enabled by their financial and family background, as well as the order of the society into which they were born.

In today's Hungarian society and, in general, in Eastern European society, hedonism is a foreign body:

– Momentary individual success, or perhaps just illusory success, are behind the choice of such a way of life and ethos; however, in this ethos all stability is missing, with even its outer appearance doubtful. Those opting for such a life – as well as their admirers – know that their fall is inevitable.

– In the relatively poor Hungarian society, tragic hedonism is not always coupled with an excessive waste of material goods, but remains content with *consuming "surrogates"*. In the meantime, however, the specifically human capacities of the individual become exhausted.

– Hedonism is today more self-destructive than it was in antiquity; first of all because it is coupled with such a chase for money that it often kills energies and destroys even the most coherent personality structures. As this ethos spreads, an important role is played by the threat of nuclear war. It increasingly becomes "easy death" for everyone, yet with the essential difference that the "young" are able and want to grasp the moment.

## Renaissance of the humane ethos: precondition of a successful reform

Socialist humanism is not an ethos without historical precedents. Its precedents include all the humanist efforts which have tried to employ human energies to serve humanity against those forces which have attempted to justify, by their system of values or beliefs, the most barbarous acts. Such acts have included levels of bestiality, which have besmirched the highest of ideals – in fact nothing can justify such behaviour.

It was humanism that lifted Christianity from its mediaeval barbarism and bestiality; socialist humanism ought to fulfil a similar task today: it ought to help Eastern European

societies move away from the ghostly phenomenon of Stalinism, which even now haunts the socialist countries in which Stalinism no longer exists.

The humanist socialist ethos in fact goes beyond the alternative of the capitalist (Protestant) ethic and the socialist bureaucratic (humanist) ethos, which can be practically as well as theoretically contrasted. (The tragic-hedonistic ethos is a retreat, not an advance.)

The most significant motives of that ethos are the following:

– The creation of the financial basis of the independence of the individual and his family (the Hungarian reforms were intended to increase the extent of this possibility). This is the positive function of accumulating property;

– After providing for physical existence, all energy must be spent on self-accomplishment. The work which people do should be in accordance with their particular abilities.

– When the individual has settled down, his leisure must be made veritable leisure.

– As much as possible must be learned from the vast cultural treasure-trove of humanity.

– Last but not least, human relations must be enriched.

In today's Hungarian society, the emergence of the humanist socialist ethos is clearly seen in various groups of society, such as

– in the independent club movement (including peace clubs),

– in the production partnerships in which *subordination relationships* do not exist,

– in various groups of political opposition.

The emergence of a "second culture" during the 1970s offered perspectives for making such changes in Hungary. In a labyrinth of ethoses, there appeared the chance of forming a kind of humanist ethos and, with it, an appropriate mode of life. However, hopelessness often overcomes these groups and pessimism triumphs over the spirit of struggle for the better.

## The crisis of ethos and its role among the national diseases of Hungary

It follows from the preceding – if they can be verified by relevant sociological investigations (of which my knowledge of the subject makes me sure) – that the well-known national diseases of Hungary have their roots in that the two traditional ethoses – socialist egalitarianism and the socialist version of the "Protestant ethic" – in one way or another, are in a deadlock. The tragic-hedonist ethos, intended as a compensation for these, simply exhausts the creative energies of society; while the humanist socialist ethos is still limited to a narrow sphere and is unable to counterbalance the destructive effect on society of the crisis of the two traditional types of ethos.

I see the symptoms of ethical crisis in Hungarian society first of all in the following:

– A morale has established itself in which it is ethical as well as natural to waste, – in widely different manners and valueless for the individual –, "official working hours".

These make up a large part of an individual's daily time. Investigations ("snapshots") carried out in different periods, especially those in the 1960s, revealed shocking figures. In major sectors, less than half of the "official" worktime was spent in useful activity, and the situation has worsened since.

– Corruption is accepted in ever wider circles, and not just as a "forgivable sin", but as the necessary concomitant of any economic activity. Under the circumstances of a shortage economy, this is practically a rational deed, since the economy would not be able to function without it. At the same time, however, its destructive effect in the moral field is immeasurable, since corruption resorted to for the sake of production and that motivated only by private interest cannot be separated.

– Suicide has become a widespread disease. In the last fifteen years, its rate has doubled: the figure of 25 "successful" suicides per 100 000 inhabitants has risen to 50. The causes have been extensively, yet often fruitlessly, debated. In the course of the debates, two basically conflicting positions have crystallized:

– The system is responsible. This is because contradictions have developed which are unbearable for people and they sentence themselves to death in one way or another;

– The system is not responsible: the Hungarian rate of suicide has always been high on the global scale. The phenomenon is more like an intensified continuation of a well-recognised trend.

Under the crossfire of the system-critical and the apologetic stands, the real explanation is to be found – in my opinion – in the crisis of the ethos, and in the hedonistic ethos. Since the rapid spread of the latter has not yet been analyzed, the fight againts suicide also remains at the level of superficial individual therapies.

This is, of course, not to say that suicides are mostly committed by followers of the hedonistic ethos – much rather that they contribute to the development of the suicidal situation of others.

* * *

Even in possession of the mass communication media, the political power is powerless when it comes to developing ethos. If that were not so, there would be no need to talk of a crisis of ethos.

Indirectly, however, political power can exert a strong influence on this sphere. It can do this primarily by means of reform which change the forms of ownership and create favourable conditions for the development and assertion of the humanist socialist ethos on a large scale.

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# ТЕЗИСЫ О КРИЗИСЕ ЭТОСА И ЭКОНОМИЧЕСКОМ КРИЗИСЕ

А. ХЕГЕДЮШ

В венгерской экономической науке общепринята мистификация экономических интересов. Однако многие группы людей часто действуют не «в соответствии со своими интересами», а вопреки им. Чтобы понять подобную ситуацию, полезно привлечь анализ той среды общественного сознания, в которой в мышлении различных общественных групп складываются интересы. Эта среда — сплав связанных с определенной группой элементов сознания — этос. Сюда относятся этические взгляды, входящая в образ жизни эстетика, приверженность определенным сознательным или традиционным ценностям, взгляды в связи с правильным жизненным порядком.

В современных — и в частности и в обществах средне-восточноевропейского типа — существуют рядом противоположные друг другу или по крайней мере отличающиеся друг от друга весьма существенными чертами этосы.

В современных восточноевропейских обществах стоящая у власти элита ссылается в качестве традиции на этос эгалитарности. Когда сложился социализм восточноевропейского типа, вначале казалось, что эгалитарный социалистический этос поведет за собой все общество. Однако эти процессы через некоторое время остановились. Началось формирование нового типа неравенства, а с ним и иерархии. Упорядочивающим принципом этого служила система привилегий, предоставленных бюрократии и важному с политической точки зрения слою интеллигенции. (Бюрократический этос — категория, пригодная для анализа обществ различных эпох, но как специфическое понятие может быть использовано и для специфически характерных особенностей этоса социалистической бюрократии). Экономический кризис последнего десятилетия привел к кризису и этос социалистической бюрократии и одновременно и принцип, служащий для оправдания новой структуры неравенства, в соответствии с которым доходы должны распределяться в зависимости от разной степени ответственности, лежащей на каждом отдельном человеке в иерархической системе.

В то же время в социалистических обществах продолжает существовать и протестантский этос. Однако значительным препятствием его распространению является то, что в этих обществах почти нет возможности для образования гражданской частной собственности. Также существует и быстро распространяется и трагико-гедонистский этос. Этот гедонизм, по мнению А. Хегедюша, является инородным телом в общественной жизни современного венгерского общества и имеет к тому же самоуничтожающее воздействие, так как погоня за заработками требует таких усилий, которые губят даже самые сильные личности.

Этос социаличестого гуманицма, который преодолевает капиталистический (протестантский) и социалистический бюрократический этосы, — отодвигание, а не преодоление трагико-гедонистского этоса. Суть нового этоса — то, что после достижения материальной эгзистенции люди будут затрачивать свою энергию не самовыражение, учебу и обогащение человеческих отношений. В современном венгерском обществе формирование гуманистического социалистического этоса наблюдается только в маргинальных группах, например в независимом клубном движении, в исключающих отношения подчиненности производственных обьединениях, в различных группах политической оппозиции и в институтах второй культуры.

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# HUNGARY'S EXPORTS TO THE OECD: A CONSTANT MARKET SHARES ANALYSIS

H. W. HOEN–H.-J. WAGENER

The article investigates the effect of Hungarian reform measures on the country's export performance on OECD markets. Hungarian trade behaviour is compared to the behaviour of the other European CMEA countries which embarked upon reform less decidedly or later. Measure of performance is the change in market share which with computational methods of constant market share analysis can be ascribed to structural and competitive effects. Not wholly unexpectedly, the analysis yields two major results. CMEA countries suffered severe market share losses on OECD markets during the last two decennia with Hungary doing only slightly better than the average. Weak performance can be ascribed mainly to negative competition effects, i.e. a low adaptive capacity to changing world market conditions.

## 1. Introduction

During the first two decades after World War II Hungarian foreign trade was characterized by national self-sufficiency and an orientation towards the socialist market – as was the case in other CMEA countries. The economic systems of these countries were coordinated by instruments fundamentally different from the regulated markets of western economies. Thus the particular economic mechanism of the CMEA countries helped to seclude them from the international division of labour.

In the second half on the 60's it became clear that the inward orientation of economic policy was proving to be a drag for economic development in the long run. Intensification of economic growth makes necessary to intensify the international division of labour as well yet. The administrative decision and coordination mechanism in the CMEA was unable to provide instruments suitable for reintegration into the world market which, in principle, is guided by market forces. This resulted in the objective necessity for reforms of the economic mechanism (see among others *Inotai* [4], *Csaba* [3], *Köves* [6], *Bíró* [1].)

Hungary was the first country within the CMEA to deliberately translate this necessity into a reform programme which was clearly inspired by the requirements of the international division of labour. A major element of the new economic mechanism inaugurated in 1968 was a new foreign trade system. Since then it has been subject to several ups and downs. The intention was to intensify hard currency trade, although this is not identical with East-West trade. However, the concomitantly revised foreign trade strategy of Hungary saw in the western market an important target area.

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Twenty years after the first reform steps of 1968 it may be appropriate to investigate the effects of the measures taken upon foreign trade performance. In this article we want to do so for a restricted part of foreign trade, namely Hungarian exports to the OECD markets. Exports to the West are often seen as an effective way of enlarging the international division of labour. Therefore, it may be of some interest to learn about export development to the OECD during the period 1968–1984 for which a detailed set of data is available. In this context we would like to concentrate on the question whether Hungarian foreign trade behaviour differs in a significant way from the behaviour of other CMEA countries which, up to now, have taken up the route of reform much less decidedly.

It should be clear from the outset that such an overall problem can be treated only with many "ifs" and "buts". Nevertheless, we will try to find information about foreign trade behaviour using suitable methods of analysis – although such results have to be interpreted with the necessary caution. The method of analysis which we apply in the following is a comparative decomposition of export flows, relating the export performance of the country under investigation in the OECD markets to a reference group. This method is usually called constant market shares (CMS) analysis and it will be explained briefly in paragraph two. Paragraph three deals with the data used. The results of the calculation for Hungary are presented in paragraph four. In paragraph five these are compared with corresponding calculations for the other East-European CMEA countries. Finally, some conslusions are drawn.

## 2. The constant market shares approach

A country's foreign trade performance is usually measured by its market shares in foreign markets. The fact that Hungary's share in world trade turnover fell from 0.7 percent in 1970 to 0.4 percent in 1985 can be taken as an indicator of the aggregate export performance of the Hungarian economic system. It does not allow us, however, to probe into the possible causes of this serious decline. For that purpose we need an analysis on a less aggregated level.

Once we have defined a market, the loss or, in the opposite case, the gain of market shares can purely and logically be ascribed to different factors:

– Structural effects: a country's exports concentrate on markets which are less expansive than the world market. These may be slower growing goods markets or slower growing regional markets.

– Competition effects: a country's exports lose or win market shares on individual markets.

Identification of such effects does not tell us anything about the causes of foreign trade development. Structural effects may be caused by protectionism in expansive markets, by geographical or cultural distance from the exporting country, or by tradition-bound marketing. Competition effects may be due to the inadequate quality of

the exported products or to an internal differentiation (upgrading, for instance) of the importing markets. Thus, if in the following we try to trace the factors influencing foreign trade performance, it does not permit a deeper analysis of causes. This has to be done on the basis of the results obtained.

The developing of an aggregate can be analyzed on a less aggregate level by means of an appropriate method of decomposition. In empirical foreign trade studies the constant market shares approach is applied rather frequently to this end (cf. *Leamer* and *Stern* [7], *Richardson* [10] and [11], Jepma [5]). Decomposition can go down to different levels. The so-called two-level approach decomposes the aggregate change into a hypothetical change in trade under the condition of constant market shares (i.e. a scale effect), and a hypothetical change in trade under the condition of unchanged markets (i.e. a competition effect). In the case of discrete time intervals an interaction term has to be added. The so-called three-level approach differentiates into commodity markets and regional markets and thus we can also calculate – beside scale effects and competition effects – structural effects for the commodity structure and the regional structure separately.

The three-level approach is based upon the following identity:

$$(1) \qquad \Delta q = s^0 \Delta Q + \left\{\sum_i s_i^0 \Delta Q_i - s^0 \Delta Q\right\} + \left\{\sum_i \sum_j s_{ij}^0 \Delta Q_{ij} - \sum_i s_i^0 \Delta Q_i\right\} + \sum_i \sum_j Q_{ij}^1 \Delta s_{ij} \qquad (1)$$

$$\text{(I)} \qquad \text{(IIa)} \qquad \text{(IIb)} \qquad \text{(III)}$$

In our case, this applies to OECD imports from Hungary or the CMEA, compared to total OECD imports, i.e. taking the world as the reference group, the variables have the following meaning:

$q_{ij}$ – import of good i from the investigated country (Hungary or CMEA) into OECD country j,

$Q_{ij}$ – import of good i from the reference group (total world) into OECD country j,

$s_{ij}$ – $q_{ij}/Q_{ij}$,

the superscripts 0 and 1 indicate the periods compared.

In this identity, the term (I) represents the scale effect or the change in exports to the OECD given the condition that the total market share remains constant. If $\Delta q$ is bigger (smaller) than (I), this means that the market share of total exports has risen (fallen). (IIa) represents the structural effect with respect to commodities. It will be positive if those goods, the demand for which within the OECD is rising above the average, have a greater weight in the exports of the country under investigation than in the exports of the reference group. (IIb) represents the structural effect with respect to regions. It will be positive if OECD countries, whose imports are growing relatively rapidly, have a greater weight in the exports of the country under investigation than in the exports of the reference group. (III) represents the competition effect, measuring aggregate gains or losses of market shares on individual markets.

Identity (1) has the disadvantage of being asymmetrical*. This deficiency can be corrected along different lines. Here, we accept the solution of Jepma [5]. In addition, it is possible to decompose the competition effect into a static and a dynamic component (Richardson [10] p. 47). The identity thus can be reformulated in the following way:

$$\Delta q = s^0 \Delta Q + \left\{\sum_i \sum_j s_{ij}^0 \Delta Q_{ij} - \sum_i s_i^0 \Delta Q_i\right\} + \left\{\sum_i \sum_j s_{ij}^0 \Delta Q_{ij} - \sum_j s_j^0 \Delta Q_j\right\} +$$

(Ia) (IIa) (IIb)

$$+ \left\{[\sum_i s_i^0 \Delta Q_i - s^0 \Delta Q] - [\sum_i \sum_j s_{ij}^0 \Delta Q_{ij} - \sum_j s_j^0 \Delta Q_j]\right\} + \sum_i \sum_j \Delta s_{ij} Q_{ij}^0 + \sum_i \sum_j \Delta s_{ij} \Delta Q_{ij} \qquad (2)$$

(IIc) (IIIa) (IIIb)

(I), (IIa) and (IIb) remain the scale effect and the structural effect in connection with commodities the structural effect in connection with commodities and regions, respectively. The dissolution of the symmetry produces a structural residual effect (IIc), called "structural interaction effect" by Jepma [5] p. 24). It indicates the degree to which the country under investigation is exporting goods with a rapidly growing demand into regions with rapidly growing imports, in comparison with the reference group. If the interaction term (IIc) is positive, it enforces the structural effects. If it is negative, either succesful products are marketed in stagnating regions or dynamic regions are supplied with unsalable goods – again, in comparison with the reference group.

The static competition effect (IIIa) shows changes of market shares in individual markets whose absolute size is comparatively big (i.e. high $Q_{ij}$). The dynamic competition effect (IIIb) shows changed of market shares in individual markets whose absolute size is, comparatively, growing rapidly (i.e. high $\Delta Q_{ij}$). The more pronounced decomposition of identity (2) can theoretically be defended by the abundance of data which are available. Whether it can be interpreted in a meaningful way from a practical point of view, has to be judged by the results of the empirical calculations.

## 3. The data

The CMS-approach tries to analyze long-term structural changes. Upswings and downswings of business cycles can have disturbing influences. Therefore, in the literature

*Identity (1) can be formulated differently, such that the regional effect ranges first and the commodity effect second. The total structural effect remains the same, but the position has some influence upon the size of the individual components, as can be seen easily from the alternative formulation of identity (1):

$$\Delta q = s^0 \Delta Q + \left\{\sum_j s_j^0 \Delta Q_j - s^0 \Delta Q\right\} + \left\{\sum_i \sum_j s_{ij}^0 \Delta Q_{ij} - \sum_j s_j^0 \Delta Q\right\} + \sum_i \sum_j Q_{ij}^0 \Delta s_{ij}$$

one can find mowing averages and other methods in order to eliminate business fluctuations. After some experiments leading to side effects which were difficult to interpret, we opted for a traditional discrete approach and chose 1968, 1972, 1980 and 1984 as benchmark years. Thus it is hoped that the influence of CMEA-crises (Poland 1981, for instance) and of OECD-crises (1973 and 1979) will have only a limited effect upon the results.

Any discrete approach is tainted with an index number problem. Depending on the chosen base-year this will lead to over- and underestimation of individual effects. Of course, it is possible to calculate identity (2) "quasi-continuously", on a year-to-year basis. Since we want to know the size of the individual effects for the total period and sub-periods, we then run into an aggregation problem which has its own intricacies. We therefore stick to the traditional discrete approach.

Calculations are based upon OECD import statistics (OECD, *Trade by commodities,* series C, Imports)*. This is necessitated by the practical requirement of getting comparable data for the country under investigation and the reference group. East-European export statistics deviate from western practices as far as their reporting systems, their valuation procedures and their classifications are concerned (*Marer* [9]; *van Leeuwen–Schout* [8]). A major drawback of the chosen set of data is to be seen in the fact that OECD statistics do not cover the so-called infra-German trade. For our calculations that implies that East-German Exports to West Germany are excluded.**

Identities (1) and (2) show that a CMS-approach compares the commodity structure and the regional structure of a country's foreign trade with the structures of a reference group. Our main purpose was to evaluate Hungarian export performance in OECD markets in relation to the export results of the other East-European CMEA countries – leaving the Soviet Union aside for obvious reasons. It seems rather logical now to take these CMEA countries as the reference group. The market shares of this group of countries in OECD markets, however, is very small and hence subject to big fluctuations. This would produce highly unstable results and therefore the CMEA cannot be taken as an appropriate reference group. An alternative is to take the rest of the world as the reference group and relate Hungary's export performance to it. In order to be able to make comparisons with the performances of the other East-European countries, it becomes necessary to make independent calculations for them with the same reference group.

We have restricted the market area of CMEA exports to the West to 15 highly developed OECD countries. These countries absorb more than 90 percent of Hungary's

*For the year 1968 import data for Finland, which at that time was not yet a member of the OECD, are taken from UN statistics (UN, *Commodity trade statistics,* series D, 1968). In this case we had to estimate values for some imports on the basis of data for 1969 and 1970.

**The share of the Federal Republic in the total OECD exports of the GDR can be estimated at 55 percent. This causes a serious shortcoming for our analysis. However, it is almost impossible to classify intra-German trade according to SITC and then incorporate it into OECD data. Since the CMS-approach analyzes changes rather than levels, we still consider the method to be valuable.

**Table 1**
*Shares of 15 OECD countries in the exports of Hungary and the CMEA-5, in percent*

| Country | CMEA-5 | | | Hungary | | |
|---|---|---|---|---|---|---|
| | 1968 | 1976 | 1984 | 1968 | 1976 | 1984 |
| Benelux, Denmark | 12.3 | 13.3 | 10.4 | 11.3 | 9.5 | 6.2 |
| FRG | 18.2 | 23.2 | 19.7 | 24.0 | 32.9 | 29.5 |
| Finland, Norway, Sweden | 9.0 | 13.2 | 10.0 | 8.1 | 7.9 | 5.0 |
| France | 7.8 | 12.3 | 8.7 | 7.5 | 7.2 | 6.7 |
| Italy | 14.3 | 10.8 | 13.7 | 19.7 | 15.2 | 12.4 |
| Austria | 6.8 | 6.2 | 7.2 | 12.5 | 12.5 | 16.6 |
| Switzerland | 2.8 | 2.1 | 5.2 | 5.2 | 5.0 | 6.6 |
| UK | 15.2 | 7.8 | 8.8 | 7.4 | 4.0 | 4.2 |
| USA, Canada | 8.5 | 9.0 | 13.2 | 3.5 | 4.8 | 10.8 |
| Japan | 5.3 | 2.3 | 3.2 | 0.7 | 0.9 | 2.0 |

**Table 2**
*Shares of commodity groups in the OECD exports of Hungary and the CMEA-5, in percent*

| SITC | Commodity group | CMEA-5 | | Hungary | |
|---|---|---|---|---|---|
| | | 1968 | 1984 | 1968 | 1984 |
| 0+1+01 | food without meat | 16.9 | 5.7 | 31.3 | 11.4 |
| 01 | meat | 9.5 | 2.5 | 13.3 | 10.8 |
| 2+4 | raw materials | 16.6 | 8.6 | 11.3 | 11.2 |
| 3 | fuels | 12.5 | 33.0 | 5.9 | 12.9 |
| 5 | chemicals | 7.4 | 8.1 | 4.6 | 10.4 |
| 61+63+64+65 | leather, textiles, wood and paper | 4.7 | 4.6 | 5.9 | 4.5 |
| 62+66+67+68+69 | semi-fabricates | 15.2 | 15.7 | 9.7 | 12.5 |
| 7 | machines | 8.0 | 7.6 | 5.1 | 10.3 |
| 8 | consumer goods | 8.4 | 13.6 | 11.6 | 15.3 |
| 9 | others | 0.8 | 0.6 | 1.4 | 0.8 |

exports to the West. In order not to get too small individual markets, causing fluctuations in the results which are difficult to interpret, we put some countries together in a group. *Table 1* shows the importance of these 15 countries for Hungarian exports and the other East-European CMEA countries (CMEA-5).

As far as the commodity structure is concerned, it turned out useful not to work with an over-detailed classification. Therefore, we chose 10 commodity groups based on the

**Table 3**
*Decomposition of Hungary's export performance with the OECD-15*

| Period | Change | Scale effect | Structural effects | | | Competition effects | |
|---|---|---|---|---|---|---|---|
| | | | regional | com-modity | inter-action | static | dynamic |
| a) in million US $ | | | | | | | |
| 1968–72 | 431.8 | 310.9 | 1.4 | –91.5 | 66.4 | 87.2 | 57.3 |
| 1972–76 | 611.7 | 957.3 | 88.3 | 35.2 | – 82.1 | –51.3 | –159.2 |
| 1976–80 | 1,295.0 | 1,083.6 | –105.1 | 291.9 | 52.2 | 182.5 | –210.1 |
| 1980–84 | –219.6 | –83.7 | 223.2 | –81.6 | –174.8 | 132.9 | –235.7 |
| 1968–84 | 2,118.8 | 2,268.2 | 311.3 | 154.0 | –138.2 | 351.3 | –547.7 |
| b) in percent | | | | | | | |
| 1968–72 | 431.8 | 72 | 0 | –21 | 15 | 20 | 13 |
| 1972–76 | 611.7 | 156 | 14 | 6 | – 13 | – 8 | – 26 |
| 1976–80 | 1,295.0 | 84 | – 8 | 23 | 4 | 14 | – 16 |
| 1980–84 | –219.6 | –38 | 102 | –37 | – 80 | 61 | –107 |
| 1968–84 | 2,118.8 | 107 | 1 | 7 | – 7 | 17 | – 26 |

SITC classification*. *Table 2* shows their shares in the OECD exports of Hungary and CMEA-5.

Both tables show clearly that the regional structure as well as the commodity structure exhibit sizeable changes over the reference period. It is now the objective of CMS-analysis to find out whether these changes had a positive or negative effect upon the foreign trade performance of Hungary or the other East-European CMEA countries.

## 4. Results of CMS-analysis for Hungary

*Table 3* shows the results of the calculations of CMS-analysis for Hungary in US-dollars and in percent.

The results show that Hungary was nearly able to keep its aggregate market share on the OECD market over the whole period between 1968–1984. A scale effect below 100 percent (and in case of a negative $\Delta Q$ below –100 percent) indicates market share gains. This table development of exports is composed of two sub-periods with severe market share losses (1972–1976 and 1980–1984) and two rather successful sub-periods (1968–1972 and 1976–1980).

*In 1977 the SITC classification was revised for second time. In order to be consistent with preceding years we had to make some adjustments for SITC group 8.

The relatively small market share losses over the whole period are mainly due to negative competition effects. As to the structural effects, the positive commodity effect is compensated by a negative interaction term. The negative competition effect is produced by a strong dynamic residual which surpasses the positive static residual by almost 100 percent. This implies that Hungarian exports did not succeed in keeping up, let alone in increasing, their market shares in rapidly expanding individual markets.

This unfavourable development of Hungary's competitive position occurred during the sub-period 1972–1976 and was almost exclusively responsible for the unfavourable developments in the two unsuccessful sub-periods. Structural effects are, on the whole, rather weak in all sub-periods, although the regional effects and the commodity effects exhibit strong fluctuations. Looking at the regional and commodity effects on an aggregate level, one always has to take the interaction term into account, and this makes interpretation somewhat difficult. We can conclude from the results for the structural effects, however, that the regional and commodity structures of Hungarian exports did

**Table 4**

*Static competition effects disaggregated to individual markets, in percent*

| | 68–72 | 72–76 | 76–80 | 80–84 | 68–84 |
|---|---|---|---|---|---|
| a) Regional markets | | | | | |
| Benelux, Denmark | 35.2 | –215.2 | –11.5 | – 8.7 | –32.0 |
| FRG | 7.9 | 29.0 | 5.2 | 60.3 | 31.7 |
| France | –14.1 | – 3.3 | 15.3 | 173.1 | 69.5 |
| Italy | 4.2 | 18.5 | 10.7 | 2.8 | 10.4 |
| UK | 1.4 | 43.3 | 11.7 | – 44.7 | – 4.2 |
| Finland, Norway, Sweden | 18.0 | – 17.2 | 90.5 | 6.6 | 51.5 |
| Austria | 28.2 | 47.0 | –32.8 | 38.3 | 11.4 |
| Switzerland | 0.0 | – 1.9 | 0.2 | 4.5 | 1.6 |
| USA, Canada | 15.7 | 6.0 | 6.7 | –120.3 | –37.3 |
| Japan | 3.3 | – .6.4 | 3.9 | – 12.0 | – 2.5 |
| Total (in mn US $) | 87.2 | – 51.3 | 182.5 | 132.9 | 351.3 |
| b) Commodity markets | | | | | |
| Food without meat | 3.1 | – 25.5 | – 5.3 | – 17.1 | –12.1 |
| Meat | 28.0 | 50.3 | 130.6 | –169.9 | 17.9 |
| Raw materials | 0.0 | 8.6 | – 1.4 | – 12.3 | – 4.1 |
| Fuels | 1.0 | – 6.0 | – 2.3 | 16.9 | 4.6 |
| Chemicals | 48.9 | –161.8 | –16.8 | – 0.5 | –20.4 |
| Leather, textiles etc. | 14.3 | – 8.8 | 5.9 | 18.8 | 12.4 |
| Semi-fabricates | 7.2 | – 18.5 | – 4.9 | 137.6 | 48.6 |
| Machines | – 5.8 | 0.2 | – 4.4 | 9.5 | – 0.1 |
| Consumer goods | 3.6 | 31.2 | 8.1 | 39.1 | 24.4 |
| Others | – 0.3 | 30.4 | – 9.5 | 77.8 | 28.8 |
| Total (in mn US $) | 87.2 | – 51.3 | 182.5 | 132.9 | 351.3 |

not have a sizeable impact on the development of market shares in the OECD market. We may therefore disregard a closer analysis of the structural effects on a disaggregate level.

The competition effects have, as we saw, a net impact upon Hungarian market shares in OECD imports and hence a disaggregate analysis may be of interest. The static competition effect (see term IIIa in identity (2)) represents changes in market shares in regional and commodity markets, weighted by the exports of the reference group. The dynamic competition effect (see term IIIb in identity (2)) weights these changes by the export changes of the reference group.

As far as regional disaggregation of the static competition effect is concerned, *Table 4* shows clearly that Hungarian export performance on Northwest-European and non-European OECD markets is rather weak. These are markets with a high geographical distance from the country of origin. On the other hand there is no significant difference between relative performance on EC-markets and on EFTA-markets. This conclusion is in accord with the results of a gravitation model analysis carried out by P. *Boot* [2], who found for total CMEA exports: "At least in the year 1983, the revealed protectionism of the EC is no bigger than of EFTA" (Boot [2] p. 24).

As to commodity disaggregation of the static competition effect, we see that positive influences mainly stem from such commodity groups as meat, leather and textiles, semi-fabricates and consumer goods. In these industries Hungarian producers are in close competition with the newly industrialized countries and the developing countries, and it appears that they did quite well. This, however, may be due to the fact that they took over market shares from the old industrialized countries, since the shares of the NICs are expanding as well. Because of this development these are also industries susceptible to protectionism which, up to now, seems to be of no greater influence.

The dynamic competition effect can best be interpreted as the adaptive capacity of Hungarian foreign trade to changing market situations. Any exporter should try to reduce market shares in relatively shrinking markets and try to increase market shares in relatively prosperous areas. The numerous negative signs in *Table 5* indicate that this did not happen in the majority of cases. It is not particularly astonishing that these negative signs are to be found not so much in the distant OECD markets, i.e. Japan, USA, Canada and the UK. Hungarian market shares are rather modest there and changes may be subject to random developments. We know, however, that Hungary did quite well in these markets. More remarkable is the strong negative influence originating from the Scandinavian market, which also does not count among the concentration areas of Hungarian export activity.

Competitive performance deteriorated severely during the last two sub-periods. These, on the world scale, are characterized by keener competition. Almost exclusively negative signs for the commodity markets seem to suggest that Hungarian exporters selected their markets in the individual industries less carefully then the reference group, as far as market changes are concerned. This is a question of adaptive decision-making. Given this information, it should be revealing to probe more closely into foreign trade decision-making. However, this is not the task of this paper.

**Table 5**
*Dynamic competition effect disaggregated to individual markets, in percent*

| | 68–72 | 72–76 | 76–80 | 80–84 | 68–84 |
|---|---|---|---|---|---|
| a) Regional markets | | | | | |
| Benelux, Denmark | 40.3 | –55.5 | –18.4 | 1.7 | –18.3 |
| FRG | –24.8 | –62.5 | 3.4 | –10.2 | –23.9 |
| France | –19.5 | – 3.3 | 21.9 | –24.3 | – 5.1 |
| Italy | 4.4 | 8.3 | 10.0 | 0.9 | 7.1 |
| UK | 4.5 | 12.9 | 6.5 | 1.9 | 7.5 |
| Finland, Norway, Sweden | 13.3 | – 5.8 | –44.6 | –68.7 | –47.0 |
| Austria | 31.1 | 6.3 | –52.2 | – 0.8 | –15.2 |
| Switzerland | – 0.2 | – 1.0 | –27.2 | – 3.8 | –12.4 |
| USA, Canada | 43.5 | 2.4 | – 0.4 | 5.2 | 7.3 |
| Japan | 6.3 | – 1.8 | – 1.1 | – 1.9 | – 0.3 |
| Total (in mn US $) | 57.3 | –159.2 | –210.1 | –235.7 | –547.7 |
| b) Commodity markets | | | | | |
| Food without meat | 3.8 | – 9.7 | – 4.5 | – 0.1 | – 4.2 |
| Meat | 53.9 | 12.9 | – 3.3 | –61.0 | –18.1 |
| Raw materials | – 1.4 | 3.4 | – 3.2 | 0.0 | – 0.4 |
| Fuels | – 1.9 | – 1.4 | –26.2 | – 5.7 | –13.1 |
| Chemicals | 70.2 | –42.0 | –34.1 | – 2.2 | –18.9 |
| Leather, textiles etc. | –20.8 | –64.6 | – 8.5 | 0.9 | –23.8 |
| Semi-fabricates | – 0.2 | – 7.7 | – 7.1 | –17.9 | –12.7 |
| Machines | – 5.9 | 2.2 | – 7.5 | – 5.0 | – 5.0 |
| Consumer goods | 3.5 | 4.8 | 5.2 | 1.7 | 4.5 |
| Others | – 1.0 | 2.1 | –10.9 | –10.5 | – 8.2 |
| Total (in mn US $) | 57.3 | –159.2 | –210.1 | –235.7 | –547.7 |

## 5. Comparison with the export performance of other CMEA countries

In the context of our initial question, we are not only interested in Hungarian exports to the OECD in relation to total OECD imports. In order to get an indication of the impact of economic reforms, comparison with other East-European CMEA countries should be revealing. It would have been quite logical to take the CMEA-5 group as the reference group for the CMS-calculations. As was said earlier, however, their weight in OECD markets is too small to yield reliable results. We therefore have made calculations similar to those for Hungary, for the CMEA-5 group, with total OECD imports as the reference group. The results are to be found in *Table 6.*

The five other East-European CMEA countries have lost market shares in the OECD

**Table 6**
*Decomposition of the CMEA-5's export performance in the OECD-15*

| Period | Change | Scale effect | Structural effects | | | Competition effects | |
|---|---|---|---|---|---|---|---|
| | | | regional | com-modity | inter-action | static | dynamic |
| a) in mn US $ | | | | | | | |
| 1968–72 | 1,693.2 | 2,050.7 | –210.1 | –276.0 | 209.9 | 11.9 | – 93.2 |
| 1972–76 | 4,168.1 | 4,845.3 | 163.2 | 159.9 | –9.8 | –191.7 | – 479.1 |
| 1976–80 | 5,868.7 | 6,340.0 | 676.2 | 984.9 | 570.9 | –276.1 | –2,427.2 |
| 1980–84 | –1,210.8 | –428.5 | 740.0 | –198.8 | –1,043.3 | –1,249.1 | –1,529.4 |
| 1968–84 | 10,519.2 | 12,807.5 | 1,369.3 | 350.2 | – 272.2 | 793.2 | –4,528.9 |
| b) in percent | | | | | | | |
| 1968–72 | 1,693.2 | 121 | –12 | –16 | 12 | 1 | – 6 |
| 1972–76 | 4,168.1 | 116 | 4 | – 4 | 0 | –5 | – 11 |
| 1976–80 | 5,868.7 | 108 | 12 | 17 | 10 | –5 | – 41 |
| 1980–84 | –1,210.8 | –35 | 61 | –16 | –86 | 103 | –126 |
| 1968–84 | 10,519.2 | 122 | 13 | 3 | – 3 | 8 | – 43 |

markets during the total period under investigation and in all individual sub-periods. This happened to a much higher degree than was the case with Hungary. The most severe losses were encountered during the last sub-period, which coincides with a stagnation period in the West and rather keen competition on the world markets. In such a situation the exporters of raw materials and semi-fabricates are usually hit hardest. The commodity structure of CMEA exports, including Hungary, is still dominated by these products. This, however, is only half of the story. The other half is weak competitiveness, which becomes virulent when the fight for market shares becomes sharper.

We also see from *Table 6* that in both cases positive regional effects are overcompensated by negative commodity effects and the interaction term in the sub-period 1980–84. For the rest of the investigated period, too, the structural effects of CMEA exports do not differ in a significant way from those of the Hungarian exports given in *Table 3* – although their impact seems to be a little more favourable, thanks to the regional effects.

As far as the competition effect is concerned the situation, again, seems to be comparable. It should be noticed, however, that the static competition effects are less positive for the CMEA-5 and the dynamic competition effects markedly more negative. In other words, we may conclude that Hungarian export performance in the West does not differ systematically from the rest of the CMEA. However, Hungary belongs to the relatively more successful exporters in Eastern Europe. Yet, if we made CMS-calculations separately for individual countries of the CMEA-5, it might turn out that Hungary does not hold the leading position.

Disaggregation of the static and dynamic competition effects, which we do not want to reproduce in detail here, confirms the general impression. Northwestern-Europe and the non-European OECD markets had a strongly negative influence, and this is concentrated in the last two sub-periods for the markets in America, Japan and Great Britain.

## 6. Summary

Those who expect (from the computationally complex CMS-approach) completely new insights into the foreign trade behaviour of East-European countries may be somewhat disappointed by the results – as will those who expected from the Hungarian reforms of the economic mechanism a completely new export behaviour. Both seem not to be the case. The reforms of the economic mechanism, which were not propelled with the same vigour during the whole of our investigation period, may provide incentives for a more appropriate marketing behaviour. They are unable, however, to change – in the medium-run – the decision-making structure and the production structure of Hungarian industry to such a degree that it presents itself as a completely new competitor on the western markets. In fact, the results of our analysis evoke the question whether the realized changes in the production and decision-making structures really do live up to the intentions.

This question obviously cannot be answered by means of the chosen approach. The method only allows us to decompose the development of export flows of the country under investigation into certain effects which can logically be separated from each other. The first impression will be, in most cases, that close inspection of the data would have yielded similar results. Nevertheless, we think that this first impression may be deceptive. Systematic processing of a vast amount of individual data leads to coherently aggregated information. Departing from these, one then can start with a detailed causal analysis.

One thing should be clear: the fact that the CMEA countries suffered severe market share losses during the last two decennia, with Hungary in only a relatively better position, is mainly due to a low adaptive capacity to situations of changing market conditions. This we have called a negative competition effect. In itself, however, this statement does not explain anything. Since we assume that the OECD market is as open for the CMEA as it is for the reference group, we are looking for the reasons for the low competitiveness mainly within the CMEA countries. We know that the assumption is not quite correct, since intra-EC trade plays a major role in the exports of the reference group to the OECD-15. On the other side, we notice that the newly industrialized countries seem to be gaining considerable market shares on the OECD markets although their geographical and cultural distance from these markets is much more unfavourable than is the case with Eastern-Europe. Other studies, such as Boot [2], come to the conclusion that the relative weight of the CMEA in the OECD markets is small compared to the geographical distance and the level of development. We may add that it will require serious efforts in the field of structural change and in marketing in order to improve the situation.

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# ВЕНГЕРСКИЙ ЭКСПОРТ В СТРАНЫ ОЭСР — АНАЛИЗ ПОСТОЯННЫХ РЫНОЧНЫХ ПРОПОРЦИЙ

Х. В. ХОЕН—Х. Ю. ВАГЕНЕР

Целью экономической реформы в Венгрии было, в частности, улучшение интеграции с мировым рынком. В статье рассматривается, как сказались меры венгерской реформы на результатах венгерского экспорта на рынки ОЭСР. Результаты внешней торговли ВНР сравниваются с пятью восточноевропейскими странами СЭВ, менее решительно или позднее вставшими на путь реформ. Пиказать результатов — измененив рыночных пропорций. С помощья методов расчета анализ постоянных рыночных пропорций распределяет эти изменения на структурные и конкурентные воздействия.

Анализ дал два основных результата, которые не явились неожиданными. За последние 20 лет восточноевропейские страны СЭВ сдали свои позиции на рынке ОЭСР. Результаты Венгрии в торговле с Западом не намного лучше средних и экспортные показатели как правило не отличаются от доли СЭВ. Может быть поставлен вопрос, почему намеченные изменения в результатах и структуре принятия решений были реализованы в такой слабой степени. Слабые результаты могут объясняться прежде всего негативным воздействием конкуренции. Низкая приспособляемость к изменениям условий мирового рынка означает, что не удалось выйти с сужающихся рынков и добиться достаточно быстрого проникновения на расширяющиеся рынки. Восточная Европа как экспортер сырья и полуфабрикатов в большей степени пострадала в период стагнации, чем в период высокой экономической активности.

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# CHANGES IN THE STRUCTURE OF PRODUCTION AND FOREIGN TRADE OF THE HUNGARIAN INDUSTRY IN THE PERIOD OF RESTRICTIONS (1978–1986)

J. GÁCS

Relying on statistical analyses the author makes an attempt to show the direction and speed of structural changes in the industry in the past ten years. He presents the fields in which the structure has become rigid and those where the development of new proportions can be felt against the earlier state of the industries. Many of the synthetic indicators of structural change indicate a slowing down of structural changes, but none of them shows a ceomplete lack of the latter ones. Industrial organizations could, in the future, better adjust to changes in external markets if they were pressed by the demand for market profitability, if the scope of their management and financing possibilities expanded and became stabilized and if, relying on a well-founded concept, the economic leadership made up their minds to transform the Hungarian economy into a genuine open one.

## Introduction

After 1978–79 the functioning and performance of Hungarian economy was directly affected by the unprecedented degree of external imbalance and by the subsequent restrictions applied by the central management. The growth of industrial production decelerated markedly in these years. As against an average annual growth rate of 6.0 percent between 1970–78 (at comparable prices) in 1978–86 this rate dropped to 1.4 percent. In the first period only two of the 57 industries registered no growth (coal mining and brick and slate production). In the second period production decreased in 19 industries. A production decline of such an extent is a new and unusual phenomenon in Hungary's economic history of the past 40 years.

Similarly unusual is the abrupt drop in output of several industries. The most striking example is the leather and fur industry where production today is only two thirds of what it used to be eight years ago. Quarrying and gravel production also decreased by nearly 30 percent, while the output of the miscellaneous wood industries and handicrafts and homecrafts by approximately 20 percent. Another sign of the slackening of general growth is the declaration of production growth (or even fall) in each of the industries of the industrial sector disaggregated to 9 industries (*see Table 1*). A more detailed breakdown of the industrial sector shows that in 48 of the 57 lines of industrial production the second period was characterized by a smaller rate of production growth than the first (or by a

*My colleague, Ákos *Valentinyi* provided great assistance in the collection of data, selection of indicators and computation. I owe him many thanks.

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**Table 1**
*Average yearly growth of gross output in the industry (at comparable prices)*

| | 1970–1978 | 1978–1986 |
|---|---|---|
| Mining | 2.2 | −0.6 |
| Electric energy industry | 7.9 | 2.5 |
| Metallurgy | 4.4 | −0.1 |
| Engineering industry | 7.2 | 2.2 |
| Building material industry | 5.2 | 0.9 |
| Chemical industry | 10.1 | 2.0 |
| Light industry* | 4.8 | 0.7 |
| Other industries | 8.1 | 0.0 |
| Food industry | 4.4 | 2.1 |
| Industry, total | 6.0 | 1.4 |

*Sources: Ipargazdasági évkönyv 1978–1985, Ipari zsebkönyv 1986* (both published by the Central Statistical Office of Hungary)

*The Hungarian term comprises textiles, clothing, leather and fur processing, paper industry, wood processing and printing.

decline), in one industry the fall in production decelerated and only 8 industries (four of them belonging to the food industry) achieved an increase in their rate of growth.

Well-established knowledge about the post-1978 period of Hungarian industrial development is very narrow. Most assessments and statements run along the same logic: in Hungarian industry the extensive slackening of growth has implied a stagnation covering all of the industries and has thus conserved the old industrial structure. According to these analyses the dropping volume of industrial investments and the obstructed flow of capital have essentially impeded the restructuring of production on the capacity side. Moreover the danger of restoring a previous industrial structure ill-suited to this country's conditions emerged because the allocation of investment shifted in favour of primary industries. It is generally believed that both the structure of imports for industrial use and the structure of industrial exports were frozen by the lack of sufficient incentives and adequate means to support commercially based decisions and this is why the adjustment to world market changes were lacking.

A good many of the above statements based on impressions and partial correlationships are most probably true while others cannot be verified. In the statistical analysis below I attempt to clarify the directions and the rate of change of the industrial structure during the past eight years from several aspects. I will show the dimensions in which the structure actually stiffened and the ones in which there were palpable shifts. Shifts for me mean either a new phenomenon characterising the entire industry or an evolution of new

proportions in the structure of the industries. In the analysis I try to scrutinize data in as disaggregated form as possible. I considered this a prerequisite to reaching well established conclusions. At the same time the results thus obtained would be more likely to directly reflect the behaviour of individual companies or groups of companies and, consequently, serve as a reference for a future research on enterprise behaviour in this period.

Owing to the incompleteness and limits to comparability of available published data, the database of this study is not fully consistent. In some sources data were found for the nine aggregate groups of the industrial sector only, in others industry was represented by 36 more or less aggregated lines of production, or again by 57 lines. It was frequently difficult to take into account the changes in the definition of certain production lines, to reconcile statistics of foreign trade with production statistics. The lack of data at unchanged prices and of many 1986 data was also a problem. I am nevertheless convinced that these problems of data inconsistency, while limiting the accuracy of the analysis, do not invalidate the emerging trends.

## Synthetic indicators of structural change in the industry

According to production data of 57 industries (measured in comparable prices) the average yearly growth rates of production ranged from −2.0 to 13.6 percent in the period between 1970–78 (period 1), while between 1978–86 (period 2) they fell into a zone of −5.1 to 9.1 percent. The spread of growth rates apparently narrowed somewhat and declined: it became 1.4 percentage points narrower but the standard deviation of the rates of production fell minimally, from 3.1 to 3.0.

The above data suggest that, at variance with the general view, the degree of differentiation which industrial production underwent in the post-1978 period was nearly the same as in the preceeding stage of 1970–78. Structural change, however, can be analysed from many aspects and by a variety of methods. In this study comparative computations were made about the development of two indicators of structural change for the two periods. Alas, owing to unavailability of data we had to give up our aspiration to make computations for production data at unchanged prices, so we used current price data instead.

By one of the said indicators of structural change the shift in the shares of industries in total output is measured. The formula of this indicator is as follows:

$$C = 0.5 \sum_{i=1}^{k} (a_{i1} - a_{i0})$$

where $a_{i1}$ is the share of industry i in total output in the last year of the period under study; $a_{i0}$ is the share of industry i in the first year of the period.* The value of this indicator may vary between 0 and 100.

*For the explanation of this indicator see [1].

In the industrial output this indicator of structural change was 9.6 in period 1 and 10.4 in period 2.

The second indicator of structural change quantifies the distance between the two multidimensional vectors formed from the output values of industries in one period and in the other. Its formula is the following:

$$T = \left| \frac{A_1}{|A_1|} - \frac{A_0}{|A_0|} \right|$$

where $A_1$ is the vector of industrial output in the first year of the period and $| \; |$ means the absolute value of this vector. This indicator can also have values between 0 and 100.*

As it is shown in *Table 2,* structural change measured by this latter indicator was actually less between 1978 and 1986 than between 1970 and 1978: in the second period

**Table 2**

*Values of the indicator T of structural change in industry*

| | 1972 | 1978 | 1980 | 1984 | 1986 |
|---|---|---|---|---|---|
| | | | in output | | |
| 1970 | 14.99 | 22.36 | 31.30 | 35.94 | 33.30 |
| 1972 | | 14.75 | 26.20 | 30.80 | 27.85 |
| 1978 | | | 15.56 | 20.09 | 17.01 |
| 1980 | | | | 8.27 | 12.10 |
| 1984 | | | | | 9.12 |
| | | | in rouble exports | | |
| 1972 | | 11.08 | 14.74 | 14.84 | 13.82 |
| 1978 | | | 5.44 | 6.92 | 5.71 |
| 1980 | | | | 6.80 | 5.68 |
| 1984 | | | | | 4.43 |
| | | | in non-rouble exports | | |
| 1972 | | 31.71 | 31.77 | 37.23 | 39.75 |
| 1978 | | | 15.91 | 27.66 | 20.95 |
| 1980 | | | | 15.84 | 15.24 |
| 1984 | | | | | 25.85 |

*Sources* of data used for the computations: *Iparstatisztikai évkönyv 1978–1985*; *Ipari zsebkönyv* 1986; *Ágazati kapcsolatok mérlege,* 1972 *(export–import elszámolások)*; *Statisztikai évkönyv,* 1970, 1972; *A Külkereskedelmi Minisztérium Statisztikai Osztályának tájékoztatója,* 1978–1986. (All these are publications of the Central Statistical Office, with the exception of the last one published by the Ministry of Foreign Trade.)

*For the explanation of the indicator see Frigyes–Simon [2].

it amounts to 17.01 as against 22.36 in the first period. (For the selected years all the possible indicators are included in the table; in the first column from left the base years of the structural shifts are indicated while in the upper line the closing years are given.)

The data in the table reflect slackening structural change in the industry, especially in the 1980s. It is an interesting feature that the shift that took place after 1984 showed some degree of reversion as compared to the changes from the 1970s to 1984.

As noted above, the two synthetic indicators were computed from production data at current prices, therefore in addition to other possible distortions*, the results obtained could be influenced by price changes in the respective periods. In the 16 years the largest structural change as compared to the length of the subperiods was recorded by indicator T between 1978 and 1980, clearly reflecting – among others – the impact of the price revisions of 1980.

The two indicators of structural change were also computed for employment, the gross value of fixed assets as well as for rouble and non-rouble exports (the latter three measured at current prices). These data unambiguously indicate that structural changes slowed down – although they did not cease out completely (see *Tables 2* and *3*).

It is apparent from the data of *Table 3* that, even for the whole 14-year period, structural change in rouble exports was insignificant compared to the changes in production and non-rouble exports. This slowness of transformation is assumed to be only partly rooted in the tardy and lagging assertion of price changes in this given relation and to a greater extent in the institutional system of CMEA trade that makes trade structure highly rigid.

**Table 3**

*Values of the indicator C of structural change in industry*

| | 1970–1978 | 1978–1985 |
|---|---|---|
| Number of employees | 7.1 | 4.6 |
| Gross value of fixed assets (at current prices) | 10.4 | 5.1 |
| | **1972–1978** | **1978–1986** |
| Rouble exports (at current prices) | 9.6 | 5.7 |
| Non-rouble exports (at current prices) | 18.8 | 11.3 |

*Source:* as in *Table 2.*

*Statistical data show gross output in the industries according to the actual setup of the industrial organizations. The changes actually effected during this period in the organizational setup could not be eliminated from the database, at best neutralized by data aggregation. Because of the cummulative nature of gross output data, value added would have been a better indicator of activity. Unfortunately, necessary data were not available.

Structural change of non-rouble exports has been of the same order of magnitude in every subperiod but larger than the structural change in production. Even though the rate of structural change decreased here by one third from 1972–1978 to 1978–1986 (37.71 and 20.95 respectively), and in these calculations period 2 is two years longer than period 1, it is nevertheless remarkable that non-rouble exports regularly and in each subperiod (namely, 1978–80, 1980–84 and 1984–86) underwent considerable structural changes (of about 16 points) – but not necessarily in the same direction.

## Changes in the structure of ownership and size of industrial organizations

Significant changes took place in the distribution by ownership of industrial organizations in the first half of the 1980s. Previous restrictions on private activities and partnerships were eased and a new opportunity was centrally opened up by the center, permitting partnerships of private workers to use state owned production equipment. This partly accounts for the significant changes in the number of industrial organizations and distribution by proprietors. The number of cooperative and private small enterprises has surged since 1982, as can be seen in *Table 4.* Accordingly the operations of such organizations also increased at a high rate, and even in the year 1986, when the rate of expansion of such organizations slowed down by necessity, the increase of their production greatly exceeded that of state industry. Measured at current prices, gross

**Table 4**
*Changes in the number of industrial organizations*

| | 1975 | 1980 | 1982 | 1986 |
|---|---|---|---|---|
| State enterprises | 779 | 699 | 726 | 1,007 |
| of this controlled by ministries, | 543 | 546 | 573 | 695 |
| councils | 236 | 153 | 153 | 312 |
| Industrial cooperatives | 793 | 661 | 635 | 604[1] |
| Small cooperatives | – | – | 80 | 352[1] |
| Industrial and service cooperative sections | – | – | 158 | 968 |
| Intrafirm business partnerships | – | – | 1,634 | 14,069 |
| Private business partnerships | – | – | 837 | 3,383 |
| Artisans | 35,677 | 39,275 | 43,429 | 43,530 |
| Employees of artisans (capita) | .. | 7,591 | 8,178 | 10,500 |
| Persons possessing licence for industrial activity to run in addition to main (full-time) job | .. | 10,948 | 14,968 | 20,024[2] |

[1] Data for 1985. In 1986 the number of industrial cooperatives and small cooperatives was altogether 1107.
[2] Data for 1985.
*Sources: Statisztikai évkönyv,* 1986; *Magyar statisztikai zsebkönyv,* 1986; Kristóf [3].

output in 1986 increased by 3.3 percent in state-owned industrial enterprises, by 9.5 percent in industrial cooperatives, 9.7 percent in business sections of cooperatives and enterprise business work partnerships*, 40.8 percent in business work partnerships** and by 9.6 percent in the shops of private artisans. Considering the low initial benchmark, the short period of unbroken fast development and the still restrictive and uncertain conditions of operation it is understandable that the share of private artisans and of the so-called new-type organizations in the output of industrial organizations did not yet exceed 3 percent in 1986.

Special attention should be paid to the difference between the performance of state enterprises and industrial cooperatives shown in the 1978–1986 period. Between 1978 and 1986, expansion of the volume of gross output amounted to 12.2 percent in the state industry, while cooperatives scored 27.3 percent. The difference in favour of industrial cooperatives had been manifest earlier as well, however, this discrepancy has widened lately. While in period 1 the rate of growth of production in industrial cooperatives was only one and a half times the growth in state enterprises, after 1978 this difference became more than twofold.

The growing share of industrial cooperatives does not seem to be concentrated on one or two lines of production, on the contrary, it has expanded over a large area. 40 industries show an appreciable share of cooperatives in output. With respect to production data between 1978 and 1985 (at current prices) the share of cooperatives increased in 32 production lines and in only 7 production lines did it shift toward the state enterprises. (Strangely enough, for the entire industrial sector current price data indicate a growing weight for the state sector.) On the basis of comparable price data, the share of cooperatives increased in about as many production lines as it decreased, along with the already noted growth of the weight of the whole cooperative industry.

As regards labour productivity growth, similarly to gross output the discrepancy between the two sectors has become wider. Between 1970–1978, the cooperative industry increased its productivity faster than state industry. However, due to the more rapid and flexible adjustment of the cooperative industry, in period 2 this difference increased and nearly reached a ratio of 2:1.***

In addition to, and partly in consequence of the changes in the distribution by ownership of industrial organizations, remarkable shifts took place in the size structure of the organizations in the first part of the 1980s. Beside the said changes it was of cardinal importance that, following the breaking up of several trusts and companies in monopolistic position, the number of state-owned companies increased and the previous

*VGMK by the Hungarian abbreviation.

**GMK by the Hungarian abbreviation.

***In both periods the rate of growth of fixed assets was substantially higher in the cooperative industry, but this does not give a full explanation for the indicated difference in the growth of labour productivity, since the difference between the growth rates of fixed assets in fact decreased from 1970–78 to 1978–86.

decline in the number of council-owned enterprises was first halted and then reversed (see *Table 4*).

Both the importance and the limitations of the changes in the size structure of companies are revealed by the comparison of enterprise size data in 1978 and 1986. In every company size category employing more than 100 blue-collar workers the ratio of the number of these companies (but not necessarily the number itself) decreased. With respect to share in production, however, only companies belonging to the size category of over 2000 workers lost weight.

## Dynamic and declining industries

A significant transformation of the industrial structure implies nothing more than that certain industries are developing quickly, others find production growth slowing down, or that output even shrinks. In this context we naturally cannot speak of general stagnation: between 1978 and 1986, several production lines showed faster or slower development than the average of the industry and, as has been mentioned above, there was a pronounced drop of production in one third of the production lines. Still, what were the typical features of the dynamic industries in the post-1978 industrial development? Did the same ones show fast development that had grown at exceptionally high rates at the beginning of the seventies (in this way preserving the old structure of the industry) or did a considerable number of other production lines catch up and develop much more robustly than the average? Were they enabled to grow fast because of the relatively substantial increments in fixed assets and the provision of plentiful labour or, on the contrary, were they the industries demanding less from these shrinking resources or utilizing more economically their reserves in labour and physical capacities? In the following we will try to find the answers to these questions (and to the respective ones concerning the declining industries) always having in mind that ocassionally the evidence may turn out to be inconclusive.

In this analysis a line of industrial production is considered to be dynamic, average or declining according to the elasticity of its growth rate with respect to the rate of growth in the whole industrial sector (all growth rates measured at comparable prices). Our classification is the following:

| | | |
|---|---|---|
| If the elasticity | $E<0$ | declining industry |
| | $0 \leqslant E<0.7$ | inelastic industry |
| | $0.7 \leqslant E<1.3$ | average industry |
| | $1.3 \leqslant E<1.7$ | industry with medium elasticity |
| | $1.7 \leqslant E$ | industry with high elasticity |

In the analysis "highly elastic industries" will be considered dynamic while the declining ones as the other characteristic extremity of structural change. According to actual growth performance the classification of the 57 industries is given in *Table 5*.

**Table 5**
*The classification of industries according to growth elasticity*
(explanation in the text)

| 1970–1978 | 1978–1986 |
|---|---|
| *Declining lines* | |
| Coal mining | Coal mining |
| Brick & slate production | Crude oil production |
| | Ferrous metallurgy |
| | Other non-ferrous metallurgy |
| | Iron & metal mass products |
| | Brick & slate production |
| | Quarrying & gravel production |
| | Lime & cement industry |
| | Concrete panel production |
| | Sawmill & plywood industry |
| | Architectural carpenter industry |
| | "Other" wood industry |
| | Cotton industry |
| | Rayon industry |
| | Leather and fur industry |
| | Textile clothing industry |
| | Handicrafts and homecrafts |
| | Baker's ware production |
| *Inelastic lines* | |
| Ferrous metallurgy | Bauxite production |
| "Other" non-ferrous metallurgy | "Other" ore production |
| Iron and metal mass products | Electric engineering products |
| Concrete panel production | Conserving industry |
| Architectural carpenter industry | Wine production |
| "Other" wood industry | |
| Cotton industry | |
| Flax and hemp production | |
| Leather & fur industry | |
| Textile clothing industry | |
| Baker's ware production | |
| Confectionery industry | |
| Tobacco industry | |
| Milling industry | |
| *Average lines* | |
| Crude oil production | Machine & equipment production |
| Other ore production | Rubber industry |
| Machine & equipment production | Textile piece goods industry |
| Lime & cement industry | Knitwear industry |
| Building insulation industry | Meat production |

(Table 5 cont.)

| 1970–1978 | 1978–1986 |
|---|---|
| Glass industry | Milling industry |
| Rubber industry | Sugar production |
| Household chemical industry | |
| Paper industry | |
| Printing | |
| Wool industry | |
| Rayon industry | |
| Textile piece goods industry | |
| Knitwear industry | |
| Shoe industry | |
| Meat production | |
| Poultry industry | |
| Dairy production | |
| Sugar production | |
| Spirits & starch production | |
| Wine production | |
| Brewery production | |
| *Medium elasticity lines* | |
| Bauxite production | Transport vehicle production |
| Electric energy industry | Furniture industry |
| Aluminium metallurgy | Wool industry |
| Transport vehicle production | Shoe industry |
| Electric engineering industry | Dairy production |
| Precision engineering industry | |
| Ceramics industry | |
| Plastics industry | |
| Furniture industry | |
| Handicrafts and homecrafts | |
| Edible oil production | |
| Mineral water & soft drink prod. | |
| *High elasticity lines* | |
| Telecommunication engineering | Electric engineering industry |
| Gas production | Aluminium metallurgy |
| Pharmaceutical industry | Telecommunication engineering industry |
| Sawmill & plywood industry | Precision engineering industry |
| | Building insulation industry |
| | Ceramics industry |
| | Glass industry |
| | Gas production |
| | Plastics industry |
| | Pharmaceutical industry |
| | Household chemicals industry |

(Table 5 cont.)

| 1970–1978 | 1978–1986 |
|---|---|
| | Paper industry |
| | Printing |
| | Flax and hemp production |
| | Poultry industry |
| | Confectionery industry |
| | Edible oil production |
| | Spirits and starch production |
| | Brewery production |
| | Mineral water & soft drink prod. |
| | Tobacco industry |

*Note:* Because of changes in the classification of industries in official statistics, we could not help omitting the analysis of the following production lines: Petroleum refinery, Organic and inorganic chemical industry, Synthetic fertilizer and plant protective production and Plastics and synthetic fibre production.

*Source: Statisztikai évkönyv* 1970, 1978; *Ipari zsebkönyv* 1986. (Published by the Central Statistical Office)

From the comparison of periods 1 and 2 it can be seen that the development of some of the lines show a certain level of *stability*. Thus for example the highly elastic class of period 2 includes three of the four lines that had grown with high elasticity in period 1 (telecommunication industry, gas production and pharmaceutical industry), while two declining industries of period 1 appear again in the class of declining industries of period 2. At the same time there are *considerable rearrangements,* expecially among the dynamic (highly elastic) lines: the group of industries qualifying for high elasticity in period 2 consists of not only the ones that used to grow with medium or high elasticity, but just as many of those that used to show average, what is more, inelastic growth (for instance flax and hemp production, confectionery industry and tobacco industry promoted from inelastic to highly elastic lines). If the regressive lines of period 2 are considered it is found that the lines that used to be regressive and inelastic earlier represent a higher percentage here, implying that the preceding trends were more powerful here. In some cases however, remarkable shifts took place, for example industries with medium elasticity in period 1, like handicrafts & homecrafts and of high elasticity like sawmill and plywood had to curtail their production in period 2.

As a next step of the analysis I checked whether dynamic growth (or failure to grow) was typical rather of *capital intensive* or rather of *labour intensive* lines during the past eight years? * Data show a slight (relative) preponderance of capital intensive lines among

*Irrespectively of periods those lines were classified as fixed asset intensive that in respect of the index of fixed assets per industrial employee unmistakeably showed higher values than the whole industrial sector in the years 1978 and 1985, while the industries showing clearly smaller than average values were considered labour intensive.

industries with fast growth rate while the declining industries were clearly dominated by the labour intensive ones.

Subsequent to the analysis of the impact of the initial capital intensity we analized the role of actual *expansion of fixed assets* in the development of industries. According to data* in period 2 faster growth rates were usually achieved by industries capable of increasing their respective fixed assets at an above-average rate: the class of dynamic lines includes all the six industries that proved to be "highly elastic" with respect to fixed asset expansion in the industrial sector. However, this relationship did not materialize with hundred percent regularity since in most of the dynamic lines fixed assets were increased with an average elasticity. Moreover, there were five industries increasing their production in a highly elastic manner although their fixed assets were expanded in an inelastic way. (These lines are the ceramics industry, flax and hemp production, brewery production, tobacco industry and mineral water & soft drink production, with one exception all being typically labour intensive industries.)

Declining industries behaved to some (but not full) degree in a reverse manner. As expected, the cutback of production was more frequently associated with below-average fixed asset expansion; still, three of these lines formed their fixed assets with a growth rate far above the average. At the same time it is conspicious that in this group of industries, fixed assets were typically developed at average rates: 9 of the 18 declining lines expanded their fixed assets at the average rate. Only one single industry of the declining group (and also of the whole industry) decreased its gross fixed assets in the eight years.**

The degree of *up-to-dateness of fixed assets* used in industry (most commonly measured by the ratio of net to gross value of fixed assets) showed a remarkable decrease during the past years: from 69 percent it dropped to 65 percent between 1978 and 1985. As this decrease took place in the majority of lines (in 43 out of 57), differentiation among industries can be considered here rather in terms of the rate of obsolescence than in that of the rate of increase of up-to-dateness.*** In fact, however, no appreiable differences could be detected here: machinery in dynamic industries became obsolete at a similar (or a slightly faster) rate than in declining industries.

As shown by representative surveys of the Central Statistical Office of Hungary the *utilization of industrial fixed assets* has been decreasing through the eighties. Although there is no available long-range time series containing absolutely consistent and

*For this analysis the yearly average rate of growth (at current prices) of gross fixed assets in the individual industries and the respective elasticity groups of this indicator were used.

**It should be considered in the evaluation of the above that the declining lines were classified on the basis of comparable (constant) price data while the growth of fixed assets was taken into account at current prices. It follows that in real terms fixed assets could actually decrease in much more lines than indicated.

***Nevertheless industries where the park of fixed assets was updated can be found both in the dynamic and the declining group. Paradoxically there are more such lines among the declining industries than among the dynamic ones.

comparable data, there are indications, that this decline in capacity utilization is deeper, spans a longer period of time and is more widespread in the whole industry than the troughs in utilization observed before.

There were displacements also between the causes of insufficient utilization. First of all among the causes of disutilization of capacities the importance of economic reasons increased. From among these economic reasons the weight of material shortages increased and then became stabilized at a higher level. Non-utilization of capacities due to insufficient demand increased steadily and steeply. Labour-shortage related non-utilization had kept increasing for a while, then fell back, supposedly because of the growing importance of the lack of orders (see *Table 6*).

Unfortunately the data series of capacity utilization quoted above are not available for the 57 industries, so we ourselves made calculations for the values of a well-known capacity uzilization indicator.* This indicator shows the degree of utilization of the electric engines installed in the individual industries. Although the interpretation of this indicator has certain limitations, nevertheless it does not seem to be less reliable than the indicators for which data were shown in *Table 6*.

**Table 6**

*Utilization of industrial capacities*

(Utilization of calendar time base (machine hours) of machines, equipment and machine lines of major activities and the causes of idle-time machine hours)

| | 1976 | 1979 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|---|
| Utilization of capacity | 60.4 | 58.4 | 54.5 | 53.4 | 52.5 | 52.8 | 53.1 |
| Ratio of idle-time machine-hours due to economic reasons (percent of total machine hours) | 25.9 | 30.7 | 36.3 | 37.0 | 38.4 | 38.4 | 37.7 |
| Of this: | | | | | | | |
| due to lack of material | 7.9 | 10.1 | 11.7 | 10.2 | 12.6 | 12.7 | 10.8 |
| due to lack of workforce | 11.5 | 12.6 | 14.1 | 15.9 | 14.2 | 13.2 | 12.6 |
| due to lack of orders | 6.5 | 8.0 | 10.5 | 10.9 | 11.6 | 12.5 | 14.3 |

*Note:* The ratios of idle-time machine hours represent the time missed from standard working time base for the years 1976 and 1979, and time missed from calendar working time for the other years.

*Sources: Az ipar gépi kapacitásainak kihasználása* (Utilization of the machine capacities of the industry) 1979, 1981. *Iparstatisztikai évkönyv 1982–1985, Ipari zsebkönyv,* 1986 (All published by the Central Statistical Office).

*The computations were made for the years 1978, 1980 and 1984. We chose the year 1984 instead of 1985, the last year for which data were accessible, because we assumed that the unusually harsh winter of this latter year could influence capacity utilization in different industries in an uneven and unique manner. Explanations for different indicators of capacity utilization can be found in *Rimler* [4].

Comparing the changes in the dynamic vs. declining lines, strangely and surprisingly no substantial difference was found between these two groups. Industry as a whole is dominated by lines with badly declining capacity utilization (30 out of 57), and the ratio of lines with badly declining capacity utilization is only slightly smaller among the lines with dynamic growth rates (9 out of 21) and only slightly higher among the declining ones (9 out of 17). The distribution of other categories of capacity utilization (i.e. medium declining, average, medium increasing, highly increasing) similarly do not show differences.

As a next step of the analysis we studied the typical changes in *employment* of the dynamic vs. declining industries. In contrast to some previous parts of our analysis here characteristic differences were found. In the entire industry employment decreased at a fast rate (by 1.7 percent on yearly average) between 1978 and 1985. Here our analysis, just like in the previous sections, relies on the classification of industries by growth elasticities (although in the case of employment to speak about the elasticity of contraction is more justified).

The analysis of employment trends in different industries showed that the majority of the dynamic lines either increased their staff (there were 10 lines in this category) or were less powerfully pressed to reduce their labour force than the average industry (5 lines). At the same time in the case of the declining group most lines decreased the number of employees at a higher (6 lines) or at a much higher (another 6 lines) rate than the average cut (a much higher rate of cutting employment means 3 percent or more yearly decrease).

If employment drops at faster than the average rate in the lines with declining production, and decreases at a slower than the average one or even increases in the dynamic industries then one cannot unambiguously predict how *labour productivity* develops in dynamic and declining industries. Labour productivity, however, again has proven to be one of the indicators according to which salient differences were found between the dynamic *vs.* the declining industries. While only one of the declining lines was able to enhance productivity at a rate higher than the industrial average, most of the dynamic lines achieved higher, and a large number of them much higher productivity growth than the average.

The above analysis touched upon the performance of industries from the point of view of production, fixed asset formation, capacity utilization, employment and labour productivity. Taking into account the results, the following conclusions can be inferred.

In the period of sharp deceleration of industrial growth between 1978 and 1986 individual industries show a sort of polarization. One group, the dynamic industries increased production at a relatively fast rate. In most cases already in the preceding stages, and also at the time of restrictions, they developed their fixed assets usually at higher than average rates, and at the time of a general drop of industrial employment they increased (or only slightly reduced) the number of their employees. Although these lines also suffered from the characteristic symptom of the whole industry, i.e. a growing non-utilization of capacities, they could stand it relatively easily and were not forced by the drop in utilization to decrease the number of the employees. This could happen

partly because in the process of a – relatively – dynamic growth they hoped to make fuller use of their respective capacities in the future and they knew that this would require the existing staff. At the same time, as the rapid growth in labour productivity implies, the underutilization of labour was probably less acute in these industries, than the underutilization of fixed assets. This may give an explanation for the fact that decreasing capacity utilization was not accompanied here by a fall in employment.

The other pole of differentiation is formed by the declining industries. Although in many of the industries which were forced to decrease their output we cannot see a deliberate, systematic set-back nor a faithful reckoning with the consequences of the unfavourable economic performance, some of the indicators already show signs of a spontaneous regression. In this group of industries the drop in capacity utilization was accompanied by lower than average fixed asset formation and a rapid rate of losing employment. Labour productivity growth was either slow or, what is more, even negative.

This latter was not a must. In the case of industries facing a shrinking market (note that two metallurgical industries and six lines supplying the construction industry belong here) it is not a necessity to restructure the production under the conditions of decreasing efficiency. Deliberate reduction of capacities and staff can be done along with updating. In these industries, however, fixed assets were seldom reduced (scrapped or sold) and, for a variety of reasons, most of the lines had no access to the capital necessary for an efficient reorganization of production. At the same time, although employment in these industries was reduced faster than the industry average, it was still not fast enough to cope with the drop in demand for the products of these industries or with the devaluation of these products in the market.

## Structural changes in the foreign trade of the industry

Reviews of foreign trade of industrial organizations usually establish that in the period between 1978–86 the domestic industry failed to adjust to the changes of the external markets. Up-to date manufactures that could have been sold with sufficient profitability have not gained ground in non-rouble exports. Under the pressure to boost exports a surge in the export of the less processed, material-type goods has taken place. The exportation of unprofitable and subsidy-intensive food products increased both to rouble and non-rouble markets faster than had been planned and considered to be desirable.

Indeed, these tendencies are reflected in the aggregate data of Hungarian foreign trade.* The biggest item of non-rouble exports is still the group of materials, semi-finished products and components. Although the export price index of this group increased at quite a fast rate in the reviewed period, domestic conditions did not bolster the efficient expansion of production of this commodity group simply because this production growth

*On this level of analysis the indicators characterizing the foreign trade of the industry cannot be separated from data on foreign trade of other sectors, especially of agriculture.

was basically built on the growing consumption of imported energy and raw materials – which on the other hand also had a steeply rising price index.

The export of food industry inputs, livestock and foodstuffs is the other major item in non-rouble exports. Here we cannot claim that favourable domestic conditions were missing. The insignificant increase of export prices lagging far behind the growth of costs was due much more to the deteriorating conditions on the external markets and the slow adjustment of product structure to the changing requirements. Accordingly, the divergence between costs and export prices made this export less and less efficient while its volume was growing at a very rapid rate.

The export of machinery, transport equipment and other investment goods did not drop in value or volume (nor in respective shares). However, it is a matter of fact that in value terms the non-rouble exports of the commodity groups belonging to the manufacturing industry (i.e. machinery and industrial consumer goods) did not quite amount to a third of non-rouble exports either in 1978 or 1986 (the other two thirds consisted of materials, resp., food products). These outcomes of foreign trade activity failed to fulfill the expectations that a country with the endowments and the level of development like Hungary should have substantially increased the share of manufactures in its exports in the 1980s. (For example, according to the 6th five year plan this share should have been increased from 30 to 40 percent between 1980 and 1985.)*

In the analysis of foreign trade performance of industry it would not be correct to stress only the unchanged character of flows that stiffened the established proportions. First of all one should refer to the fact that between 1978 and 1986 the industrial production became *increasingly export-oriented.* As shown by *Table 7,* the ratio of the industrial output that goes for export has increased, even if not steadily. This is especially clear in the case of non-rouble exports.

The growth of the export ratio was not concentrated to only a few lines. The number of industries increasing or decreasing their export ratio was 23, resp. 15 in total export. In rouble-exports there was a kind of balance (16:18) whereas in the case of non-rouble

**Table 7**
*Export/output ratios in industry*
(at current prices, percent)

| | 1972 | 1978 | 1980 | 1984 | 1986 |
|---|---|---|---|---|---|
| Rouble export/output | 15.34 | 14.15 | 11.24 | 13.14 | 14.41 |
| Non-rouble export/output | 10.38 | 11.51 | 12.93 | 13.74 | 11.86 |
| Total export/output | 25.72 | 25.66 | 24.17 | 26.88 | 26.27 |

*Source:* as in *Table 2.*

*Similarly, contrary to the plan, there was no growth in the share of manufacturing industry in rouble exports. This share, however, had been already quite high by 1980.

exports the majority of industrial production lines became more markedly export oriented (28:9).

One cannot evade stating here that in the 1980s the growth in export orientation of industrial organizations was not induced by market signals only and was achieved not only through the autonomous decision making of the firms. But even where the role of exportation increased owing to administrative pressures the new sales ratios had certain repercussions in the production and trade activities of the firms. We know of many cases when these effects were rather destructive; forced exportation, for instance, typically brought about the disarrangement of subcontractor relations in the domestic market. At the same time there are ample examples showing that a more intensive export orientation of even this kind induced firms and cooperatives to discover and better understand their external markets as well as to establish a more open attitude towards the world market.

From the analysis of export/output ratios in the individual industries one can conclude that some industries more than marginally increased their respective non-rouble export ratios. There are eight lines – quite different in nature and weight – whose export ratios were increased in an apparently consolidated way by 5 percentage points. None of them belongs to industries using a disproportionally high ratio of export subsidies.* These industries are the following: machine and equipment production, ceramics industry, glass industry, petroleum refinery, rubber industry, plastics industry, textile clothing industry, spirits and starch production. A 5 percentage points growth of the export ratio in eight years' time is certainly not a spectacular changing of markets. But perhaps even this rate and the fact that several of the said industries achieved dynamic production growth in this period suggest that with sufficient incentives, pressure and opportunities the Hungarian enterprises can actively discover new markets (i.e. not simply redirect existing trade flows), and are capable of producing and selling the goods demanded by those markets.

The assertion of the export drive outlined above does not mean that the operations of industry became so outward looking that the industry would have discard a large share of its functions related to supply for the domestic market with passing this task on imports. Between 1978 and 1986 it was not only the external orientation of production that strengthened but also the *substitution of imports*: domestic production recorded a high share in local supply. The indicators in *Table 8* unambiguously show that in the post-1978 period import penetration from both rouble and non-rouble markets decreased and the part of domestic supply that was covered by domestic industry increased.**

*This means that between 1978 and 1985 none of these industries were provided with higher than average export subsidies in more than one year.

**The indicator of import penetration is given by the import/domestic supply ratio. Domestic supply is defined as output + import–export, while the indigenous part of this supply is made up by the difference between output and export.

The calculations on import substitution were made from foreign data grouped according to the activity approach and not the organization approach. Only for this data could we justify the homogeneity assumption implied by the concept of these indicators that import, export and production of the same goods are interchangeable.

**Table 8**
*Sources of the domestic supply of industrial commodities*

| | 1972 | 1978 | 1980 | 1984 | 1986 |
|---|---|---|---|---|---|
| Rouble import/domestic supply | 15.44 | 15.32 | 13.26 | 14.25 | 14.79 |
| Dollar import/domestic supply | 11.97 | 17.13 | 14.62 | 13.73 | 15.07 |
| (Output – export)/dom. supply | 72.59 | 67.56 | 72.12 | 72.02 | 70.14 |
| Total | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

*Note:* Domestic supply = output + import – export
*Source:* the same as in *Table 2.*

It is clear that, in principle, import substitution is not necessarily a less efficient activity than production for export.* In the reviewed period, however, enhanced import substitution was a command of external restrictions of imports from the rouble area and internal administrative restrictions of imports from the non-rouble markets. Enterprise decisions about substitution were in most cases made not in accordance with microeconomic efficiency considerations. Even when import substitution turned out to be lucrative for a company, this kind of efficiency was mostly due to the strong protection of domestic market. A look at the data os *Table 9* suggests that in the case of several manufacturing and food industry commodity groups the 70 to 90 percent domestic coverage of domestic supply could develop in Hungary by the mid-eighties only as a consequence of high protection.

Like enhanced export orientation, import substitution was not limited to a few lines or commodity groups. Import penetration decreased in 14 commodity groups in the case of rouble imports (it increased in 12), and decreased in 15 commodity groups in the case of non-rouble imports (it increased in 12). At the same time domestic coverage of domestic supply increased in 17 commodity groups and decreased in only 9. It must be noted that the industries where production grew at relatively high rates between 1978 and 1986 (the ones called dynamic lines above) in many cases based their production growth on import substitution. However, because of slack domestic demand and a growing pressure to export this was not sufficient: these industries also had to increase their export orientation in one or both of the export markets.

In terms of domestic supply import substitution was particularly substantial in mining and the metallurgical industries, in machine and equipment production, in most chemical industries, in paper industry and edible oil production. At the same time imports reached

*In recent years, however, less and less theoretical support has been given by the literature to administrations that opt for development strategies based essentially on import substitution.

**Table 9**

*Indicators of domestic coverage of domestic supply*

[(Output – export)/domestic supply]

| | 1972 | 1978 | 1980 | 1984 | 1986 |
|---|---|---|---|---|---|
| Coal mining | 86.41 | 85.13 | 89.38 | 91.03 | 84.48 |
| Crude oil & mineral gas prod. | 63.44 | 44.58 | 59.62 | 55.97 | 50.25 |
| Other mining | 39.91 | 44.52 | 54.01 | 52.90 | 57.90 |
| Electric energy industry | 87.76 | 90.55 | 87.89 | 88.60 | 89.08 |
| Ferrous metallurgy | 73.75 | 75.38 | 81.12 | 80.91 | 80.31 |
| Aluminium metallurgy | 66.11 | 68.97 | 79.21 | 72.13 | 71.45 |
| "Other" non-ferrous metallurgy | 43.11 | 40.10 | 41.18 | 39.65 | 45.82 |
| Machine and equipment prod. | 47.14 | 31.42 | 34.08 | 39.62 | 36.87 |
| Transport vehicle prod. | 57.15 | 53.10 | 51.10 | 53.38 | 50.83 |
| Electric engineering prod. | 88.23 | 82.60 | 83.38 | 80.73 | 80.67 |
| Telecomm. and vacuum engin. | 71.92 | 77.46 | 79.19 | 79.34 | 76.59 |
| Precision engineering | 55.32 | 38.46 | 35.84 | 30.85 | 38.62 |
| Iron & metal mass products | 81.92 | 74.49 | 76.04 | 73.56 | 72.37 |
| Brick, slate and incombust. | 87.11 | 70.33 | 77.29 | 73.61 | 72.15 |
| Glass industry | 74.34 | 88.44 | 83.79 | 79.41 | 81.86 |
| "Other" building mat. ind. | 83.42 | 73.95 | 88.48 | 89.68 | 90.16 |
| Petroleum refinery | 88.91 | 82.98 | 88.34 | 89.42 | 86.68 |
| Pharmaceutical industry | 74.54 | 74.34 | 73.39 | 69.31 | 66.61 |
| "Other" chemical industries | 59.40 | 51.04 | 57.40 | 59.55 | 59.25 |
| Rubber industry | 70.99 | 54.05 | 53.19 | 56.41 | 57.15 |
| Plastics industry | 79.33 | 67.76 | 76.43 | 80.85 | 80.09 |
| Wood industry | 72.38 | 70.15 | 78.03 | 72.12 | 72.63 |
| Paper industry | 56.00 | 58.69 | 57.81 | 62.92 | 62.85 |
| Printing | 90.25 | 91.94 | 92.14 | 93.18 | 92.50 |
| Textile industry | 81.61 | 73.33 | 72.33 | 70.42 | 67.75 |
| Leather and fur industry | 91.77 | 90.83 | 91.09 | 84.36 | 80.59 |
| Shoe industry | 89.82 | 83.56 | 88.19 | 82.18 | 73.31 |
| Textile clothing industry | 95.58 | 74.42 | 80.36 | 72.06 | 65.90 |
| "Other" industries | 98.28 | 90.60 | 92.37 | 89.18 | 83.82 |
| Meat production | 87.07 | 92.85 | 88.56 | 88.07 | 87.93 |
| Dairy production | 84.10 | 98.95 | 99.37 | 99.20 | 99.00 |
| Conserving industry | 83.00 | 82.06 | 76.54 | 77.73 | 69.35 |
| Confectionery industry | 94.95 | 95.88 | 96.79 | 93.38 | 91.46 |
| Edible oil production | 42.50 | 35.71 | 42.62 | 44.38 | 49.48 |
| Spirits and starch prod. | 92.78 | 88.25 | 89.43 | 89.61 | 83.10 |
| "Other" food industries | 86.55 | 87.78 | 92.09 | 94.50 | 90.75 |
| Industry, total | 72.59 | 67.56 | 72.12 | 72.02 | 70.14 |

*Source:* the same as in *Table 2.*

a percievable higher share than before only in glass industry, pharmaceutical industry, textile industry and conserving industry.

In the period under study foreign trade activity was characterized by a central coercion to raise exports to the non-rouble area, a rather differentiated system of export incentives as well as by a comprehensive restriction of non-rouble imports and the stiffening of external limitations on rouble imports. From all of these one could infer that in this period *intra-industry trade,* a progressive area of foreign trade activity, declined rather than expanded. Our computations do not verify this assumptions. The values of intra-industry trade indicators obtained reveal quite a complex picture. As it can be read from *Table 10,* after 1978 the share of intra-industry trade in total foreign trade continued to grow, in dollar trade it showed a remarkable increase while in the rouble trade this ratio dropped considerably.*

**Table 10**
*The extent of intra-industry trade in the Hungarian industry*
(intraindustry trade/total trade, percent)

| | 1972 | 1978 | 1980 | 1984 | 1986 |
|---|---|---|---|---|---|
| Rouble trade | 54.52 | 63.65 | 58.22 | 53.51 | 52.27 |
| Non-rouble trade | 50.45 | 53.59 | 56.09 | 60.41 | 61.21 |
| Total trade | 60.52 | 63.33 | 65.78 | 65.55 | 67.76 |

*Source:* the same as in *Table 2.*

The decline in rouble intra-industry trade was most probably connected with the fact that, in the reviewed period, the opportunity to get indebted towards the Soviet Union was confined. Accordingly, Hungary could not go on to rely on covering the increments in raw material prices in this way and was increasingly forced to pay the growing raw material bill by enhanced manufacturing and food shipments. Consequently, the importance of balancing shipments in the same commodity group, a factor that used to contribute to the growth of intra-industry trade indicators in CMEA trade, decreased.

The growth in non-rouble intra-industry trade may have been related to the characteristic feature of import restrictions and the export drive that both were relatively comprehensive, covering every industry (or else intra-industry trade would have been held

*In the computations the so-called volume indicator of intra-industry trade (indicator B) was computed on the basis of commodity group data corresponding to 36 industrial lines. The formula of the indicator is the following:

$$B = 1 - \sum_i |x_i - m_i| / \sum_i (x_i + m_i)$$

where $x_i$ and $m_i$ are the export resp. import in commodity group i. For an explanation of this indicator see *Halpern–Kőrösi–Richter* [5].

back by these policies). At the same time certainly also other reasons contributed to the steady or – in non-rouble trade – accelerating growth in intra-industry trade. Such as the differentiation of domestic demand or the more responsive adjustment – in certain fields – to the sophisticated demand of external markets; the gradual relaxation of supply responsibility at companies with nation-wide influence, the extension of the institution of parallel foreign trade activity, the appearance of Far Eastern goods in the domestic market thus breeding competition with traditional products of the domestic light industry.

When explaining the developments in intra-industry trade we cannot exclude the possibility that central pressures exerted by the authorities to boost exports in many lines resulted in an artificial increase in the value of the intra-industry trade index but not of intra-industry trade itself. One could read numerous press reports on cases when a Hungarian manufacturing firm, in order to obtain the input previously having been shipped by its Hungarian supplier, was forced to buy these very inputs back from the West after its producer exported it to that market. These cases could occur since firms originally having quite lucrative deals with their traditional domestic buyers now were driven to achieve a better export performance by central expectations or specific short-term export incentives. The result was, among others, an increase in the index of intra-industry trade although trade was extended in such an unreasonable way that the very same products were exchanged for each other.*

The tendencies in the evolution of intra-industry trade outlined above were in line with the findings of Halpern–Kőrösi–Richter [5]. These authors made computations for the same indicator as we have, but for another population (the Hungarian manufacturing industry), for data of a different aggregation level (SITC two-digit industries), and in a breakdown to somewhat different trade relations. The results obtained by them also indicate that after 1978 intra-industry trade with CMEA countries changed over from growth to decline and in the trade with OECD countries continued to expand. They had no time, however, to observe what we can already see from *Table 10* that since 1984 intra-industry trade reached a higher level in the dollar markets than in the rouble-accounted trade.

In the review of structural changes of foreign trade the next point of analysis is the development of *sectoral and geographic concentration of trade.* The changes in concentration indicators show whether foreign trade of a given country becomes more evenly distributed between different sectors (trade partner countries) than before or developments make it more powerfully concentrated to a few sectors (partner countries). According to *Michaely* [6], the indicator of sectoral concentration of export is as follows:

$$c_x = \sqrt{\Sigma(x_i/x)^2}$$

*I am grateful to János *Deák* for directing my attention to this point.

where $x_i$ is the export of sector i and $x=\Sigma x_i$. By analogy, this indicator can be applied to imports and to the distribution of exports and imports between countries. Its value may fall between a small positive number near zero (exactly $1/\sqrt{N}$, where N is the number of industries resp. countries) and 100. 100 is the concentration value of absolutely concentrated trade (i.e. concentrated to one industry or one country).

According to the results presented in *Table 11* sectoral concentration of foreign trade changed slowly in Hungary both before and after 1978. This corresponded to world-wide experience. The change was particularly tardy in imports, while the concentration of exports was slightly more variable. It can be stated that, after 1978, the concentration of both rouble imports and rouble exports increased. In the long run, between 1972 and 1986, there was a substantial difference between the two export markets: the already more concentrated rouble export became even more concentrated while exports to the dollar market became more evenly distributed between industries.

**Table 11**
*Concentration indicators of foreign trade*

| | 1972 | 1978 | 1980 | 1984 | 1986 |
|---|---|---|---|---|---|
| | *Sectoral concentration in industry* | | | | |
| Output | 20.79 | 20.58 | 20.92 | 21.22 | 20.92 |
| Total import | 24.89 | 25.80 | 25.53 | 25.50 | 26.36 |
| Rouble import | 31.06 | 30.27 | 30.87 | 32.24 | 32.36 |
| Non-rouble import | 31.84 | 30.79 | 31.89 | 31.18 | 29.73 |
| Total export | 29.13 | 28.37 | 27.67 | 27.47 | 27.26 |
| Rouble export | 28.54 | 32.20 | 33.65 | 33.13 | 33.18 |
| Non-rouble export | 27.48 | 23.19 | 24.01 | 24.23 | 23.10 |
| | *Geographic concentration of Hungarian foreign trade* | | | | |
| Total export | 42.04 | 35.72 | 35.44 | 36.30 | 38.37 |
| Total import | 40.30 | 34.45 | 34.29 | 35.98 | 36.06 |

*Source:* same as in *Table 2.*

Comparative international analyses revealed an inverse relationship between the level of foreign trade concentration and the level of development of the respective economies. Accordingly, more advanced economies are less prone to unexpected shocks in their export markets. Unfortunately, due to differences in aggregation the above data on sectoral concentration of the Hungarian industry cannot be compared with those of other economies and this prevents an international evaluation of the achieved level of concentration in Hungary.

The geographic concentration indicators were computed not for the industry only but for the whole Hungarian foreign trade and without segmenting it to rouble and

non-rouble trade. The indicators clearly show that, despite efforts to diversify trade among countries, the geographic concentration of exports as well as imports increased between 1978 and 1986. One of the explanations for this lies in the increase of the share of Hungary's trade with her biggest partner, the Soviet Union. This growth occurred in both exports and imports: from 31.3 percent to 35.0 percent resp. from 28.8 percent to 30.8 percent. When calculated for all other countries but the Soviet Union, the indicator showed a slight drop in the case of exports (1 percentage point) and an even smaller increase in imports (0.6 percentage point).

## Summary and conclusions

There are several enlightening and useful critical analyses that, starting from the assessment of recent structural changes in the world economy, justly point to the rigid structure of the Hungarian industry and its foreign trade. Some basic characteristics of this economy prevented the swift structural changes that could be detected in countries usually cited by way of example. Here we must mention the economic and political institutional system relying on the steadyness of hierarchical relations, the economic policy comprising many elements of traditional planning that has been preoccupied with the continuous and detailed correcting of shifts and imbalances emerging in the evolution of the economy. It would be a mistake, however, not to recognize the structural changes that evolved during the period of restrictions. Although most of these changes were modest and spontaneous ones, they are nevertheless important because they may act as a germ of future progress.

Most synthetic indicators of structural change show a deceleration in the transformation of industrial structure. Modification of the size and proprietory structure of industry has been accompanied by a differentiation of economic performance. This clearly indicates that if the existing institutional obstacles to the development of non-state as well as small and medium size enterprises were liquidated, this sector of the industry could help, directly or indirectly, in vitalizing the whole industry.

The analysis of dynamic and declining industries revealed that a certain process of polarization has already set off in the Hungarian industry. Although this polarization is not as rapid as in those market economies where fast adjustment is the rule, there is a possibility for this polarization to accelerate if market type financing becomes predominant and the paternalistic behaviour of the state is steadily confined.

In the last eight years the structure of industrial foreign trade has not improved but remained unfavourable. When compared with recent transformations in the structure of world trade it even shows a deteriorating tendency.* According to our analysis both export orientation and import substitution activity became more pronounced at domestic

*See for instance the analysis in *Inotai* [7].

firms. However, both kinds of activity got impetus from administrative restrictions, pressures and specific subsidies. This is why stronger export orientation and a more intense substitution of imports many times enhanced such, seemingly efficient, industrial activities and trade flows, that could only be maintained at enormous social costs.

But we must also stress the less important, but positive consequences of this dual orientation. The strengthening of export orientation and import substitution directed the attention of Hungarian firms to external markets, foreign products actually or potentially competing with Hungarian ones as well as to external prices, exchange rates and the different forms of conducting foreign trade. This also means that industrial organizations acquired the ability to better adjust to changes in external markets in the future. This ability, however, can be utilized only if some other conditions are met. Firstly, efficiency constraints for the firms should be effective, then possibilities of financing should become more diverse and stable, and last but not least the central management of the economy should make up its mind and on the basis of a well-established concept the Hungarian economy should be transformed into a really open economy.*

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*On the notion of openness and the necessary changes to make an open economy see *Lányi* [8], *Nagy* [9] and *Gács* [10].

# ИЗМЕНЕНИЕ ПРОИЗВОДСТВЕННОЙ И ВНЕШНЕТОРГОВОЙ СТРУКТУРЫ ВЕНГЕРСКОЙ ПРОМЫШЛЕННОСТИ В РЕСТРИКЦИОННЫЙ ПЕРИОД (1978—86 ГГ.)

Я. ГАЧ

В своей статье автор с помощью статистического анализа стремится дать многостороннее освещение того, в каких направлениях и с какой скоростью изменялась промышленная структура за прошедшие восемь лет. Он показывает те стороны, где наблюдалось окостенение структуры, и те, где ощущался сдвиг, наблюдалось складывание новых пропорций по сравнению с прежним положением отраслей промышленности. Большая часть синтетических показателей изменения структуры говорит о замедлении структурных изменений, однако ни один не показывает их полное отсутствие. Перегруппировка организационной структуры промышленности в зависимости от отношений собственности и размеров сопровождалась дифференциацией экономических результатов. Анализ динамичных и свертываемых специальных отраслей показывает, что в венгерской промышленности начался своего рода поляризационный процесс. Внешнеторговая структура промышленности продолжает быть весьма неблагоприятной и имеет тенденцию к ухудшению. Нацеленность на экспорт и замена импорта под влиянием административных ограничений и давления, а также дифференцированной поддержки усилились, и это привело к такой производственной деятельности и торговому обороту, которые на долгий период могут быть сохранены лишь с помощью высоких общественных затрат. Усиление такой ориентации в двух направлениях венгерских предприятий означает в то же время то, что промышленные организации в будущем смогут легче приспосабливаться к изменениям внешнего рынка, если будут принуждены к этому рыночной доходностью, если расширятся и стабилизуются их хозяйственные и финансовые возможности и если хозяйственное руководство решится на то, чтобы на основе продуманной концепции превратить венгерскую экономику в подлинно открытую экономику.

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# A DEBATE ON THE CRISIS OF THE HUNGARIAN REFORM IN THE 1970s

## THE CRISIS OF THE HUNGARIAN REFORM IN THE 1970s*

I. T. BEREND

### Successful reform and plans for further development after 1968

The reform decision made by the Central Committee of the Hungarian Socialist Workers' Party in May 1966 can be regarded as one of historical importance. It abolished the centralized bureaucratic planning based on mandatory targets and thus started the transformation of the functional and management system of the economy. Intensified interests and market incentives brought about a more flexible system which, important compromises notwithstanding, provided favourable opportunities for exploiting the prosperous trends at that time evident in the world economy. Accelerated growth, faster technological modernization, improvement in services, large-scale development of motoring and a surplus on the balance of payments (which had rarely occurred before) were all signs of successful adjustment to the international trends of prosperity. In this article, although I do not want to examine the frequently discussed questions of the results and effects of the economic reform, it does seem indispensable to briefly discuss the fact that the preparation of the "second stage" of the reform originally introduced with deliberate compromises and planned to be gradual, in other words, the preparation of a more consistent assertion of the 1966 reform conception began very soon after the introduction of the reform. The Economic Policy Committee, the highest economic policy body of the Hungarian Socialist Workers' Party, discussed a proposition concerning the "Subject matter of the further development of the economic management system, and the organization of the work" at its meeting of 30th September 1968. Consequently, it made the statement that "the functioning of the economic management system, its analysis, the strengthening of its influence and its further perfection necessitate two

*A true account on and evaluation of the debate necessitates a hint on two facts, not mentioned in the papers above.

1. The pioneering paper by I. T. Berend was written and published in Hungarian before the Party Conference in June 1988, that is, before the shift which made analyses of this type possible.

2. Beside the two articles rejoining the debate a third one has also been published in *Valóság*, the monthly that published I. T. Berend's paper, namely, by László *Szabó*, a well-known journalist, who is more than once cited in the debate. As his argumentation does not contain any relevant aspects of the questions disputed we did not find it necessary to include his paper in the presentation of the debate.

different lines of activity." On the one hand, it was seen to require "theoretical activity involving scientific analysis concerned with a long-term outlining of the means of economic management and the regulators needed to serve the evolvement and completion of the reform, and of its feasible variations." To guide this activity, a committee was formed with István *Friss*, Péter *Vályi*, József *Bognár*, Lajos *Faluvégi* and Tamás *Nagy* as members. At the same time, preparatory work was started on positive reform measures such as the "establishment of a uniform rate of exchange... (convertibility – uniform rate of exchange – domestic price system)". In addition, there began an analysis of questions concerning "the extent to which the administrative, banking and other organizations can come up to demands; according to which principles, and in which direction they should be further developed..." The following areas also became topics of research: "ways to improve the social control of the economy, the role of the supervisory committee... advantages and disadvantages of filling management jobs through competition, etc." [1].

The proposition of the Chairman of the National Board for Material and Prices, submitted in spring 1969. already contained a far-reaching new measure of the Economic Policy Committee concerning the price reform: "The task facing the long-term price policy arise exactly from the fact that the criteria providing the basis of the 1968 price reform have, so far, been only partly asserted." Lack of competition, exceptions integrated into the system of regulators, a wide gap between consumer and producer prices, and the restrictive effect of fixed prices were indicated as causes. It was stated that "these circumstances cannot be fundamentally changed within a short time", but further reform measures must be taken so that "world market relative prices should more definitely affect price formation. The aim is that, by the early 1980s, consumer prices which can in fact promote rational changes in demand and supply should be predominant."

The Economic Policy Committee made yet another far-reaching fundamental decision at the same meeting: "In the course of elaborating the price policy conception, it has to be taken into account that the convertibility of the forint, and a currency reform will be items on the agenda in the coming years... In the course of further perfection of the price system, efforts must be made to ensure that relative prices on the domestic market should more clearly reflect relative prices on the world market, thereby contributing to the restructuring of production..." [2]

From 1969 on, the large-scale plans for further development of the reform affected fields which had been untouched by the 1968 reform, on account of unavoidable compromises. One of these fields, particularly to be stressed, was the programme of institutional transformation, deliberately neglected by the reform. The Economic Policy Committee discussed the proposition concerning the "further development of large enterprise organization" in summer 1969. It made the following statement: "The monopolistic position must not be maintained in the production and trade of such consumer articles... where this position entails disadvantages for household supply and price formation." A decision was made supporting the principle which recommended the

splitting up of a few large enterprises and trusts. It was also laid down that "it has to be investigated, in which fields and by what means small and medium enterprises using up-to-date equipment and functioning profitably should be established." [3]

When, eighteen months later, the implementation of this decision was reviewed, reports had already been made of a few minor investigation covering 70–80 enterprises (i.e. in 1970). [4] In that year, an exhaustive institutional reform plan for the restructuring of enterprise organization was drawn up.

The Economic Policy Committee stated that: "The enterprise organization, in the way it has developed in the past, has failed to provide the optimum organizational framework for the evolvement of the reform in several fields. It did not seem expedient to revise enterprise organizations simultaneously with introducing the reform. However, in order to improve the efficiency of the reform, it is necessary to carry out a revision and correction of the enterprise organizations.

Under the work programme of the Economic Policy Committee, we started a revision of organization in certain industries – building industry, transport and trade... In the course of the rush reorganization of 1962–64, many enterprises were fused into national large-scale enterprises to comply with the requirements of the central management. In a number of industries the large enterprise or the trust worked in a monopolistic position... Such a position developed in several such fields in which this structure is an obstacle to any sound competition... Large monopolistic organizations often play a role that is disadvantageous for consumer and producer prices... The crux of the problem involves the existence of unjustified monopolistic positions and... with a lack of the small and medium enterprises which are indispensable for satisfying consumer needs... competition must also be made possible by splitting up large enterprises and by organizing factory units into independent enterprises."

"In conformance with the guiding principles, the types of measures for the development of organizations are as follows: splitting up large economic units (the large enterprise and trust)... cutting off units from monopolistic large enterprise organizations; ... The establishment of direct relations between domestic and foreign trade on the one hand and producer organizations on the other, widening the sphere of those enterprises disposing of dependent foreign trade rights, and the creation of new organizational forms."* The appendix of the proposition also contained the detailed suggestions of each ministry for the abolition of enterprise monopolies and the splitting up of a few large enterprises.

*"In consideration of practical needs, monopolistic types of organization seem to be justified in certain public utility services, e.g. MÁV – Hungarian State Railways, the post office, if that is reasonable in view of optimum size (with regard to international competitiveness). This also applies to such fields where domestic and international load distribution requires direct operative measures (for example, electric energy industry, aluminium metallurgy, meat industry). The monopolistic position must not be maintained in the field of consumer articles and non-communal services in which such a position entails disadvantages for household supply and price formation." [5]

It may seem surprising how long I have dwelt on (not to mention the length of the passages quoted) the 1970 programme of the institutional reform, which aimed at splitting up the large enterprise organization. This is, however, justified by the importance of the envisaged reform measure and by the need to demonstrate the existence of a reform strategy encompassing progressive principles, and striving to assert itself gradually and consistently.

The work that was started between 1968–70 on further development of the reform (i.e. the preparation of the planned "second stage" of the reform) is of such significance that it justifies presentation of work accomplished in another field: that concerning capital and labour to flow more freely and, further, together with the top-level decisions made on the subject. Relying on the decision of the Economic Policy Committee, the Economic Policy Department of the Central Committee formed a work commission with the task of examining the flow of social capital. In the report of this work the following can be read: "The commission has made extensive analyses and drawn up proposals... for the temporary or definitive redistribution of the decentralized development resources and for the introduction of a partial commercial credit, for an increased variety of forms serving redistribution of the fixed assets of economic units, for the legal regulation of the issue of and subscription to bonds, and for the establishment of an institution that would organize and deal with the planned flow of capital.

The commission's proposals have been discussed and approved by the Economic Policy Committee..." In addition, the Commission considered it to be important that the freer flow of resources should start as a complementary form, in a decentralized manner.

"Legal rules that are in force have so far not allowed a temporary or definitive redistribution of the decentralized development sources in the sphere (and within the scope of authority) of enterprises." The commission, however, took a stand which enabled "the temporary and definitive transfer of development funds. This will allow development funds that are free for short or long periods to be allocated to areas in which they can be used more efficiently. Development funds can be definitively transferred for investment purposes or for financing permanent needs for working capital, and credits can be granted from such funds for the placement of commercial supplies... State-owned enterprises and cooperatives may transfer or let or freely lend to one another their fixed assets and material goods (machines, equipment, etc.)... The Work Commission suggested that issue of and subscription to bonds be allowed, since this form of redistribution of social capital can be fitted into the Hungarian economic management system and it would entail economic advantages. On the basis of the decision made by the Economic Policy Committee, preparatory work began on the legal settlement of the question. According to the conception. the issuers will be the central organs of the state, certain groups of councils, large enterprises, cooperative centres and banking institutions; the subscribers will be the economic units (enterprises, cooperatives), councils and private individuals. The proposed bonds will be negotiable through the banking institution authorized thereto; this may involve the selling, or contracting of a loan against security on the bond. Bond issue will be subject to licence and, in order to

acquire the necessary experience (after the legal settlement), in the first instance it will only operate in a narrow sphere, mainly with a view to satifying local communal needs."

". . . As was suggested by the work commission, the Economic Policy Committee has decided to establish a Central Development Institute. . . According to the conception, the Institute will deal with grants and allocations in connection with the large-scale development of working enterprises ("increase of the capital stock"), their reduction or winding up ("withdrawal of capital"), foundation of small and medium enterprises, and investments (also involving favours und grants). Preparations for the establishment of the institute are under way, as is also the investigation of questions regarding the development of a rational organization of the banking system.

The Economic Policy Committee further considers it important that economic research pay more attention to the theoretical problems of the flow of social capital." [6]

In 1970, the economic management started work on the reform of the flow of assets and capital, the flow and mobility of labour, the wage reform transforming wage and income proportions in order to promote the former. In this respect, one important measure taken within the framework of the 1968 reform was now considered as only an initial step. This involved the abolition of the earlier applied strict penalties for "arbitrarily" leaving an enterprise, i.e. the liberation of the flow of labour, which had been put into practice by a modification of the Labour Code. The deputy ministers' meeting in the Ministry of Labour – charged with the preparatory work in restructuring wages and income relations and of forming concepts for a long-range income policy – reported on the progress of these preparations of further development in the following manner: "In the middle of the present year, the Economic Committee instructed the Minister of Labour to draw up a long-range programme for the transformation of income relations and to submit it to the Economic Committee before the end of the next year."

"On the basis of the known criteria and economic processes, certain questions must be answered. For instance, how should the difference between minimum and maximum earnings – in percentage and in absolute forint amounts – change? What role should qualifications play in determining relative earnings? In comparison with the present situation, what shift is necessary in the relative earnings? What does the notion of high earnings indicate? Is it possible at all to determine this in an absolute or relative sense? . . .

Analyses should be made of the direct and indirect prospects for, and the necessity of, influencing extremely high personal incomes." [7]

Thus it is evident that between 1968 and 1970 the development and further progress of a price system more reflective of relative values and international market effects, the preparation of an institutional reform of enterprise organization so as to improve the conditions of competition on the market, the preparatory works necessary for creating a convertible currency, the laying down of the conditions for the freer flow of capital and labour among enterprises and the establishment of the necessary institutions were already on the agenda and fitted into the existing strategy of a genuine further development of the reform. These measures would have eliminated many of the compromises and

restraints which had been built into the 1968 reform. As such, they would have promoted a gradual yet essential further development of a more consistent mechanism of economic functioning, taking into account political and social conditions.

However, in the early 1970s, further development programmes were soon taken off the agenda.

## Halt – adverse criticism of the reform

The preparatory works of an institutional reform came to a halt. It became quite clear that the further development of the solitary Hungarian reform and a consistent assertion of its principles were hardly feasible. The entire history of the Hungarian reform process demonstrates clearly that it was definitely influenced by the reform trends emerging in the socialist countries, the policy adopted in 1956 by the 20th Congress of the Communist Party of the Soviet Union, the 1964–65 Soviet reform initiatives (the so-called Liberman dispute) and the Czechoslovak reform decision. János *Kádár* could justly state at the November, 1967 meeting of the Central Committee: "Economic management reforms similar to ours are in the making in several countries. . . I think that is an international necessity urged by development." [8] However, after the introduction of the Hungarian reform, i.e. at the end of the 1960s and beginning of the 1970s, the situation radically changed. Reforms were not only taken off the agenda, but reform became increasingly suspicious of "reformism".

The Hungarian reform process (which the party leadership insisted on carrying further in spite of the radically changed international environment since the preparatory phase) elicited distrust. Consequently, it faced open or covert criticism from the end of the 1960s. Prime Minister Jenő *Fock* openly discussed the matter before the public at the national propaganda meeting in 1971. He talked of the unease in other socialist countries about the abolition of compulsory plans, the introduction of market elements, and the weakening of the omnipotence of the state. These developments were judged to be perilous to socialist conditions.

In December 1973 an article in the daily *Népszabadság* talked about the "fraternal worries" shown towards the Hungarian reform: "Although the instances are less frequent, we have seen in our friends not only trust but also worries with regard to our economic management system. What is a planned economy without compulsory plans for enterprises? How is the state's role asserted, if more than half of the investments are put at the disposal of enterprises? Such and similar questions have often been raised, especially in the course of disputes among economists." [9]

It is hard to judge and, at the present time, impossible to reveal in detail, what mass of direct and indirect criticism and pressure existed beneath the publicly known surface, it was just the tip of the iceberg that could be seen.

In any case, the criticism – expressed in various forms in the early 1970s – encouraged the Hungarian party leadership to adopt a defensive stance, forcing it to

repeatedly declare that it did not want essential changes, that the reform that had been put into effect did not produce an economic management system different from that of other socialist countries, and that no "Hungarian model" existed at all.

In October 1972 the central party daily stressed in an inner editorial: "We are witnessing the increased use of *one of the latest methods of anticommunism: propagation of the various « models »* of socialism. . .

Its objective is . . . to stir up nationalism, encourage national separation, and give rise to distrust between countries that are building a new society. According to these dual efforts, the « models » themselves can be divited into two different groups. One comprises the so-called «types of socialism», and these are described as «democratic» and «humane», etc.; the other consists of "national types", such as «Russian» or «Hungrian» socialism. . .

*The models of «national» socialism attempt to confront national particularities with the general rules of socialist building* . . . They make use of the «models» to «justify» and promote national separatism, as well as to belittle the international significance of the Soviet experience in the building of socialism. *The purpose of the theory of different national models of socialism is to rouse nationalistic and anti-Soviet feeling.*

Bourgeois propaganda also proclaims the existence of a «Hungarian model», contrasting it with the work of other countries building socialism . . . In this respect, our position is clearly to refuse the unfounded conceptions surrounding a so-called «Hungarian mode.»" [10]

In spite of the first few successful years and further development of the "new economic mechanism", the hesitation of the reform process soon led to the emergence of even stronger anti-reform criticism and disputes. This was rooted mainly in the inner social conflicts had been deepened by the reform.

The reform, although quite extensive, had only partly been put into effect and this raised difficult new requirements, disturbed deep-rooted habits, and upset hard-set doctrines. There were also numerous misunderstandings. The latter were magnified by inexperience and the errors committed, as well as by the omission of necessary interventions. The functioning of the reform mechanism basically hurt earlier vested in various fields and on various levels. In other words, interests jeopardized by the reform were important factors underlying the tensions and the criticism. The principle of differentiation of incomes according to quality, value, and amount of performance worked against the interests of those refusing to increase their efforts, those seeking comfortable positions, or those unable to improve their performance. Such attitudes helped to produce average – or below-average – results, and thus the levelling off of incomes served their interests well.

That type of medium-level manager who was never compelled to make an independent decision, nor was capable of making one, who shifted responsibility on to higher levels, who rested content in a comfortable approach of "not doing anything will cause no trouble", and who put obstacles in the way of those "obsessed" with seeking new ways and taking risks – it is in the interest of such a manager to see that the environment gives him security (also strengthened through a few personal ties). The emphasis laid on

competence alarmed the tens of thousands holding medium-level posts in the administration and the political leadership who had only political-ideological trustworthiness and good connections to their credit.

The reform obviously hurt a lot of interests. This intensified conflicts and elicited attacks.

More exactly, it provided opportunities to pretend to act in the interest of workers and the protection of socialism, to exploit the undeniably emerging social tensions, and to ensure a kind of mass support – all with the intention of backing up the political attack on the ruling power and the political trends. Accordingly, certain groups conjured up images of increasing capitalistic tendencies and talked of the discarding, or at least a serious weakening, of the planned economy. In the field of income policy, they pointed to the suppression of workers' interests and talked about a "private paradise". They were worried about state-owned industry because the agricultural cooperatives were becoming "over-pretentious"; they were anxious about socialist principles because of the levels of income differentiation and the trickeries that distorted it; and, against the "economist's" approach to efficiency, they laid emphasis on ownership, incomes policy, and the socialist way of life.

The situation was an intricate one, fraught with many confusions. For example, by giving priority to household supply, the reform intended to allow greater scope to small enterprise or to the small- and large-enterprise combination. This was inevitable, for state-owned big industry, the advanced state-owned network of services, and the socialist large-scale farms could not satisfy the demand for commodities (either in volume or the necessary range of choice) and indispensable services. Of course, such services were mainly in the interest of workers – who constitute the greater part of the population – for they eliminated, for example, meat shortages that had frequently occurred before, and provided mending and repair services.

It has to be added that the political leadership had to explain this interaction as early as the mid-1960s, at the time of the preparation and introduction of the reform. Party leaders made serious efforts at explaining to party members and to all workers that the recognition and assertion of the interests of agriculture and the peasantry represent, in the final account, a policy in the workers' interest. For example, in connection with the raising of agricultural procurement prices, Lajos *Fehér* argued in a public debate in early 1966 against, those who ". . . object to « the extent of support » given to the peasantry. Many even add that, «as a matter of fact, workers pay for the raising of the peasants' living standards.» A certain amount of anti-peasant feeling arises in town from time to time. Such feeling is now strenghthening." [11]

János Kádár stressed in a speech he delivered about the same time: "Such superficial statements according to which problems are solved at the expense of cities are much too biassed and fraught with emotional elements. It has even been said that peasants are not working but speculating... Party members must by all means understand that the measures taken are part of a well-considered conception which, in harmony with our

previous policy, is to serve the interests of the working class and of the whole working people. . ." [12]

Beside the trustworthiness of these words, facts: a fast elimination of meat shortages and the general improvement of supply were genuinely convincing, at least for some time. After a few years, however, parallel with the development of income differentiation, anti-peasant and anti-intellectual emotions were again prevalent. Peasants' incomes were, namely, growing faster than workers' incomes, though the latter were growing at a higher rate than ever before. There appeared, of course, those "clever" people who grew rich in 2–3 years by exploiting the grave shortages of the capacities of the state-owned building industry, and by making use of the building boom brought about by increasing incomes. Yet there was a lack of measures which could have hindered the growth of differences and the exploitation of deepening social tensions. For example, there were no adequate measures of taxation.

Another opinion, which emerged and enjoyed mass support, claimed that "order must be made", the economy must be subordinated to incomes policy, household farming should not enable peasants to grow wealthier than workers, the outstanding incomes earned by intellectuals and managers in their main jobs and their extras should be limited, and these measures were to be implemented in such a way that, limitations notwithstanding, risk-taking initiatives would be encouraged along with the productive spirit, so that no recession should occur in any field. No adequate compromises were found, however.

The leading group of reform critics within the political leadership, who aimed to "cut off the excesses of the reform", opened a line of attack in autumn 1972. It will be the task of a coming generation of researchers to reveal the matter in full by poring over archival sources.* It is already a well-known fact, however, that in spring 1972, when he was sixty years old, János Kádár offered his resignation to the Central Committee. The latter did not accept the resignation but asked János Kádár to retain his post. At the same time, certain conservative political groups increased their activities and, in their drive for greater power, they found the best ideological basis in the protection of "workers' interests" and "socialist values". It was clear that they had some international support.

Criticism of the Hungarian reform at home found ample support and a reference basis in the conservative circles of the other socialist countries, and in their distrust of the Hungarian reform. This criticism broke through officially and publicly, though only partially, in November 1972. The decree approved at the Central Committee meeting, while stating that "the economic management system put into force on the 1st January 1968 is an appropriate and efficient means of serving the socialist planned economy and of building socialism", stressed that the execution of earlier decisions had not been adequate in every respect, and, "what is more, it does not follow the desired course in certain fields, nor is it implemented in the desirable way." [13]

*At the time of writing this manuscript, the party archives were open to research up to the end of 1970; details revealing the divisions of 1970 were thus not available.

Two and a half years later, in his contribution to the 11th Congress of the Hungarian Socialist Workers' Party, Árpád *Pullai* – secretary of the Central Committee – said in reference to the November 1972 Central Committee meeting: "The party did not hesitate to examine the correctness of some of its earlier decisions. It had the strength and the courage to make corrections in accordance with society's interests and our principles. . . it corrected the trend where it was not satisfactory." [14]

Zoltán *Komócsin,* secretary in charge of the foreign affairs section of the Central Committee spoke even more plainly in his article "With unchanged politics" in *Népszabadság* in spring 1974: ". . . it was stated in the resolution of the 10th Congress that the Hungarian economic management system introduced in 1968 has stood the test. . . Yet we must *not* be dogmatic and insist *rigidly on every word that has been said. . . What was good yesterday may grow out-of-date today and it may need to be changed. . . let us learn* – the more the better – *from the approved methods of the other socialist countries. . .* It is a well-known fact that the economic management system of the European fraternal countries. . . is different from ours in numerous respects." The conclusion suggested that *"with constant adjustment and further development of practice in accordance with the changing requirements of reality,* we continue our way without wavering. . ." [15] Such reasoning expressed a need to revise the reform.

In autumn 1972 and in the ensuing years, efforts were made to release tensions and to carry out the corrections necessary for the sake of the reform, but attempts were also made to abolish the most important achievements of the reform. There was great confusion. Important groups of the political leadership maintained that the "two-front struggle" was the correct response in this situation and emphasized the risks confronting both sides in the debate. The editor-in-chief of the central party periodical *Társadalmi Szemle* thought it important in January 1973 to contradict certain rumours about the Central Committee decision "which say that essential opinions representing different platforms were expressed. Some say. . . that the followers of two basic conceptions, representing radically different objects, clashed. . . and continue to clash, and a battle between «reformists» and «dogmatists» has been mentioned." [16]

So much is in any case certain: that those against the reform were also compelled to make compromises. János Kádár repeatedly and very definitely made the statement in public: ". . . the Hungarian economic policy – including its agricultural policy – and the cultural policy are unchanged; we will pursue our well-tried economic management system. . ." [17] In the given situation, however, when conservative trends were also predominant on the international level, it seems that no way could be found to defend the reform line other than that of compromises and flexible retreat. Although the line was in a less advantageous and weaker form, the compromise at least enabled the fundamental achievements of the reform to be maintained.

The November decree of the Central Committee caused disappointment in certain anti-reformist circles. The editors of the central party periodical put questions to four leading party workers in early December 1972. "We asked them about the reception of the highly significant Central Committee stand taken. . ." One of those questioned – Pál

*Romány,* first secretary of the Party Committee of the Country of Bács-Kiskun – said, among other things: "Some expected a kind of «making order» . . . hoping to see it proved that errors can be made only «at the top» and that, consequently, the economic management system, or perhaps the cultural policy is to be blamed. . . Such expectations have not been fulfilled . . . those pressing for nothing but firmness and voicing pseudo-radical views wanted our party to retreat. . ."

A similar view was expressed by the first secretary of the Party Committee of the 13th District of Budapest: "Some expected the meeting to justify their opinion, which is that the economic management system has failed and that our policy was wrong." [18]

The central party periodical reverted to these questions some time later and, in an editoral, particularly stressed the point that «leftist» self-justifiers are mistaken in their expectations. . . our party has definitely blocked the way of retreat, i.e. the way back to a sectarian-dogmatic policy and its methods. . ."*

## Retreat and recentralization tendencies

The fundamental institutions of the reform introduced in 1968 – economic management without compulsory plans, enterprises' market orientation, and the reliance of the state's control and influencing activities on economic regulators – were no longer to be eliminated. Yet decisions of fundamental importance were made which tended towards recentralization and, by virtue of corrections, there was something of a deliberate retreat. Among them, one statement deserves special attention. This says that "economic management organs should examine separately, and watch the activities of, the biggest 40–50 state-owned enterprises which produce the greater part of Hungary's industrial output and, where it is necessary, special measures must be taken to guarantee for them the necessary working conditions." As a result, the Council of Ministers in fact took the 50 biggest industrial enterprises and, in 1973, placed them under direct central control. These held 60 percent of Hungarian industrial assets, produced approximately a half of the country's industrial output, provided for more than 60 percent of exports and employed 700 thousand men. Although the general and mainly indirect market regulation of the economic management system remained valid for these enterprises, in fact important elements of the system of command management were informally smuggled back into their functioning. This was made obvious by declarations such as that of the Secretary of the Budapest Party Committee: "For us, the political purpose of the decision is the main thing, which is the consistent assertion of our working class policy."

". . . It is now possible for the economic management organs to receive direct and authentic information on the activities of these enterprises. . . Relying upon such information, they can maintain control more efficiently, if the work and interests of the

*Following a strictly "two-front" line, the editorial referred, in the same sentence, to a simultaneous repression of "all revisionist attempts." [19]

biggest industrial enterprises are in harmony with national economic interests, with national economic targets, and with the requirements of the economic policy of the party. Also, they can give immediate help to overcome the enterprises' unexpected difficulties.

It is the sectoral ministers who are mainly responsible . . . for executing the decisions. . . . I mention as an example the fact that the 1976–80 development conceptions of these enterprises will be discussed at a special meeting of the management and control organs concerned." [20]

Also, the Central Committee has ruled that the government should elaborate "an amendment of the economic regulators with a view to a planned development of the national economy. . ." [21]

The amendment of economic regulators started without delay and, in January 1976, corrections that were deemed necessary – along with the new rules which made use of lessons learned but also contributed to retreat – came into operation. In comparison with 1975, 5 percent more of the net income realized in the national economy was centralized. "This also involves a certain expectable centralization of decision-making and financing, in the course of the period," said Ottó *Gadó* about the amendment of the system of regulators. "The so-called large investment projects involving development loans, earlier planned and financed as enterprise investments, came within the central decision-making sphere." What is more, "informal" central interventions were institutionalized in the implementation process, so as to strengthen the role of control organs. This was in order that "the ministries could discuss and report on the important enterprise investment decisions." Through the reduction of import subsidies, and an increase of wage taxes, enterprise profit was reduced by 30–35 percent. In words still stressing anti-egalitarianism, the new regulation set strict limits to enterprises' incentive rewards. These were not to exceed 20 percent of the wages cost of the previous year (including the profit share at the end of the year). At the same time, taxation of the profit sharing fund was implemented in such a way that it reached into the 80 percent upper tax bracket since with "the payment of more than 40 days' profit shares development would be rendered impossible. . ." Through the new order of taxation, profit-sharing was to a considerable extent levelled – differences in fact could move between 15–18 and 36–42 days' wages. At the same time, the new wages regulation system placed a 600 percent payment obligation on average wage-increases over 6 percent, by means of the linear taxation of the average wage-increase.

"This system also «levels» and reduces dispersion" is the way Ottó Gadó summed up the situation in his description of the new regulatory system and he added that, "thereby a distortion of relative wages was rendered avoidable. . . although incentive was to some extent subdued."

Finally, a number of achievements of the reform were allowed to be impaired and overruled by the condition that, "if some objectives of the national plan cannot be attained with a suitable modification of the regulating system, and if it is justified in order to assert the interests of the national economy, ministers may avail themselves of

the right of instructing the state enterprises, as laid down in the legal regulations." [22, 22a]

The corrections thus allowed a wide scope for direct central intervention, thus damaging enterprise independence. In autumn 1975 Árpád Pullai also stressed the importance of direct party control: "Such views and positions. . . have emerged which, though not expressly challenging the leading role of the party, would in fact repress it, should they be asserted. For example, some people thought, at the time of the introduction of the economic reform, that the regulators would somehow lead the economy quasi-automatically toward socialism. As a consequence of some erroneous views and a few incorrect measures, the leading role of the party was temporarily weakened in various fields of the economy – in factories, enterprises, and cooperatives. We, too, made a mistake when, at the time of the introduction of the economic management reform, we talked more of what the party organizations should *not* interfere with and less of what they should do. . ." [23]

Passions flared up about the issue. "It is difficult to render in words, to reproduce the atmosphere at the party meeting of the 13th District" the press report said in February 1975. "What is involved was made clear primarily by the party committee secretaries of the two biggest enterprises – given preferential treatment – of Angyalföld: the Hungarian Shipyard and Crane Factory, and the Láng Machine Factory. In their contributions, both levelled sharp criticism at the practice in which some of the central organs left the management of the socialist economy to the automatism of various regulators and considered direct control methods as outdated in the intensive phase of the development of the economy. This practice had, in recent years, given rise to several such economic decisions which, obviously, had disregarded the political consequences. Thus the collectives of large enterprises – of primary importance to the national economy – had been brought into an extremely difficult situation."

Referring to the long traditions of these factories as strongholds of the industrial workers, the contributors challenged the efforts which had been directed at the structural transformation of production. They had found that such efforts hurt their interests. In their judgement the decisions had brought "difficult times" to their enterprises and had caused uncertainty of existence, almost as if there was some anti-worker conspiracy. "That this has not succeeded is thanks to the November 1972 resolution of the Central Committee of the Party. . ." [24]

Among the reasons for direct intervention, however, the *protection* of the state-owned large enterprises, strongholds of industrial workers, played an important role not only on the enterprise level. "The development of state-owned large enterprises is not exclusively an economic question," Central Committee Secretary Béla *Biszku* argued in his contribution at the Party Congress "but it is an integral part of party policy. . . It can well serve the strengthening of the class base of a society that is building socialism." [25] Trade unions and trade union functionaries championed the same views on behalf of the workers of large factories, thus protecting their interests. These developments considerably strengthened the power positions of party and trade union officials.

In summer 1975, a newspaper article, reporting on the findings of party supervision, in large enterprises mentioned a favourable turn as compared with earlier years: "Some of the economic leaders thought at the time that it was enough if the party organization simply provided propaganda for the respective tasks, i.e. for their execution, and the rest was the economic leaders' business... Then, the party secretary could easily be reproached for «unauthorized interference» in economic managers' business"... It rarely occurs today that one or another economic manager should question the right of the party organization... ' [26]

At about the same time, *Társadalmi Szemle* argued as follows: "Planned economic management... applies direct means in order to achieve the objectives that have been set. Some of the real processes are directly guided on the basis of the national economic plan, through central investments, instructions as to the fulfilment of special production programmes, the emphasizing of certain «expectations», the laying down of quotas, and in a few other forms as well." [27]

The intention to restore direct central intervention could not have been made more obvious by the Central Committee Secretary Árpád Pullai's remarks, made in Parliament in December 1972: "... every enterprise – the biggest included – is part of the country's economic processes. They are autonomous, yet not independent of what takes place from time to time in the national economy. The competent ministries must not leave these enterprises to themselves in their duties and difficulties to the extent that they have been in recent years. *Every large enterprise is responsible for its economic management. Yet every ministry is also responsible for the activities and development of the production units belonging to them.*"

"It is part and parcel of a planned economy that, *should any deviation from the current plan occur* – with a ministry, an enterprise, or a workshop – *all competent organs* and persons *should act with* competence and *determination.* In serving the purposes of the plan, operative action is not an artificial, «external» interference in the economy, but a part and method of normal activity." [28] (Let us remember: at the time of this official stand, there was no mandatory plan for enterprises.)

One measure of symbolic value, confirming central control, was the establishment of the National Planning Commission beside the Council of Ministers. This was intended to strengthen the role and efficiency of planning. [29] Another measure of symbolic significance was the raised status of the National Planning Office and the appointment of its president – who before had not even been a minister – to be deputy prime minister.

The November 1972 meeting of the Central Committee also deemed it necessary to effectuate changes in price policy. Although proclaiming the reform principles, it declared that "stability of prices must be guaranteed to a maximum degree... price control is to be extended and made stricter. The duty to give preliminary notice of intended changes in prices is to be extended... The ratio of limited prices in the building industry must be raised from the present 60 percent to 90 percent..." [30]

What effect the resulting change had on the price system of the 1968 reform – in which the objective effect of the changes in world market prices also had a part from late

1973 – is made clear by Minister of Finance, Lajos *Faluvégi*'s words two years later: "producer prices have lost much of their flexibility. . . again, profit fails to express the real efficiency of the enterprise, since prices and costs are not realistic, either. Prices are subsidized to no small extent. . . nearly 30 percent of budget expenditure consists of subsidies; more than half of the total of enterprises' profits comes from subsidies." [31]

Reform criticism was quite strongly directed at the enrichment of peasants, at the unscrupulous assertion of agricultural cooperatives' group interests as against the interests of "society as a whole." In the spirit of a working class policy, emphasis was laid on restraining the auxiliary industrial activities of agricultural cooperatives. The general policy emphasized turning the specifically Hungarian cooperative model, shaped during the previous reform process, back towards the classical "artiel-type" Soviet model, for ideological reasons. Central intervention was urged also in this field, and the local government organs (councils) were given an increased and more direct right of intervention in the affairs of independent and self-managed cooperative enterprises. Looking back on former years, the central party organs stated in June 1976; ". . . as the need has arisen to assert the central will more strongly, councils have been given an increasing number of production policy tasks, such as are *not specifically stated in legal regulation.* (These involve the promotion of special agricultural projects – for example, for cattle, sugar beet, and vegetables – as well as of specializations and unions.)" [32]

It is worth calling attention to the fact that the quoted resolution reflects the return to informal central intervention, i.e. recentralization. This was non-institutionalized, but easy to assert within the given socio-political framework. Such interventions gained special impetus from the "purification" campaign launched against profiteering and corruption. "Order must be made", "a strong hand is needed" – were the widely popular slogans. The leaders of several state farms and cooperatives were arrested and legal proceedings were started.

### In the centre: attack against the "excesses"

Once again, I wish to emphasize strongly: there were abuses in abundance. Beside the sudden opening of possibilities, this was also due to uncertain feelings about the perspectives of enterprise and money-making, in consideration of the experience of former decades. Also, the complexity of the regulation and the infinite number of legal restrictions easily drove all kinds of economic activity to the narrow line between keeping the law and offending against it. In the course of the "purification" campaign, many real abuses were discovered. However, the treatment of such affairs, the form of making them public, their mass occurrence, manipulation, and the ideological-political bias accompanying them created an atmosphere in favour of restraining the reform mechanism. In February 1973, in the central daily paper *Népszabadság,* a series was started with the title *Oknyomozás árügyekben* (Investigation in price metters). The reporter had the task of inquiring into unjustified price increases. In one case he even blamed the party secretary of the price-raising cooperative, because of the latter's answer to the following question:

Was it indeed necessary to raise prices and, if so, was there a good reason for raising the price of a plastic shopping bag to such an extent? The answer was that "he was first of all concerned with the problems of the cooperative. That is to say, with group interests," the journalist added. [33]

About the same time, the same journalist described at length the private business disguised as official – of Univerzal, a new fodder concentrate. It actually was a typical case of profiteering. [34]

Similar disclosures proliferated in journals and a year later the proud statement was published: the number of disclosed criminal offences against social property fell from 34 thousand in 1972 to 29 thousand in 1973, due to increased external and internal control. [35] A highly illustrative case is that of the self-employed motor-schools, publicized in December 1963. In autumn 1972, papers reported that state-owned institutions could not satisfy the demand raised by increased opportunities for motor car driving and people were queuing up for motor-schools. *At the time,* the foundation of "self-employed work teams" was suggested as the only solution. "Well, since then a fair number of such work teams have been formed. In the meantime, however, they have not all earned good reputations: on the gates of two Budapest work teams, the inscription is there, symbolically: «closed because of cheating», and the «official winding up» of a third has also begun... The outsider... is easily led to think that *an evil spirit was released from the bottle* in 1971 by the Ministry of Transport and Communications when it made it legal to establish motor-schools on a self-employed basis." [36] In connection with this affair it was emphatically stated, of course, that the method itself was not to be eliminated. It was the control that needed to be tightened in order to prevent abuses. Yet the press campaign contributed – even in case of the correct treatment of individual cases – to the development of a definite political medium, and intensified distrust in general. This was the case in particular with agricultural cooperatives and state farms, where public attention was often drawn to "irregular functioning" and a number of police and judicial procedures were started against the heads of those state farms and cooperatives suspected of abuses. I think it is needless to prove that, as a consequence, not only were abuses discovered, but an increasingly chilly atmosphere surrounded the independent, flexible enterprising activities, such that they grew ever riskier.

Regulation, price policy, taxation and other instruments offered adequate possibilities for restraint. In 1974–75 the government made ample use of those instruments. However, the restrictive measures, and the propaganda which created an atmosphere of suspicion suddenly interrupted the upward trend of household-plot commodity production. In 1967, 220 thousand pigs were purchased from household-plot farms, whereas in 1974 the figure stood at 2.4 million. In other words, the pig stock of these farms increased more than tenfold as a result of the reform.

In summer 1975, however, a journalist of *Népszabadság* reported, after indicating the above-mentioned data, the following surprising news: "Yet all this is not to say that everything is all right about household-plot farms. A few of the cooperative leaders think

that work on the household farming plots draws members away from the common activities. Therefore, these leaders *do not sufficiently help* household-plot production.

. . . What kind of troubles may arise. . . is demonstrated exactly by the change that took place in pig breeding last year. In the said year, the previous smooth development of household-plot farming broke, which is shown most clearly by the fact that by the second half of 1974, the number of sows in household-plots and auxiliary farms fell from 417 thousand to 290 thousand." [37]

So much is quite clear from that newspaper article that in 1974 the sow population of household-plot farms *fell by* no less than *a quarter.* The vague attempts at explanation were hardly convincing. A few weeks afterwards, further information on the matter could be read in the same daily in an article by Árpád *Pünkösti* under the title *Visszatér a múlt?* (Are times past coming back? ): "In the village, beside transformation, progressive tax is the subject that has been upsetting people for some time. Let us see how.

Zoltán Szél and his wife have built up a nice little world of their own: mechanized household, mechanized farming. . . A horse, two cows, motorbicycle, Polski-Fiat car. Behind it, ten years of hard work. Zoltán Szél had two jobs: he did farming and transporting. His wife drove the plough till midnight, after midnight he continued. . . and then the pain and torment of being harassed.

. . . « Like this special tax now. I am not going to work to pay most of my income in tax», he says quietly but emphatically. A few days ago, his wife left her bed to sleep, through three nights, in the pigsty, so that the sow did not crush to death any one of the twelve piglets. Last year they reared that many porkers and two calves, but they will not do it any more. (Have similar decisions played a role in the fact that last year the number of sows fell by 30 percent in the district of Szeged? )

At Zákányszék there were 13 special tax-payers. Last year 51 farms were found to exceed the yearly Ft.50 thousand of net income. A great uproar!

. . . This is a difficult situation. Is it possible in today's world to simply bring back the past by a few measures? Some say that this is something similar to the kulak-lists, because it is as it was in the past, with the difference that the limit is not 25 cadastral yokes* but Ft50 thousand. . .

Zoltán Szél, therefore, steps out of the bracket of special tax. He will not work 14-hour days any more, he will have more time for choir-singing, theatre, etc. This is certainly good on the cultural side, but I do not think it is so good on the supply side." [38]

It can be seen that the tone of the press took a sharp turn in summer 1975, as a consequence of the frightening reaction to pig-slaughtering i.e. the menacing meat shortage. What we are interested in now is, however, not that, but the facts presented.

*14.25 acres was the limit above which peasants were classified as kulak. Ed. note.

## The ideology of "development" of socialist ownership

The ideological basis for standing up against household-plot farming and auxiliary activities consisted in the consolidation of socialist production relations and the suppression of capitalist tendencies. This was voiced by Béla Biszku, second man in the party leadership, who lent the greatest emphasis exactly to this issue in his address at the national propaganda meeting, held at Balatonaliga in September 1975.

It is worth following his train of thought. He started by declaring that *state property* was public property, i.e. it represented *"a more developed form of socialist ownership."* "State property is public property in this country because it is not owned by a group or section of society, but by the whole nation... it serves the interests of the entire society, because its results do not benefit a group or a sector of society, but society as a whole." He stated that state property *"was to be considered as a higher form of socialization."* It is to be noted that Béla Biszku had already contradicted, at this initial point of his reasoning, the conclusion drawn from the historical review he had made in the introduction – namely, that the results achieved so far by Hungarian agriculture were inseparable from the clarification, after 1956, of "the most important questions of theory and principle concerning cooperative property." He justly recalled that "our theory had to be cleared of the distortions that had been spoiling it, especially in the early 1950s. One such distortion was to consider cooperative property... a lower-degree form of socialist ownership." This erroneous thesis was then "pushed to the extremes in practice."

He seemed to forget about this, however, when taking practically the same position as the one qualified as "distorted". In addition, paying little attention to the facts of life, he challenged the views that held "cooperative ownership to be more advantageous than state ownership", capable of more mobile and flexible functioning. He complained that "There were a few economists who... insisted that cooperative ownership was the more efficient form and that its fixed assets and live labour are better managed than in state-owned establishments. From this apparent «advantage» they came... to the conclusion that cooperative ownership was «more democratic» and «more social» than state ownership."

As against this, he rested content with making the following statement: "We are not faced with the actual or presumed advantages of the form of ownership, but with the form of economic management", which is "strongly limited". Yet what matters is that "these are exploited... exactly on account of the group-property character of the cooperative form of ownership... not so much in the interest of society as a whole, but in that of the group."

He indicated that the road of development of agricultural cooperatives involved "increasing the socialization of labour", leading it towards "gradually higher forms", and "confirming the socialist traits of cooperatives." What exactly was to be understood thereby was made clear by the ensuing theoretical explanation. This was to the effect that "household-plot farming is not to be considered a socialist form of farming." He

polemized with those who argued that "in this country cooperative members' household farming plots are ever closer related to the cooperative farm and consequently draw the conclusion that these are «small socialist farms». This is nonsense. The household farming plot is not public property... its income is the member's, not the cooperative's." Although Béla Biszku stressed that support for household-plot farming was to continue, his starting-point concerned forms of ownership, and his emphasis on the strengthening of the socialist traits of cooperatives as a central task made it quite clear what the unambiguous perspectives of this policy were.

The other central issue surrounding the "strengthening of socialist traits" was expressed in the constraints imposed on the auxiliary industrial activities of agricultural cooperatives. "This activity," Béla Biszku stated, "began to produce several negative tendencies in the early 1970s... this situation also gave impetus to a negative process from the aspect of ownership. The cooperatives in which such auxiliary activities were pursued on a large scale realized considerable additional income." He spoke in more detail about fourteen agricultural cooperatives near to Budapest, which had been examined by the Political Committee. In these cooperatives, only 20 percent of the earnings had come from agricultural activities and, though "satisfying important national economic and, partly, household needs" through their various industrial activities, *"they had drawn thousands of former large enterprise workers away from the Budapest factories*... These subsidiary workshops could pay much higher personal incomes than large enterprises. This source of income, which is based on the cooperatives' enterpreneurial profit, cannot be considered as socialist distribution according to work... Rules and regulations must be adjusted in order that such phenomena should not spread, but rather be driven back." [39]

The stressing of the ideological elements provided the foundations for practical restrictive measures. For example, in spring 1973 a statement could be made, with satisfaction, about the effect of the measures adopted in the spirit of the 1972 decisions: "As a result of the central measures, the auxiliary industrial and trading activities of agricultural cooperatives now follow the line indicated by the decisions of 1972; earlier unfavourable accompanying phenomena have consequently been decreasing." [40]

In summer 1973, another editorial in *Népszabadság* discussed the need to reduce the subsidiary activities of cooperatives (or of cooperative partnerships): "Recently, the people's control committees in several counties have investigated the functioning of cooperative partnerships." It says in the editorial that they discovered such activities as were contrary to bye-laws: "Machine repair partnerships began to look for customers in other fields in order to make use of their capacities. Today they perform industrial, household, and trade services in an ever broadening sphere – in many cases *deviating from the objectives laid down in their foundation deed."*

"A similar situation is emerging with the building industrial partnerships. Often they do not serve the aims for which they were once established, i.e. they do not work to satisfy the cooperatives' needs for construction, investment projects and maintenance... because they give preference to the orders of industrial enterprises, public institutions and

private individuals. . . It is of general interest that the competent administrative agencies exercising official control over these partnerships demand regular functioning everywhere, and do not allow any deviation." [41]

The purpose of the constraints and restrictions, introduced in order to correct the excesses of cooperatives, was specified in the confirmation of the "socialist traits" of the cooperatives.

Béla Biszku described the task as follows: "approximating the state and cooperative forms of ownership" and promoting "the development of uniform communist public property, which is to grow out of the two earlier forms." He laid stress on the fact that "it is not a mutual approach which is meant", but "the development of cooperative property in the direction of higher socialization." Making reference to the establishment of the Soviet agro-industrial unions, i.e. to the fact that "under guidance of the sovkhozes (state-farms), the kolkhozes (collective farms) had formed . . . large-scale unions", he clearly determined the "further development" of cooperatives "in the direction of modern, unified large-scale enterprise forms. The positive forms of this development are yet to be laid down." It was upon this ground that he deemed it necessary to fuse cooperatives, i.e. to establish the largest possible units. [42]

These principles were also formulated by the 10th Congress of the Hungarian Socialist Workers' Party in March 1975. "We will carry on our agricultura policy, further strengthen the socialist character of agricultural cooperatives. . . the rational merger of agricultural cooperatives should continue." [43]

## Catchword of distribution policy and labour policy

In addition to the affirmation of central planning and the development of socialist ownership, a further ideological weapon of primary importance was the demand for the consolidation and restoration of the socialist order of distribution. This included a higher-rate of increase of peasants' and intellectuals' incomes with special regard to eliminating "the chances of acquiring unearned income and of practising speculation and hoarding", and to a "general and proportionate sharing of the tax burden." Specific measures were put forward in the November, 1972 resolution, among other things with the intention of counterbalancing the income differentiation caused by the reform: "Of the fundamental working classes and groups, it is generally the workers, and especially the workers of large state-owned enterprises whose earnings have risen at a relatively low rate. . . The wages of the workers and foremen of state-owned industries must be raised. . . by an average of 8 percent from the 1st March, 1973."

"In order to put into effect an equitable sharing of taxation, the feasibility of introducing a comprehensive tax system covering unearned incomes (inheritance, gifts, etc.), movable property and real estate must be examined." [44] In 1973 death-duties and gift taxes were largely raised, and house-taxes for holiday home of more than two rooms were increased by 50 percent. On dwelling-houses worth more than Ft800 thousand and

on holiday homes worth more than Ft500 thousand, a house value tax was imposed in addition to the house-tax. Highly progressive taxes were charged on profits earned through the sale of real estate; tax rates on additional incomes and personal property (cars etc.) were also raised.

Béla Biszku stressed: "Incomes must be regulated in such a way that they should not be allowed to accumulate in an overlarge measure... the sources feeding these non-socialist tendencies must be first narrowed, then stopped. At the same time, the social appreciation of work must be raised... Also, placing of the constraints on easy money-making must be seriously considered. It should not be left unnoticed that... quite a large number of young people... seek careers assuring fast and easy success, instead of desiring the plesure creative work can give... non-socialist traits have grown stronger in social thinking." [45]

The editor-in-chief of *Társadalmi Szemle* recognized already in January 1973 that a debate was necessary in order that negative social phenomena should not simply be ascribed to the reform: "Many are of the opinion that the spririt of selfishness and gross materialism did not exist earlier, or at least was evident in a much narrower sphere..." Two years later, the argument was a similar one: "Why do we not eliminate group interests? , I was asked at one place, and at another: Why had group interests «to be introduced»? ... Group interest was not invented by us, not introduced by us, and it is not just... the concomitant of enterprise independence." It was stressed, at the same time, that the policy of income restriction was not directed against certain groups of society: "Our fight is not against professions or groups, but against profiteering, hoarding, unearned or such large incomes as are not proportional with the social usefulness of the work accomplished." [46]

In spring 1974, however, the emphases changed in Béla Biszku's words: "In the first place, it has to be emphasized, as a characteristic trait of decisive importance, that the party policy is first of all a *worker's policy*..." Upon this ground, he justified the constraints placed on incomes earned through peasant and private activities. These included cases such as the auxiliary industrial activities of agricultural cooperatives, where "the market boom is exploited to an undesirable extent", or in the private sector which "can, as yet, adjust itself to certain social needs more flexibly than the big industries, and state-owned and cooperative trade. The result: some of those engaged in the private sector can earn incomes of higher value than their work accomplished. Thus excessively high incomes are also administratively constrained." [47]

In the spirit of the workers' policy, a resolution was formulated also in respect of the social composition of the party and its cadre policy. Among others, it made the following statement: "the problems encountered in the course of carrying out party policy in certain cases... hinder manual workers in associating with the party... The demand for raising the standards of know-how and of management is sometimes coupled with a view in which intellectuals and holders of various leading posts are ascribed greater importance within the party than is in fact necessary." [48] A veritable campaign was launched with the object of raising workers to intellectual and leading posts, at a fast rate, avoiding the

consolidated institutional ways, such as the state school system. With this object in view, the entrance examination system of universities was amended by a revision of the measures made only a decade before which had been in the spirit of social unity and the elimination of discrimination. Accelerated one-year courses were started for young people of working-class origin so that they could enter universities without having acquired secondary school qualifications. Under this system, 200–300 young workers with no secondary school certificate were sent to university each year. [49]

The March, 1974 meeting of the Hungarian Socialist Workers' Party affirmed these measures, stating that: "The party considers it a political question, i.e. a question of principle, that the children of manual workers receive special support for their studies and graduate training."

On central initiative, a wide range of manager replacement courses were organized. The Party Committee of Fejér County organized a boarding-school course "mainly with the intention of training cadres for replacement." In March 1974 the Central Council of the Hungarian Trade Unions set up a five-month boarding-school course for worker-cadre training. KISZ (the Communist Youth League) launched such courses from 1976. The Central Committee Secretariat dealt with the issue at its meeting of 2nd February 1976 and "found that the number of managers who have been manual workers can grow at a relatively fast rate."*

Specialized knowledge, that had been strongly emphasized and upgraded as a result of the reform, now looked almost suspicious. A large number of ill-equipped and untrained economic managers had earlier been selected, on the criterion of political trustworthiness, to carry out the new tasks and now political requirements were again given primacy. *Népszabadság* said, in commenting on the government decrees concerning the political extension training of managers: "A resolution of the Council of Ministers has recently been formulated on the political extension training of top-level managers and the regulation of training for the replacement of managers. According to the resolution, the ratio of political information in education must considerably be raised. . . *it is one of the most general errors to put professional skill and talent in the first place* in such a way that political training and fitness are weighed only in the second or third place." [51] This was clear enough and, with the characteristic "overzeal" of local practice, masses of workers – first of all the worker members of the party committee of enterprises – were appointed as economic managers. This was objected against in summer 1975 even in the central daily of the Hungarian Socialist Workers' Party. Let me quote the introductory words of the article *Kapkodás nélkül* (Without haste): "A district party committee of the capital examined how the new worker members of enterprise party committees were helped in

*The Secretariat added, however, so as to dampen obviously over-zealous efforts: "In the long run, nevertheless, it remains preferable to make use of. . . the organized forms within the system of adult education. The purpose of the various initiatives is only to complement but not to replace state and party schooling. This was brought to the attention of the Central Council of the Hungarian Trade Unions as well as KISZ."

their function. It turned out that dozens of such committee members have been appointed to economic manager posts during recent months; there is even an enterprise in which nearly all members have been raised to such posts... the large number of workers hastily appointed to management posts gives ample grounds for assuming that a good many of them did not expect and, primarily, were unprepared for the honour..." [52]

Against the tendency of the assumed strengthening bourgeois mentality, ascribed to the reform process, and for the sake of evolving a real workers' policy, the central periodical of the Party published an article discussing the worker-intellectual relationship in its column entitled *Fórum*. The writer of the article started with the phrase: "the way we workers see it" saying that "in social life... there is a tension between intellectuals and other workers. This... may gradually grow into a grave conflict. As workers see it... *intellectuals are financially as well as morally overrated,* whereas labourers are considerably undervalued by society." It is said in the article, that if intellectuals think the wages of workers doing hard manual labour are too high, they should go and do such work themselves, and that "there are some who have done so but then «quickly fled back»". It also mentioned physicians who felt contempt for their patients, and believed themselves to be always overworked, except in their private office; "the address sir is slowly stolen back, its purpose being to distinguish", and *"these sirs begin to feel like «sirs» in the old meaning of the word."* [53] One of the contributors even added: "It is in the nature of socialism that the leading class, i.e. the working class must be cared for... this thesis has not been adequately observed in recent years... Thus a great many insults are now coming to light, and these are inflicted even in our days by intellectuals on manual labourers." [54]

In addition to laying emphasis on the workers' policy in various forms and by adopting wide ranging means, the ideological battle was also stepped up through direct administrative measures, in the spirit of the targets announced in November 1972. This was directed against "growing middle-class and lower-middle-class" views which were cited as being "alien to socialism." The cultural-political work commission of the Central Committee of the Hungarian Socialist Workers' Party took a stand "on the anti-Marxist view of a few sociologists" [55]. This was soon followed by a tidying up in the field of sociology.

The 11th Party Congress of March 1975 summed up the primary objectives of the political trend that was unfolding and increasingly asserting itself: "Our state is the supreme instrument of the building of socialism... Our socialist state's role is growing in the development of the national economy... In view of the increasing demands, central management and control must be made more efficient. Social interest is what is determinant: it is what group and individual interests must be subordinated to. The assertion of individual or group interests over the community's, i.e. the whole country's interests, must not be tolerated. The Congress maintains that socialist planning must be more strongly asserted; this is a fundamental task in the development of the national economy."

Among the keywords and statements of the unanimously approved resolution of the

Congress, the fundamental principle – which is clearly in favour of egalitarianism – is pointed out: "by means of a well-balanced wages policy and income regulation, disproportions which lead to tensions must be prevented. An important role is to be played therein by central wages measures."

## Against acquisitiveness, wasteful consumption and the petty bourgeoisie

Ideology was also to contribute to the above purpose, its most important point being formulated thus: "our socialist perspectives must be more clearly outlined; the superiority of the socialist over the capitalist mode of life must be demonstrated." Therefore, a fight must be carried on against "the various reactionary middle-class and petty bourgeois views." [56]

A very powerful campaign was launched against "wasteful consumption" and wide ranging debates evolved on the need "to work out a model of socialist consumption and the socialist way of life." In summer 1975, *Társadalmi Szemle* gave an excellent summary of the debates: "The remnants of an earlier view, which embraced an ascetical nature and emphasized limited consumption. . ., devoted work, and sacrifice are still with us and often. . . are seen to embody exactly the principles of socialism. During the last ten years of improving material supply and growing consumption, distrust has also emerged. . . toward consumption. If protests in the name of socialist values against the so-called middle-class and petty bourgeois tendencies manifest in consumption. . . . . . the emergence and spread of certain new needs are interpreted as being an imitation of the capitalist consumption model", and this was followed by a demand "that a model of socialist consumption be worked out." Some think – the author says – that this is the main task nowadays, ". . . starting from the assumption that. . . the elaboration of the «consumption model» is a theoretical task; that theory will be able to solve such a task, relying on the values that have developed in the course of history and are inherent in the ideal of socialism (equality, collectivism, etc.)". If, however, such a model and such a scale of values are not present, and are not inculcated upon the masses by means of intellectual-cultural education, then the raising of living standards will only contribute to "the rising of material needs and the affirmation of the owner's attitude which concentrates on material goods. . . the so-called consumer approach and behaviour will be spreading. . . there is, at the root of several of the negative phenomena so often discussed nowadays, a «petty bourgeois tendency.»" [57]

In the months that followed, and for a number of years afterwards, papers and periodicals were flooded with writings that attacked petty-bourgeois ways and materialism: "Undoubtedly," one could read in December 1975, "the reform of the economic control and mangement systems has thrown wide open new doors before individual progress; such doors have, in general, offered possibilities which are in harmony with highly important social interests and socialist objectives. Nevertheless, complex and

indirect forces have helped to a few other doors, through which petty-bourgeois selfishness and materialism has begun to infiltrate into our society." [58]

A few days later, the secretary of the Békés County Committee of the Hungarian Socialist Workers' Party talked in an interview about the profiteering president of a cooperative who had been duly punished. He concluded: "This case, however, teaches us a lesson of general validity. Thus I ask the question: does money, or the prospect of a higher income, necessarily lead towards socialism? " [59]

In October 1973, the writer of one article revealed the case of an economic manager who had travelled off the right path. He posed the question: what had led this man astray for he was one who "had gone through hundreds of difficult situations and crises, but never wavered in his political conviction and faithfulness to the party."? He gave the answer: ". . . The cause is nothing other than greed which can, at a point, exert an effect similar to that of a drug: it not only intoxicates but it completely perverts man. Can anyone in his right mind understand why a man should throw away his entire decent past and honour in exchange for a few fashionable clothes and a luxurious condominium flat?

No, it is a disease. It is like an insidious fever which conquers the organism slowly, gradually, almost unnoticed, and mercilessly eats away the last bit of one's energy." [60]

In summer 1973, a long series of polemical articles were published in *Népszabadság* on the subject of the "petty-bourgeois attitude". The contributors produced scientific arguments, philosophical and historical explanations, and personal examples to clarify their respective positions. On July 25 there appeared the letter of a woodmill worker of the cooperative of Ócsárd: "In my place, too, the petty-bourgeois attitude is a subject of lively debates. Some say that this means rightism, others that leftism is also the expression of petty-bourgeois views. It is also said that petty-bourgeois elements are middle-of-the-roaders. . .

I think one gets closer to understanding the petty-bourgeois character, if *the fundamental traits of the petty bourgeois are contrasted with those of the class-conscious large-factory worker*. . . In short, I have in mind the following as the fundamental traits of the petty bourgeois: *wavering* – always bending towards the class which is in a position of power: *comfort* – seeking the easiest possible ways in every-day life; *distrust* – since his individual effort is directed towards exploiting others, the petty bourgeois assumes the same about others; *selfishness* – his ideal is the capitalist bourgeois, therefore he is selfish and given to money-grubbing; *inward-turning*- he does not like to help in accomplishing common tasks which do not bring him direct gain; *imitation* – he likes to imitate the old ruling classes." [61]

In addition to scourging the petty bourgeois attitude, the petty bourgeois ideology was also caught in a crossfire of attacks. Setting rather wide limits, Géza *Ripp* made the following statement: *"The petty bourgeois ideology is manifest in the theoretical justification of the petty bourgeois phenomena just as it is the apparently over-radical criticism of the very same phenomena."* [62]

In an attempt to be objective, the editorial summary of the debate talked, among other things, of the "challenge of living standards", posed by the contrast between

material progress and the shortfall in the development of human consciousness. "Thanks to socialism, we have overcome poverty – if not fully, but essentially – yet now we have to learn (or teach everybody) to live a new way of life, the socialist way." [63]

Once again it became a central issue of the debates that people must be taught the proper use of things, the consumption pattern characteristic of socialism, and the socialist model of a correct way of life.

It was within the framework of this same campaign that any preference given to group interests over the national economic interest was strongly attacked. László *Szabó* wrote that certain seemingly unjustified price increases made by various enterprises had not been countered even by the local party organizations, though ". . . by no means should we let ourselves be led by those who support local and group interests, to the prejudice of the larger social interests." [64]

A wide range of means were used to influence, to teach, to discipline, and to threaten enterprise and cooperative managers in order that they should not act solely in the interest of their enterprise or cooperative, but that they should observe the declared social interest.

Thus ran the arguments of the editorial of *Népszabadság:* "In today's situation, this is to be especially stressed, because there are managers on various levels who do not or cannot understand this: they make group interests absolute, and place them over the social interest, which in practice often amounts to infringing the law and bypassing rules. Their *own* enterprise, their *own* sector, their *own* field or organization are «god» to them; they will «use all their influence», prestige, and connections in order to assert the interests of their specific field; some even interfere with other organs' work, abusing their power, and do not refrain even from corruption and cheating, etc." [65] *Népszabadság* formulated the conflict and its solution, referring to the hierarchy of values that was to be set up in the spirit of asserting the "social interest" through external influence i.e. by means of teaching and discipline: "It is a fact that different interests exist and operate simultaneously in our society. Although to no identical measure, man's individual interest, the local or group interest of state-owned enterprises, institutions, and cooperatives, and the social interest (comprising and at the same time by far exceeding the former) appear, each one, as motive forces. Undeniably, these interests may from time to time conflict: one demanding priority over the rest. Such dilemmas can only be solved by always giving the green light to the social interest." [66]

Of course, in reality there was a many-sided approach to the tensions and conflicts. These by no means stuck to superficial phenomena, or the scourging of human weakness and natural interests. It is worth quoting at some length the reasoning of an article published in 1974 in the theoretical periodical of the Hungarian Socialist Workers' Party. In the course of campaigns conducted against petty bourgeois ways the author, Lenke *Bizám,* concluded – "it is first of all acquisitiveness that is pointed out: the petty bourgeois greed, money-grubbing, insatiable appetite for durable and less durable consumer goods. The conspicuous trait of his character is that value is only what he can actually hold in his hands. The same holds for his taste. . . instead of cultural needs, the

petty bourgeois has only need for entertainment. . . that is why he always wants to relax, to get away from it all, instead of joining in something. . ."

The author, however, does not rest content with such superficial criticism. Her starting-point states precisely that "we encounter petty bourgeois phenomena in a much larger field than that occupied by the numerical proportion of small owners." The explanation, in that case, is to be found in everlasting bad human qualities, or in the "imported" influence of the West. Yet such explanations "would not only be insufficient, but mistaken in all respects." Opposed to these, the author does not start from the moral and the consumer's attitude, but from the producer's. She concludes that, the prevailing public ownership notwithstanding, masses of people "in fact engage in petty enterprise at «public expense». He grows from a public owner into a small private owner, as soon as. . . he can consider the machine, tool, desk. . . or field as a means to serve his private interests and can use them accordingly. . . It is he who – with his private interests – short-circuits the wide currents of the socialist production organization. . . In fact, he does private work instead of the productive activity which falls to him within the socialist division of labour. . . he tries to take as much as possible out of the factory. If tool and labour are underutilized, he will look for. . . ways. . . of drawing them into private utilization. . ." The author then sums up her opinion: "The petty bourgeois way customary in this country and very dangerous indeed, consists in a small owner's attitude towards the socialist public property. This can affect the building of socialism and where, in its economic bases, socialist distribution is not adequately asserted. . . the keyword for eliminating petty bourgeois ways is not contempt and the reduction of goods, but a genuine appreciation of goods and their argumentation through public ownership." [67]

In addition to "public ownership", attempts were also made to find the collective forms of spending one's free time. "We asked ourselves the question", the secretary of the Municipal Party Committee of Pécs said in an interview, "whether the individual, having obtained more free time from our state, can be expected to spend this time in conformity with the objectives of our society, i.e. to spend it in a useful, cultured manner. . . Ever more people spend their free time by working in their garden. . . working in the open air is not just recreation, it is by all means very healthy. . . Yet it cannot be denied that gardening separates the individual from the community." A solution is set forth, quoting the example of the "garden cooperative" organized in Komló. On a plot of land – which is state property – families do gardening, each on the patch assigned to them, without fences. "This is already community life." In a similar way, in a do-it-yourself workshop for all trades set up by *Hőerőmű Vállalat* (Heat Power Station) "there is opportunity for communal life in one's free time." [68]

Strong waves of demagogy stormed the widest spheres of social and political life. This was helped by the fact that criticism was not entirely groundless. The masses. that had for decades been accustomed to egalitarianism, strongly reacted to growing social and income differences, and in particular to unearned incomes and apparent trickery. Therefore, views that suggested that the "excesses" of the reform should be cut out, and "distortions occurring in the course of execution" adjusted, voiced certain real social tensions. They

were even more popular among the workers, since practical measures were urged in their interest: wage increases, higher social prestige, a housing campaign, and managerial appointments, etc.

Such developments clearly contributed to the gathering of a political group around those objectives. This was all the more so as the supporters of the criticism and of the new initiatives were by no means all against the economic reform, but wished, instead, to see the elimination of certain undesirable phenomena which had not been adequately handled in the course of the reform.

There were many who engaged in the debate and argued against the economic view centred on income distribution and against the dogmatic approach to ownership, and the emphasis laid on "petty bourgeois ways". These voices were in favour of the reform. Their arguments and these forces, of which I shall not speak now, later on were to play an important role in subsequent policy changes.

From autumn 1972, however, the forces and views previously suppressed gathered strength, and this led to the bringing about of a series of definite and clearly restrictive measures. As a consequence, the reform process halted. The worst result was that the "second phase" of the reform, originally planned to take place in the 1970s, was entirely taken off the agenda and the reform stopped half-way. The further steps, postponed with a view to adopting a gradual form of development, but held to be important envisaged a release of most of the brakes and checks incorporated in the 1968 reform and aimed at the strengthening of market impacts. The inconsistencies of the reform which had soon become evident at the beginning thus became permanent, and they automatically intensified reactionary tendencies in the functioning of economy. This was mainly made obvious by the fact that, because of the lack of a consistently normative regulation, the masses of exceptions led to the reproduction of central directives by other means of regulation. More than that was involved, however, since the amendment of regulators, and the affirmation of other measures detracted much from the achievements of the reform which, from the outset, had already involved compromises. Examples of such measures include the implementation of direct instructions in a number of cases, especially in that of the large industrial enterprises, the centralization of an increased ratio of enterprise profits, and the turning back of the development of the agricultural cooperative model towards the traditional "artiel" type.

All this was accompanied by changes in leading personnel (affecting the persons who had played an outstanding role in the elaboration and introduction of the reform): Rezső *Nyers* and Lajos *Fehér,* secretaries of the Central Committee, Prime Minister Jenő *Fock,* and Deputy Prime Minister Mátyás *Tímár* were removed from their posts. There were also personnel changes in the non-economic sphere, and these affected the composition of the leading bodies.

## The oil crisis and its consequences

The prevailing current was further strengthened during 1973–74 as a consequence of the crisis that shook the world economy.

The sudden rise in oil prices in autumn 1973, soon increasing fivefold on the world market, entailed a general rise in raw material prices. This put severe inflationary pressure on the Hungarian economy, being sensitive to foreign trade, and in particular to energy and raw material imports.

The excessive price rises led, namely, to increasing isolation from foreign trade, and to emerging protectionism in many countries. This situation hit particularly hard products of medium technological standards.

Therefore, during the first five years after the oil price explosion, the average rise in the prices of goods imported by Hungary amounted to about 70 percent, whereas the rise in the prices of Hungary's exported goods reached only 30–40 percent.

The balance of trade and the balance of payments, restored in earlier years, was soon upset. The deterioration of the terms of trade – amounting first to 20 then to 30 percent – led to loss-making in foreign trade, and the country raised credits of about $8 thousand million in five years to make up for the losses.

The situation was made worse by a lack of comprehension, i.e. by the erroneous judgements made in connection with the world economic shocks. For instance, in the beginning the opinion emerged – which, incidentally, the first government declaration on the subject also stressed – that the question was mainly about crisis phenomena of the capitalist economy. Thus it would neither affect Hungary nor any of the socialist economies, but would stop at the borders. Albeit with some delay it was recognized that what was involved was not transitory causes rooted in the political sanctions of the Arab oil-producing countries, but factors that affected the world economy vitally and which had, for a long period, been beneath the crisis phenomena and thus exerted an influence on the scope of movements of the world economy as a whole.

Because of this delay in recognizing the real state of affairs, Hungarian economic policy did not react at first, but continued its earlier path. Thus a fast growth rate was maintained (5–6 percent on a yearly average), there was a further increase of real wages although this was impossible to cover from domestic sources. The yearly 10–12 percent rate of growth of foreign trade necessary for the increase of national income was also forced. Because of the deteriorating terms of trade, the deficit also grew at a faster rate, and the accumulation rate of the credits – to bridge the lack of balance – rose so fast that by 1978 the credit stock was growing at a rate double that of the previous year.

The need to stem adverse tendencies, to restore balance and to adjust to the new requirements of the world market urged a most radical reaction. In such a situation, it was at first quite a natural reflex to try to strengthen central intervention. It was a kind of emergency, a very special situation, in which, even in a number of capitalist economies based on private ownership and thus unplanned, strong central measures were taken to ward off the crisis effects. Subjectively, therefore, the need for central measures and

centralized solutions arose. The reform which proposed market crientation seemed justified in the mid-1960s, so it was said, but in this new market situation it presented risks, so that a reversal was necessary. Such views were even formulated according to which the fullest possible isolation from the world market was necessary, since its effects were clearly negative.

In addition to these subjective factors, the reform process was also objectively hit by the world economic trauma in that the warding off of the inflationary pressure of the world market, and the at least partial elimination of its impacts, finally destroyed the results of the 1968 price reform. Since the rises in world market prices were only partially incorporated in domestic prices, the latter were again rendered inapt by a complex and inextricable system of subsidies which distorted actual relative values. Enterprises bought oil and other raw materials at much lower prices than their real cost on the world market, and due to past practice were not even interested in economizing, although the need for this was daily proclaimed.

By the mid-1970s, therefore, the Hungarian economic reform had arrived at a crisis.

## Survival of the fundamental achievements of the reform – a new turn

It has to be stated repeatedly, however, that all along the fundamental achievements of the reform survived – primarily the abolishment of the system of compulsory plans, and the institutionalized order of enterprises' market crientation. This soon proved to be of particular historical importance. Thus, the practical experiences of the five years following the oil price explosion made it increasingly clear that it was no longer possible to pursue further the previous development policy. The increasing difficulties could not be overcome, either, in the spirit of the "strong hand" and "let's make order." It was quite obvious that the Hungarian economy had to adjust itself to the world economy, and it became vital to transform the pattern of exports and of production, and to encourage competitiveness on the world market. The factors determinant in restoring the balance again intensified and multiplied the importance of enterprises' interest in the market, of a price system promoting this object, and of mechanisms working towards sensitiveness to market effects, with a view to flexible adjustment. These measures were considered even more important as it became more obvious that – and five years were enough to demonstrate it clearly – the shocks of the world economy were not transitory crisis phenomena hitting only the capitalist countries, and they could not be stopped on the border. In fact, they were the symptoms of a long-lasting structural crisis, compelling every country to react in one way or another. What is more, it depended on this reaction whether a country could keep pace, make up for its delay, or – if its reaction was partly or fully unsuccessful – it would finally be left behind. The preserved institutional continuity of the reform mechanism was soon able to provide a good basis for a new assertion of the reform tendency and for carrying on the reform process. The political

and personal conditions of this turn – the inner motive and elements of which cannot be documented now, but only later, by future researchers – was created by the new "inner change of course" among the majority of the political leaders gathered around János Kádár. This ran contrary to the transitorily prevailing anti-reform tendencies, i.e. it took a stand again for the reform and, further, strengthened the pro-reform groups, removed influential personalities of the reform opposition, and made personal changes in the Political Committe and the secretariat of the Central Committee, including the post of the economic policy secretary. Mass support for all this was assured by economic experts on various levels, and by large groups of intellectuals supporting the necessary changes and continuance of the reform. The turning back to the reform began between autumn 1977 and 1979.

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# IT MUST NOT HAPPEN AGAIN
## (Contributions to the evaluation of the anti-reform of the early 1970s)

L. ANTAL

It is a well-known fact today that the process of the reform of the economic mechanism, introduced in 1968, stopped after only a few years. This was due to a series of changes which began in the early 1970s, and these increasingly parted from the original reform conceptions. Also, within the framework of a reorganization which progressed gradually, yet was more or less open and institutionalized from 1975, a *mechanism of breaking down regulators* developed. This was basically formulated in terms of price and money categories (albeit not quite refusing administrative means either). Although this ensured the maintenance of the forms and techniques of the decentralized economic mechanism, its contents, in many respects, were similar to the earlier system of compulsory plans. (See [1])

This situation established itself on a longterm basis. Although *rhetoric* again tended to predominate in Hungarian economic literature from the mid-1970s (so that even certain clearly anti-reformist economic policy interventions were supported by "up-to-date" arguments, stressing enterprise and in some cases the market-eliminating role of transnational mammoth companies), the recentralization trend remained in the fore right up to the economic policy turn at the end of the 1970s. Although this did not amount to a restoration of the pre-1968 system (not only superficially, talking about cutting out the "excesses" of the reform, but neither as regards substance of the matter), it was a serious retreat in comparison with the fundamental objectives of the reform.*

*The question is justly asked: which changes could be considered as fitting into the line of the reform, and which as running contrary to it? In my opinion, all changes that increase the scope and

The frontal attack on the reform, not strictly limited to the economic sphere but concerned also with politics and ideology (which Iván T. *Berend* so vividly portrays), ran out in a few years, i.e. by about the mid-1970s.* However, a strongly centralized system of decision-making, market-suppressing economic control, the predominance of sectoral administrative control elements, and the increasing role of informal control (the rift between the declared spheres of decision and power relations i.e. the real capacity to influence processes) remained. Their effects have, even today, still not been fully eliminated.

This fact certainly played an important role in the period 1973–77, when economic policy was accompanied by the slogan "the economic crisis does not affect us". This displayed wilful traits, and shifted the burden of missed adjustment onto the following generation, in the form of increasing debts.** (Without strengthening the centralization and administrative elements, and repressing the market, this economic policy trend could hardly have been followed.)

The measures involved in the turn of the early 1970s – the preference for large enterprises, repression of small enterprise and complementary workshops of cooperatives, the emphasis laid on the one-sided subordination of group, and even more of individual, interests – are grave, in my opinion. This is not only because they caused economic loss through missing the opportunity to adjust to developments in the world economy. Because of this turn we have fallen behind and are now having difficulty in making up for it.

Another, similarly important question, has frequently been formulated lately: what is the guarantee that we can avoid similar turns, or that we can prevent the reserved reform efforts growing inconsistent or weak? Also what guarantee is there that no new political offensive will be launched against the various forms of small enterprise? This is a vital question today, when, after repeated reform initiatives and programmes, genuine changes

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role of self-organization – covering not only the market, but local self-government and socially initiated interest groups, including unions or associations – strengthen their autonomy and are thus in line with the reform. The increasing role of hierarchical bureaucratic coordination (for example, the administrative amalgamation of enterprises, which transforms market relations into subordinate relations) signals, though, the strengthening of anti-reformist tendencies. Upon this distinction, consecutive periods can be more or less clearly distinguished.

*In economic literature, I know of only two representative examples of such an attitude: first, the article by Gyula *Vörös*. (2), and second, a study written much later by Andrea *Szegő* (3). Characteristically, the majority of the profession – those who had an influence on shaping public opinion – had, by the mid-1970s, evaluated the changes that had taken place as the strengthening of administrative and conservative tendencies. (This is demonstrated by articles published at the time, for example, the article by Tamás *Bauer*.) Therefore, the question is not about a collective re-evaluation of the situation. Most of the articles written for the 10th anniversary of the reform, and the inverviews given, show up the events of the early 1970s – politely yet more or less openly – as representing a conservative turn. See István *Friss* (5), and – though more cautiously formulated – Béla *Csikós-Nagy* (6). As opposed to Béla Csikós-Nagy's seeking compromises, Iván T. Berend definitely reassesses the events of the early 1970s. [7]

**". . . although foreign resources offered at low interest rates provided a historical opportunity to effectuate economic restructuring without serious social conflicts, we have missed the opportunity. . . Thus we have opted for a road of development which, though spectacular, has led to rising tensions and offered, in the final account, no perspectives."[8]

have still not taken place. What is more, it is particularly pertinent when serious social losses are already inevitable (these are likely to follow even without a repression of the reform process).

The authentic history of the early 1970s may provide the answer, demonstrating the reasons why such a turn – although unable to eliminate – is clearly able to undermine the most positive and the almost revolutionary values of the change.

It would of course be tempting to trace these changes back to objective economic conditions, the general repression of reform efforts in the socialist countries, the domestic atmosphere created by the feeling that "we are alone", and the forced measures taken in the wake of the shocking deterioration of the terms of trade. (To justify the increasing number of central interventions, several publications in the mid-1970s did actually that, albeit not very convincig.) This is however, plainly not the truth. The majority of the tendencies marking the reactionary process actually started long before the price explosion. For example, we can cite the recentralization of investment decisions, the revival of the decisive role played by bargaining between enterprises and control organs, and the preferential treatment of large enterprises in conformance with the expectations formulated in the plans submitted to ministerial "juries".

The real causes were domestic ones, as is made quite clear in Iván T. Berend's article. The question is, whether it was a concentrated political counter-attack, or the predominance of large enterprise interests that led to the turn: or perhaps it was due to the fact that the reform model was, from the outset, of a destabilizing nature (it did not regulate purchasing power, it led to debts, etc.). Was the reform itself ambiguous? For example, did it help to maintain the monolithic hierarchical organization of economy, thus postponing the reform of the political institutional system, and consequently producing the counter-forces which subsequently started the recentralization processes? *

Many – myself included – consider the 1972 events not as the cause of the turn, but as a decisive battle. A critical analysis revealing the inconsistencies and weaknesses, of the reform was made with a view to further development.** We contributed to this work in the belief that this analysis would be the overture of a new reform phase. Later on, central decisions were made on the preference to be given to large enterprises, on the confirmation of the positions of branch control, and on the subordinated role of private enterprise and the auxiliary workshops of cooperatives. We interpreted this as a stalemate, or a temporary retreat based on compromise, destined to save the reform. As far as I can remember, it was much later that I understood that the turn of 1973 and 1974 was not a

*I do not intend to typify current opinions, yet it seems to me that Andrea Szegő [3] considers the reform model to be a destabilizing system: Márton *Tardos* [9] and Teréz *Laky* [10] attribute the halt of the reform and then recentralization to its fundamental compromises: Erzsébet *Szalai* considers the "counter-attack" of large enterprises as the main cause [11]. Iván T. Berend's present article emphasizes the political motives behind the turn.

**The analysis of the experience gathered in 1968–71, and the preparatory work on the changes of economic management due to follow in 1975, was carried out in 1972 in commissions organized by the party. These were under the guidance of Rezső *Nyers*. The conclusions of this work clearly spoke for the need to further develop the reform.

temporary halt. It was not the questions concerning the detail of economic control, but the genuine – not merely economic – objectives of the reform that were taken off the agenda for a long period. Thus its significant achievements were effectively retracted.

Looking back, I can see that I myself participated in the activity in the course of which the results of the reform, or its potential in respect of minor details of economic control, were gradually rendered ineffective. This was in the belief that these "clever" compromises would save what was the essence of the reform. I think that it was indeed difficult to see the limits – not only in principle, but accidentally – which represented the interests of certain institutions, especially when participating in daily discussions. Often it was impossible to judge minor details unambiguously. To form a sound judgement, a certain distance in space and time would have been needed.

The question is, after all, how a change of such importance and long-lasting effects, basically influencing Hungary's chances of adjustment to the world (not just to world economy), and not leaving the social and the political sphere unaffected, could take place without any obvious change having occurred in the decision spheres and in the economic and social mechanism and without any serious debates or confrontations. In the following, I shall seek an answer to this question.

## A quiet turn

In 1971–72 an organized and concerted counterattack was launched against the role played by large and small enterprises, auxiliary enterprises, and sectoral (branch) control. This counter-attack also affected the political atmosphere, which then altered the power relations between control organizations and enterprises for long years to come.

In the course of the counter-attack, the principles of the reform were not openly criticized, but only some of its excesses, out of respect for the principle of continuity. The criticism was directed against such undesirable consequences of the reform as profiteering, the spread of auxiliary workshops (of farms) based on such an undertaking, fast increasing incomes from clearly market-regulated activities (household-plot farming, auxiliary workshops, the second economy), the shift in the relative incomes of workers and peasants to the benefit of the latter, the growing uncertainty in the situation of large enterprises (and in them, of workers), the antisocial character of the market mechanism (for example, the disappearance of cheap items), the weakening of the control apparatuses (first of all those of industrial branches), and the reduced role of the party organizations. Obviously, the fundamental values of the reform: efficiency orientation, the recognition of group interests, individual initiative and enterprise also became questionable, even though, formally, the attack was directed only against the distortion of those values, i.e. against excesses. It was not the principle of profitability but only profiteering, not the recognition of group interests but only their exaggerated assertion, not the efforts at independence, but only the indecision of the control apparatuses and of

party organizations, not adjustment to market demands, but only the decreased importance of plans that were aimed at.

This was a *"quiet turn."* No declared change took place in the institutionalized system of control instruments, nor did it occur in the decision-making mechanism. What this amounted to is clearly shown by the preferential treatment given to large enterprises. It was partly on account of the economic problems of the large enterprises, and partly owing to the important role they played in the national economy, that the Central Committee deemed it necessary to "follow with increased attention" the economic activities of the forty-nine preferred industrial enterprises. They stressed, however, that this was to be without special treatment or regulation.* All the same, it can be demonstrated that the attention shown towards the forty-nine enterprises' activities was not just passive observation – although no ostensible expression was given to the contrary. Certain concentrated interventions in this field (i.e. the top-level control organs' treatment of the problems of the enterprises concerned) did not eliminate the obstacles in the way of improvement of efficiency. Instead, they made enterprises, to some extent, independent of their own profitability. The interventions were not reactions on real tensions, but they protected the enterprises against the disadvantageous effects of market impulses by means of financial allowances and mainly by the institutionalized system of individual treatment.**

In the course of the amendment of regulators in 1975–76, discriminatory regulation already became natural and institutionalized. It had grown to be a criterion of the amendment of regulators how the amendments would affect the preferred enterprises. Several preliminary computations were made on the subject. The financial problems of a number of large enterprises were individually settled, in advance, in connection with the amendment of prices and regulators. It was in that period that large enterprises got into the habit of writing to sectoral (branch) and functional ministries, or to the regional –

*"The enterprises in question are to be followed with attention in order that government organs can get regular information about their functioning, and of the interdependence of these enterprises with industry as a whole. The purpose is also to continuously examine whether the interests and activities of these enterprises are in harmony with the central economic policy principles and the targets of the national economic plans. The enterprises listed function within the framework of the overall valid economic control system and are thus not entitled to preferential treatment in the system of regulation. Their listing in itself does not justify any preferential treatment in the allotment of central resources, credits, allocations from the budget, exemptions, allowances, or other preferences." (Excerpt from the resolution of the Economic Committee)

**"The growth of profit of the forty-nine enterprises had been below the industrial average before 1973, and exceeded the latter between 1973–75. Already, by 1968–72 the ratio of subsidies to results (profit) was considerably higher with the preferred enterprises (70 and 35 percent, whereas after 1973 the gap opened wider: 71 and 32 percent). Also, in their development activities, a higher contribution by the state is more characteristic than in other fields of industry. (These enterprises received 56 percent of the development funds accumulated in industry, and 65.6 percent of industrial investments.)" – this was stated in the joint proposition of the National Planning Office and the Ministry of Finance, about the development of economic efficiency.

"The difference in earnings, to the benefit of the *preferred* enterprises, was also growing: *in 1970,* the earnings of the preferred enterprises' workers amounted to 115 percent and in 1975 to 120 percent of the earnings of workers of non-preferred enterprises. At the end of the 4th five-year plan period, the wages of the large industrial enterprises' workers not only reflected their individual performance and skill, but the national economic importance *of their field of employment* as well." [13]

sometimes to the central – party apparatus so that they could neutralize the effect of the regulatory prices; their strength was well reflected already by the fact to which institution they had to apply in a definite case. The final effect of such a financial system was perfectly clear.*

The same quiet turn is reflected in the revaluation of the role of the ministries. Their scope of authority was not changed, at least not essentially, yet their role suddenly increased in importance, and the apparatuses and enterprises affected immediately sensed this.**

The qualification of applications for development credits, and preferential wages (to serve rationalization) according to a sectoral breakdown after 1973, added to the *openly* used means of ministerial control. Also, in 1975–76 the sectoral positions were strengthened in the course of the price debates in the different fields. In forming the regulators (rendering "specific" solutions general) and the "long-term" managerial interests (based on complex indicators which were used for the individual judgement of managers) closer relationships between enterprises and central authorities were established. The first so-called "plan jury" in 1975 (which could be called as such only euphemistically, according to Ádám *Juhász* [15]), was in fact an "act of piracy", without official authorization. The initiator, the Ministry of Metallurgy and Engineering, was praised for the action, so that in a short time the "plan jury" became a generally adopted practice. It is to be noted that the increasing role and operation of sectoral (branch) control were not the consequence of the machinations of a few ministries. Resolution of supply problems, smooth production, and the sudden change of government priorities – laying more stress on the volume of exports against convertible currencies – were the demands made on the ministries "from above." On the other hand, in order to neutralize market effects and regulators, to keep qualified labour, and to avoid competition with small enterprises and subsidiary enterprises, the large enterprises wished to rely more on ministries. This was clearly not from a subordinate position, and in addition, the ministries possessed no legal rights of intervention. [16]

The influence of local social organs tangibly grew in the field of operative enterprise management. Therefore, the emphasis was not only on a change in the sectoral and enterprise relationships, but on the reconsolidation of the hierarchical order. This latter seemed to have grown more flexible between 1968–70, even for a time becoming somewhat confused.

*For example, the 1976 amendment of the regulators reduced producer price subsidies. While, however, such subsidies fell by 73 percent in the sphere of non-preferred enterprises, they fell by only 8 percent in the preferred ones.

**From the enterprise aspect, the following excerpt from an interview provides information on the changed role of ministries: "After 1968, ministries played a much reduced role. Today, in 1975, they are gathering strength again. After the 1968 changes in the regulatory system, they did not find their place in the new system. Therefore, matters of importance and control shifted to the National Bank of Hungary to a large extent. Now the ministries are more important again. It simply could not be maintained further that they should only ask for reports. They must always live with the problems, and then the best solutions will certainly be found." [14]

Yet, after a few years' pause, a strong wave of organizational centralization of enterprises followed. This, unlike the mergers of the 1960s, was not originated by the ministries (though in many cases it was actively supported by them). [17] For instance, the series of mergers in the cooperative sector was initiated in most cases by the regional organs. [18]

One could present still further elements of the slow centralization process, composed of minor technical elements, apparently far from political questions. What matters is that the changes did not start in legally declared, institutional forms; such a situation reflected conflicts of interests behind the scenes, in which the reformists had already been pushed into the defensive and it is exactly for this reason that they tried to make use of references to continuity. Later on, the changes became a customary practice, institutionalized in various decision-making techniques and affirming and reproducing the shifts in power relations which had been uncertain at first. These quiet changes avoided open confrontation and did not question the continuity of the political trends which were of a symbolic value to this country. However, they enabled the regulatory techniques introduced by the reform to be formally maintained, giving rise to the hope that, if there was another change in the power relations, the empty forms could be filled with contents once again. For this reason it was in the reformists' interest to see that the turn should take place quietly, though the avoidance of an open conflict of interests rendered their basic position ambiguous. In fact it hindered the formation of a unified reformist group with a clear and ripe programme which also could represent moral values. This special kind of a decision-making process, however, tended to give rise to the illusion that the retreat was only temporary and that all actors in the decision-making process had succeeded in avoiding something worse. This enabled everybody to identify with their assumed role and avoided the risk of self-conflict or helplessness, such avoidance being fundamental in state administration.

## Contradictory reform – uncertain results

That such a turn was possible can be seen even more clearly if one examines the structural contradictions of the reforms. Right up to the early 1980s, the idea of a limited *economic* reform had been predominant not only in Hungary, but in almost all the socialist countries. The attribute "economic" indicates that *intended* changes were not to affect social and political mechanisms and institutions. They aimed to make economic decisions more *rational,* i.e. to ensure that the executives would be more interested in carrying out economic policy objectives such as the plan targets. These were to remain under strong central influence in all details (in many respects being directly determined). – The process was to be rational, with no wasting of management costs.* The economic

*The only exception was Poland: there, after *Gomulka* had come to power, workers' councils were incorporated into the political-institutional system. This went beyond the technocratic interpretation

reform appeared to be a realistic compromise represented by those who hoped that far-reaching changes in the economic conditions would not stop at transforming economic interests in the strict sense, but would sooner or later lead to changes also in the norms of social attitudes, and eventually to the reform of the political-institutional system. Other political and economic leaders held, however, exactly the opposite view. They expected that if rationalizing economic measures were made in time, serious political changes could be prevented. The transitory compromise of the two opposing political positions was to create a political basis which would enable the introduction of the programme (this is, of course, what accounts for the highly abstract formulations – interpretable in several different ways – of the documents). (See [19]) This is also what explains the compromising character of the reform efforts, as well as the fragility of the compromises.

The point of the compromise was that the political-institutional system, i.e. the strictly hierarchic order of economic and social control and management, should remain unchanged: any changes or movements, any expression of interests or revaluation could only occur in the entirety of the system, and only if initiated by the leading bodies. Therefore initiatives coming from the grassroots were not ab ovo excluded, but they could only ripen into deliberately undertaken interests and arrive at common platforms if they climbed the steps of the hierarchy. The natural way of asserting interests consisted much rather in acquiring patrons than in an open organization of interests, i.e. the formation of interest groups and the establishment of standpoints polemizing with one another. (More clearly: it was much more promising to ask for individual judgement, referring to some special condition – a "particularity" in the idiom of economics – and to look for high-positioned supporters, than to organize a common platform with a number of enterprises – for example, with a view to proving the erroneous or unjust nature of a measure.)

Obviously, this hierarchic organization of interests was not in conformity with the declared logic of the 1968 reform. I think that the unchanged institutional-organizational structure, and the survival of the enterprises' hierarchic dependence with which the reform was introduced involved, from the outset, the possibility of the turn that actually occurred; what is more, it was a *necessity*. That is to say, since enterprise management remained embedded – through an all-embracing hierarchy and far-reaching personal relationships – in the control apparatuses and regional state and party organizations, the natural interest relations and channels for asserting interests also remained. Thus it was along these lines that the interests running contrary to the reform process got organized. The survival of the hierarchic dependence allowed the interests reproducing this system to be organized and asserted, so that sooner or later the reactionary process was able to

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of the reform. However, the workers' councils of Poland were soon deprived of their original function and were transformed into so-called "self-management conferences", which were in fact to affirm top-level decisions through "grass-root initiatives." It is, therefore, hardly accidental that it was exactly in Poland that government efforts to establish the self-management of enterprises were, for a long time, looked on with suspicion.

start. This was the sign that those powers and interests had united. That is why no outer force or initial impulse was needed to ensure that a change leading to a turn would eventually take place, i.e. that the process of retrogression started at first slowly, and hardly noticeable, should accelerate. Therefore, I consider the turn that occurred in the early 1970s as *necessary;* even if there was, or could have been, a slight chance for the central government to carry further the reform process started in 1968. A situation could have developed in which the leadership would have decided to give further impulse to the development of the market by breaking up large organizations, reorganizing control apparatuses and reducing their tasks, and enlarging the scope of small enterprise. This would have been, however, more like luck (or at least the lesser chance) whereas the coalition of the anti-reform forces was almost a necessity.

It may sound strange, but Iván T. Berend's article convinced me of the truth of this statement. It seems likely that, following the reform, some have not only used but abused the increased possibilities provided by the situation. Under the pretext of fighting against anomalies and hoarding, a campaign was launched against small ventures and complementary workshops, using political and legal instruments. Veritable abuses were revealed, and commented on as generally characteristic of small enterprise. The bias of the programme is obvious from its failure to give publicity to any such phenomena in the sphere of large enterprises, though such cases did occur. What is more, exactly because of the nature of the campaign, actions and legal procedures were taken against small enterprises, which proved to be assailable and even indefensible later on, when the campaign petered out.* What matters in this case is not the judgement of each action, but that the actions taken against the small enterprises, or complementary cooperative workshops, and for a short time against household-plot farming, were biassed. Namely, they were to prove that incomes "disproportionate to work" were earned characteristically in these fields, and that these forms were the hotbeds of profiteering, which came near to, or in fact violated, the law. However, abuses committed in other fields were also known (let us just think of Antal Végh's book on paying sportsmen from the pocket, or the preferential sales of plots of land mentioned in Ferenc Kubinyi's interview (see the previous footnote), which are the most characteristic instances of acquiring unearned incomes. (Everybody in Hungary knows that the gentry attitude, snobbery, and abuse of office are just as dangerous as the petty bourgeois ways. (In literature and sociographic works this fact has been illustrated just as frequently, as have been the uninhibited small entrepreneur or selfish group interests in daily propaganda. See Ferenc *Karinthy*'s drama "Házszentelő" (Housewarming)).

*There is very little about this in economics literature. However, sociographic works, interviews, and documentaries have often looked at the subject of the campaign started against enterprise in 1971–72. See, for example, the film *"Határozat"* (Resolution) produced by Judit *Ember* and Gyula *Gazdag* and Ferenc *Kubinyi*'s interview with the former president of a cooperative at Balatonkenese [20]. They are quite convincing documents of the change of the political atmosphere and of the campaign unfolded against small enterprise. It is not accidental, either, that these anti-examples were openly documented, i.e. made public when the anti-reformist tendency had lost strength.

It would be comfortable simply to feel angry with those who inform the public tendentiously, or who try to mitigate social tensions by seeking enemies. The situation is not that simple, however. What happens is that the leading men of society see the group of the newly rich arise and, in addition, not by the accustomed rules of the game i.e. not by the steps of the hierarchy. They have cars almost as expensive as the responsible leaders, and they have cottages built on the shores of Lake Balaton.

Under such conditions, enterprise managers earlier considered successful and reliable, as well as good organizers, feel that, though there is no trouble yet, their situation has grown somewhat unstable. If the reform principles are going to be seriously asserted, they fear a worsening of the situation. They see that new men appear, the "tricksters" (and yet fail to see that they indulge in trickery themselves, only in another medium and by other methods – although today these appear to be less successful). They sense that the size of their enterprise still represents a privilege, but to a smaller extent than a few years earlier, and what is worse, the small entrepreneur and the complementary workshop of the cooperative do as they like, while the large enterprise is hamstrung.

In this so far essentially unchanged atmosphere, which is imbued with uncertainty, the idea necessarily arises that something is wrong, and it arises especially in those who feel they are the potential losers. It is not extraordinary, either, that they do not refer to their own interests, but to abstract interests, and even to the values, of society. They feel that the high incomes of those frying and selling pancakes, just like the higher wage levels evident in the joint enterprises of the building industry or the agriculture, and even of the auxiliary workshops of cooperatives, must be due to some kind of lax dicipline or, even more so, to corrupt practices. It is then quite easy to find a good many prime examples (such as are to be found in any other sphere of the economy). Knowing of such cases, as well as of local conflicts, the leading men of the country declare that action must be taken against excesses, and distorted values. (This is, of course, not independent of the contradictory nature – mentioned above of the political basis of the reform process.)

When such value judgement have been formed, regional management feels it is necessary to make order among auxiliary workshops, or to be stricter with small entrepreneurs. They do not wish to violate rules, for it is only a reference to extreme cases of the misuse of the increased scope for action, which are evident on both sides. In fact they only wish to press demands (in the same way that a few years later the socialization of property was measured by the number of mergers of cooperatives or, in the recent past, the foundation of economic workteams and support of small enterprise has grown fashionable). The press, and certain representatives of the mass media do not want to lag behind events, either. In the end, the ordinary citizen following the events with interest and himself experiencing abuses, is made aware of a few conspicuous cases of rapidly accumulated wealth. Reading in the papers and hearing in official speeches that abuses have gradually proliferated, he develops the feeling that indeed a serious mass phenomenon is involved and therefore extreme rigour is necessary.

An anti-small-enterprise and anti-peasant atmosphere is not the originator, but the final outcome of this process. Thus it looks on the surface that rigour is justified by the

prevailing social atmosphere. It is important to see that no deliberate distortion of facts and no ill-will are needed for this process; a misleading of public opinion is out of the question.

For the lack of diversity of interests and opinions, the objectives and value judgements formulated at the top of the hierarchy thus grow into a campaign from which those on the lower levels cannot free themselves. We have now arrived at the reason, why the reform of the political-institutional system is indispensable for making the economic changes irreversible.

While working on my present contribution, I read in *Népszabadság* the obscure story of a small entrepreneur [21]. The story, which reports on recent events, is not a schematic one. Its main hero, the entrepreneur, is not clearly condemnable, nor is he a simple and honest small producer. He violates many rules (as manager of a department store, he takes care – at public expense – to fulfil the private needs of the local VIPs, he authorizes fictitious sales, and he provides for his representational funds illegally, etc.). In these violations, he is not motivated by profiteering, for he also has a second occupation and earns a lot. He is clearly not a likeable figure. He uses all means to force his opinions on his colleagues, most of whom do not like him. It is, however, beyond dispute that he has created a useful and, were it not for the fact that he is an entrepreneur, one could say a work-centred atmosphere. Yet, his business-like mentality is less inspiring: in his mind, rules (often indeed petty) can be violated, whereas local power relations are important. On the other hand, it is true that these days a major undertaking cannot be successfully carried out in any other way.

The point is not the story itself, which has perhaps been quoted at an exaggerated length. The peaceful coexistence of different systems of values can hardly be conceived in any other way than that which the story exemplifies. What is reassuring is that the story is not made up so as to conform to some higher expectation. This may no longer be a rarity. Also, the current dispute concerning the economic workteams of enterprises does not go to the extreme, which it would have done fifteen years ago. The tolerance of different views, the social control of the executive apparatuses, the parliamentary control of the government, and sound social publicity are still open issues. It has ceased to be, however, a dubious merit that central intentions need to be fulfilled by up to 120 percent. Perhaps even contrary opinions are tolerable, as is illustrated by the keen debates about the tax reform. Today it is a tolerated view, even though not a generally accepted one, that a reform of the political-institutional system is unavoidable.

Does all this guarantee that the reform programme can be smoothly implemented in the future? Hardly. Yet we have much to lose, while our chances have somewhat improved.

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# INTENTIONS AND CONSTRAINTS
## Reflections on reading Iván T. Berend's study

L. SZAMUELY

Iván T. *Berend*'s latest study [1] has aroused general attention in Hungary.

The cause of the general interest is obvious: in looking for a way leading out of the protracted social and economic crisis, it is of primary importance to understand why and how the former reform experiment, at one time so highly promising, came to a halt. What is more, the decade of the 1970s represents a "recent past" only figuratively speaking, not only because of its nearness in time, but primarily because of the perfect and unbroken continuity in economic policy, in the political system, and in the personal composition of the leadership. Therefore, in analyzing the past, the historian in fact writes about the present. Also, if Hungarian society wishes to progress towards a future that differs from the present – for the time being only making tentative steps in practice – it is a precondition that the past be closed down and a balance drawn.

Berend's article does not pretend to draw up a balance, the less so, as such a task cannot be correctly accomplished without archival research, and the documents of the period after 1970 are not yet open to research, as the author points out in a footnote. (p. 113) Thus he only outlines the sphere of the problems, leaving much space for himself as well as for others, to fill in the blank spots later on. Berend's present undertaking recalls two of his earlier pioneer works: when the new approach to the "recent past", from a distance of 12–15 years, infringed interests and hit sore points in the same way as it does now – yet it was important to do so in order to interpret the road of further progress.

The first such undertaking by the writer was the book which offered a novel appreciation of the economic policy of the Rákosi era, published in 1964; today this is of significant ideological and political-historical importance [2]. It was followed by a debate in *Közgazdasági Szemle,* [3, 4, 5] pursued with István *Friss,* an exponent of the period's economic policy, and later a leading personality of Hungarian scientific life. Berend's other undertaking was of no less importance: in the early 1980s, after long years of silence, he directed attention to the history of the dismissal of the 1957 reform, dealing also with the delicate question of the "fight against revisionism" [6].

Berend's present venture seems to be, in a way, more difficult than were the earlier ones, and not only because of unavailable archives, but first of all because, though the distance in time is similar to those of the earlier cases, those were periods that had clearly ended and were politically overcome. Today the situation is different. Therefore, what is to be examined is not only what was specific to the 1970s, but also, in which way and to what extent the factors causing the halt, i.e. the turn of the reform, are still effective.

**What was the cause of the retrogression?**

The study mentions two causes, one internal and one external.

The external cause was, according to Iván T. Berend, that the anti-reform tendency gained the upper hand in other European socialist countries at the end of the 1960s and beginning of the 1970s, i.e. the pressure exerted on the Hungarian leaders from outside. As he puts it: "It is hard to judge and, at the present time impossible to reveal in detail, what mass of direct and indirect criticism and pressure existed beneath the publicly known surface, it was just the tip of the iceberg that could be seen. (p. 110) We have no reason to doubt that such direct or indirect pressure was there, especially if we call to mind the events taking place in our neighbourhood in 1968 and 1969 (the breaking up by the police of university students' and teachers' meeting in Warsaw in March 1968, followed by police terror and an anti-intellectual campaign, coupled with anti-semitic instigation; the dismissal in practice of the so-called Kosygin reform in the Soviet Union in May 1968; repression of the reform experiment by means of foreign military intervention in August 1968, followed by a full take-over by anti-reformist forces in Czechoslovakia in April 1969, etc.). It remains a question, however, whether that mass of direct and indirect criticism in fact froze all movement and crushed everything, or whether this statement, apparently of fact, only reflects the Hungarian leaders' *opinion.* That is to say, the quotations and references prove beyond doubt only the latter.

The revelation of the truth in full is a task of future historians; all we can do today is to express doubts as to whether the policy of a defensive and of gradual retreat was indeed the best option available. Would it not have been possible, for example, to make use of the consequences of the workers' revolt in Gdansk over the Christmas of 1970 which split the "iceberg" (the downfall of Gomulka's ossified doctrinaire leadership) to point out that the neo-Stalinist course was undermining the power base of the regimes established in Eastern and Central Europe? Or, in the international field, were new vistas not opened up by the atmosphere of détente during the early 1970s, i.e. the process leading to Helsinki? Why had another ten years to pass before joining the International Monetary Fund and the World Bank, when already the effects of the world economic crisis could be felt – as could those of the country's sinking deep into its domestic economic recession? Shouldn't we put the question (here, too) whether reference to adverse external conditions and alleged international requirements and constraints had for long decades served as suitable excuses covering up failures, delays, passivity and resignation in Hungarian public life?

As for the internal cause of the halting of the reform, Iván T. Berend mentioned social conflicts: "The functioning of the reform mechanism basically hurt earlier vested interests in various fields and on various levels... The principle of differentiation of incomes according to quality, value, and amount of performance worked against the interests of those refusing to increase their efforts, those seeking comfortable positions, or those unable to improve their performance. Such attitudes helped to produce average or below-average – results and thus the levelling off of incomes served their interests

well... The emphasis laid on competence alarmed the tens of thousands holding medium-level posts in the administration and the political leadership, who had only political-ideological trustworthiness and good connections to their credit." (pp. 111–112)

I agree with this explanation *in principle* (though only up to a limit: it is exactly the rightist and leftist opponents of the reforms introduced in the socialist societies that usually refer to "absolute" versions of this explanation, so as to prove the "unreformability" of the Soviet-type economies). Nevertheless, I doubt if *here* and *at that time* – in Hungary during the 2–3 years following the reform – incomes were so much differentiated, and competence was of such high social prestige that it jeopardized the existence of tens of thousands. Statistical data and sociological investigations do not attest to such changes, but rather to the lack of them.

In fact, it could not have been otherwise, exactly because of the compromising character of the reform, because of the many built-in "brakes" which Berend describes so clearly. The structure of governmental power remained unaffected and so did, in practice, the institutional system of economic management and control, and overgrown large enterprise centres. In addition, the prices and financial regulators that entered into force on the 1st January 1968 guaranteed profit for every enterprise, and the average wage control system ensured that enterprises should not dismiss redundant staff (instead, it actually contributed to an artificial labour shortage), they also largely contributed to a further equalization of wages. A further list could be made of all the measures and instruments which were deliberately, from the outset, designed to avoid and were able to prevent social conflicts when launching the reform.

Were there indeed real social conflicts in the initial years of the reform of which the anti-reformists quoted by Berend gladly made use? The answer is yes, but looking at them today they seem to be just minor, or even pseudo-conflicts, the majority of which were caused exactly by the paternalistic central regulation in its search for over-assurance. Only two typical instances need to be mentioned to illustrate the point.

The first case concerns the conflict about the so-called profit sharing categories. The original conception (the reform principles approved in 1966) suggested that enterprise workers should be granted different percentages in addition to their basic wages, depending on the profit realized by the enterprise. The allowances over the regular wages (i.e. the profit share) were to constitute a higher percentage in the total earnings of those who had more influence on enterprise profit, i.e. the managers. Enterprise workers were divided into three groups, and profit share percentage was maximized for each. In the group comprising top-level managers the ceiling reached 80 percent of basic salaries, in that of mid-level managers it reached 50 percent, and for the rest of enterprise workers the ceiling was 15 percent of wages. In stressing greater responsibility and risk-taking, a contrary stipulation was laid down as well: if the enterprise made a loss instead of a profit, top-level managers were to receive only 75 percent of their basic salary, and mid-level managers only 85 percent, whereas the rest of the enterprise workers would receive their basic wages in full.

The introduction of this regulation caused bad feelings among those people who had

never before been officially informed about managers' incomes and benefits. Thus to some people the figures looked bad. However, the proportions suggested in fact corresponded to earlier income proportions, with the difference being that earlier such incomes were granted to the managers under different labels (plan fulfilment bonus, etc.). Ordinary workers were excluded from this system, so that they had neither information, nor any uniform basis for comparison. This uniform, yet differentiated scheme of profit sharing "opened their eyes," as it were, and it gave grounds also for a lot of demagogy about inequalities "bred by the reform." The "bad look" of the figures was, of course, easy to adjust: uniform rates of profit sharing were re-established in 1970, and managers were granted bonuses by other rights, from special lists. The biggest anomaly of the regulation was, however, not mentioned by the champions of social justice and equality at the time. It was, namely, that the initial conditions of the reform guaranteed profit for the enterprises from the outset. The managers thus risked nothing, while they got the award for risk-taking. . .

The other case that caused passions to be aroused was the process involving a higher fluctuation of labour in the initial years of the reform. Several factors underpinned this change. First, there was the new labour code which facilitated the changing of jobs. Second, the reform provided new opportunities for the functioning and development of various kinds of small economic units and organizations. At the time, the cooperative sector could make the best use of those opportunities (for example, by the establishment of so-called subsidiary facilities producing goods and offering services) and, as is generally known, it quickly took advantage of the new opportunities. Under the conditions of a shortage economy – that survived even after the reform – the competition among enterprises did not evolve in the market of outputs (goods and services) but, quite naturally, in the field of acquiring inputs (investments, labour, imports). On the labour market, the above-mentioned average wage control even added to excess demand.

Therefore, in this case also, anger was not caused by income differentiation and veritable social conflicts, since it is a statistically demonstrable fact that whereas incomes earned in cooperatives were rising faster than those in state-owned industry, they did not reach the level of the latter. The main cause was the growing activity on the labour market, which forced competition on the state-owned large enterprises. The latter reacted in their customary manner (it has to be admitted, though, that in the over-regulated situation there was no other way): they demanded further administrative restrictions, and they found willing partners among the political leadership. Their demand was given "ideological basis" by the explications about state ownership as a "more developed form" of socialist ownership and about its "protection" – of which a good many examples are quoted in Iván T. Berend's study.

If significant social conflicts did not and could not emerge in the period under discussion, and we cannot cite the existence of any considerable political movements either – what could have been the internal cause of the "retrogression"?

In my opinion, it is to be looked for in the reform itself, i.e. in its *partial and limited character.*

Analysts of the economic mechanism that was established after the 1968 reform agree that the dismissal of the directive planning system did not automatically lead to the development of some form of market economy. Instead, it brought about an indirect control system of the centralized planned economy, first of all by means of financial regulators. What is characteristic of this system is in fact stated by Iván T. Berend: ". . . because of the lack of a consistently normative regulation, the masses of exceptions led to the reproduction of central directives by other means of regulation." (p. 132) The setbacks of this arrangement are today well-known ("plan bargain" replaced by "regulation bargain"; enterprises' economic dependence on the state apparatus's value judgements instead of on a market judgement; distorted efficiency criteria because of manipulated regulators; permanent shortages because of the "soft" budget constraint; external and internal equilibrium disturbances; weak international competitiveness, etc.).

These setbacks are so well-known, that the advantages of this system over the command economy are quite easily forgotten. First: the elimination of the difficult and costly mechanism of breaking down the plan made it easier to carry into effect the central conceptions. Second: the financial indicators replacing plan targets laid down in physical terms have helped to develop a way of thinking in terms of money, costs, and realizable profit (even though the size of the latter is centrally manipulated). Third: enterprises, i.e. enterprise managers, received a limited yet real autonomy; in other words, from executors of central instructions they grew to be decision-makers, since the substance of indirect economic control exactly was to influence and manipulate their decision. Thus the indirect system of economic control and management may prove to be, in principle, a useful lesson, an interim and perhaps inevitable learning phase on the road leading to a genuine market economy. (It may not be accidental that in Poland since 1982, and in the Soviet Union since July 1987, such indirect control and management have been practised or attempted.) Having gathered years of experience in this field, we can venture the statement: the indirect system of central control and management involves the risk of getting stuck in this transitory or interim state. Thus there is no automatic development towards a market economy, but a tendency moving in the direction of a self-sustaining system.

Looking back into Hungarian economic history, in the original reform conception of 1968 one surely finds the idea of transition to a market economy and to an indirect system of control. More exactly, at that time the two concepts were not yet quite distinct – as I have explained in more detail elsewhere [7]. In the course of practical implementation in 1968–69, this was conceived as the introduction of the reform in several stages. The documents (pp. 106–108) Berend refers to in his study, as well as the concepts published at the time, encouraged further development towards the market model. What is then the real cause of the halt of the Hungarian reform and its inability to find a way out of this interim state? References to external factors and internal social tensions do not provide a satisfactory answer to the question, particularly not these days when the factors referred to have practically changed signs.

We shall obtain a more satisfactory answer, if we examine not only what the reform has done, but also what it has *not done* nor intended to do – or, what the above-mentioned limited nature of the Hungarian reform in fact amounted to.

## What has not changed

The reform was a "reform of the economic mechanism", as it was stated in the title of the May, 1966 party resolution that started the process of reform. That is to say, it was strictly limited to the economic sphere and even within this sphere it *did not imply a revision of economic policy objectives and development strategy.* On the contrary, party and state leadership equally considered it an axiom, i.e. beyond dispute, that the economic policy was correct, and only the instruments and methods (the mechanism) of implementing its aims needed to be improved. In fact, it was this economic policy that held the achievement of a "CMEA autarky" (i.e. satisfaction of demands raised by the CMEA market) to be the strategic aim of the so-called 'second wave' of industrialization. The real objective was not to manufacture up-to-date items of ever higher technological standards, to be exposed to competition on the world market, but to increase the volume of products of long-standing pattern or construction, satisfying less particular quality requirements. This was also promoted by the centrally financed, large-scale central development programmes of the 1970s. Such an economic policy is in practice well served by the indirect economic control and management system, but not at all by the self-regulating market.

I do not say that those who worked out the 1968 reform saw clearly that an unchanged economic policy would determine exactly that kind of economic control system. No, the latter has established itself as a result of various compromises, in a more or less spontaneous, unforeseen manner. However, when the "first stage" of the reform measures has established that particular system, there was no further objective requirement on the economic policy side to make further progress. On the contrary, it was in its interest to make this transitory and interim phase a permanent one.

The reform *did not intend to touch the system of economic and political institutions, i.e. the power structure of society,* whereas it did intend to change somwhat the way of exercising power. Out of the complex of questions which arose in the aftermath of the reform, it was mostly the narrowly interpreted economic institutional system that received most attention. Iván T. Berend also specifies that "the programme of institutional transformation, deliberately neglected by the reform" (p. 106), was envisaged only for the "second stage" of the reform. This, however, failed to arrive. Others, as well as myself [8], have amply discussed the questions concerning the contradictions and obstructing impacts that resulted from the fact that the enterprises vested with decision-making autonomy remained as parts (more exactly, as lower steps) of the hierarchy of central economic control and management. What has been discussed in the relevant literature only quite recently – mainly due to the changes in the economic

institutional system which have taken place in the early 1980s – is that the reform did not affect the division of labour between party and state (more exactly, it ignored the lack of such a division). It did not abolish the amalgamation of the political and the economic spheres, nor did it put an end to the replacement of economic criteria of decision-making by political criteria, and vice versa.

Iván Pető's excellent study, written earlier but only recently published, clearly demonstrates [9] that the 1966 reform decision required changes only in the style and forms of party activity. It did not wish to change anything in the all-embracing role of party control. The leadership took special care to ensure that the reform process, as well as the functioning of the reformed economic mechanism, should remain under the guidance and control of party organs. The knowledge of this fact renders it unnecessary to search for the reason (for example, rising social tensions), why there was no further impulse to transform the indirect economic management and control system, established in the "first stage" of the reform, into some variety of the real market economy (the regulated one included). Market control is, namely, incompatible with party control – at least in the manner conceived in the 1966 party resolution.

The other built-in "guarantee" of braking the reform was the *unchanged official ideology,* which preserved, even in the post-reform period, the concept of the socialist society and economy canonized by Stalin. Quite a few theoretical novelties of the Hungarian reform (recognition of different models of the socialist economy, of the plurality and equality of the different forms of ownership, of the commodity-producing nature of socialist economy, of the enterprise's autonomy as against control by the state) were not adopted in official ideology. I called this state of things "being at cross-purposes" in one of my works [10]: economic management goes the way of recognized necessities, while ideology tries, with its huge propaganda apparatus, to maintain an ideal of socialism which is ever more distant from the solution of the real problems.

This state of things did not come about spontaneously, as a consequence of some failure in agit-prop activities, or because of inertia. It is one of the merits of Iván Pető's study that he factually demonstrates that the past thirty years of the Hungarian political leadership have been basically characterized by efforts at the preservation of stability. Only in exceptional cases was the continuity partially broken, and when they were forced to break it, this was always interpreted as a minor correction of the well-proved line [11]. Even the working out of the reform blueprint was done behind closed doors, and the intentions underlying a radical change were for long hidden from the public. Ideology, agitation, and propaganda were always directed at keeping up continuity, i.e. at justifying the correct and unbroken line of the policy.

This accounts for what is today the incomprehensible fact that all through the 1960s and the 1970s it was left unsaid that the 1968 reform was in fact a realization of the conceptions formulated in 1956–57. It was also not revealed that those conceptions were branded as "revisionist" after 1957, and that consequently the propositions had been

placed in the archives. (That is why the above-mentioned 1981 article of Iván T. Berend caused such a stir, when it broke the long-preserved tradition of silence.)

It is also in this light that we are able to understand the strange phenomenon of which Iván Pető writes: "when, in April 1965, the Central Committee published its guiding principles for solving the ideological problems of the day ... among them the theses dealing with the connection between economy and ideology, the reform projects were not mentioned, though the earlier charge of revisionism, and the outline of the conceptions, would have provided sufficient ground for it... A comprehensive, 'theoretical' evaluation of the reform was neglected not only in the peparatory phase, but later as well, since the much increased practical flexibility in the field of economy was by no means accompanied by a change in the ideological theses" [12].

In the light of this lasting state of "being at cross-purposes", the pretty collection of anti-reformist criticism taken from the two leading party organs – the daily *Népszabadság*, and the periodical *Társadalmi Szemle* – does not seem surprising at all. These articles, namely, each attacked the processes and phenomena of, or attributed to, the reform, from an ideological basis. Therefore, since the official ideology had not been submitted to any revision, it is hardly possible to talk of its "retrogression" during the early 1970s. In this respect, the use of the term "losing ground – gaining ground" seems to be more appropriate.

In this light, it is extremely important that Iván T. Berend recalled in his study two laughable as well as sad recurrences of ossified ideology in the early 1970s – which have been buried in – not at all beneficial – oblivion until now.

One episode, which is rather comical, consisted in the revival of the vulgar-Marxist interpreation of the leading role of the working class, along with the practical measures it entailed. The restructuring process taking place in the Hungarian economy, – even though lagging behind advanced industrial countries by several decades – is, namely, necessarily accompanied by a decrease in the share, and later in the absolute number, of workers producing material goods, and especially of manual workers. The dogmatists among the leadership of the country, and their aids, interpreted this objective process as a weakening or shrinking of the social basis of socialism i.e. of the ruling power of the working class. Therefore, they set out to "stop" the process in 1973. In his study, Iván T. Berend refers to the revision of "the measures made only a decade before, which had been in the spirit of social unity and the elimination of discrimination" (p. 126) in the field or higher education and the selection of managers. To this can be added, for example, the instructions whereby the Central Statistical Office changed its criteria of the working class category, so that a growth in the number of the working class could be demonstrated; the anachronistic restrictions and discriminations introduced in admissions to the party; and the specially favourable terms of home building credit granted, beyond social and income considerations, depending on how well one succeeded in posing as a manual worker.

A lot more examples could be given, but the point is that the demagogical pseudo-measures brought "in protection of the working class" were enabled by official

ideology. This had definitely broken away from a genuine analysis of social reality and development trends, and had adopted an un- and anti-scientific attitude.

A sorry product of this attitude was the other episode mentioned by Berend (p. 127): a special party resolution condemning philosophers (Lukács's disciples) and sociologists of international fame. This was followed by their expulsion from the intellectual life of Hungary (prohibition of their employment and publication), and then the forcing of some of them into exile. Reading the words of this resolution [13] today, one can hardly decide what is more amazing: that, only fifteen years ago, a political body in Hungary took the liberty – and the responsibility – to lay down in a resolution what was a correct theory or method of examination in sociology, and what was not, and what was a Marxist approach and what was not; or the fact that the existence of different models of socialism, and of different trends within Marxism, and the use of the concept of social modernization were considered as condemnable.

Iván T. Berend was right in publicly recalling this shameful episode of Hungarian political and scientific life. It is only through open talk and unambiguous attitude – for example, annulment of the above-mentioned political resolution and redress for the injustice and wrongs done to the scholars affected – that it will become possible to prevent ideological doctrines being used as a club to "put research in its place", i.e. to hinder, if only temporarily, social development.

## Which way to go now?

Fortunately, history does not repeat itself – yet if it did, its outcome would not be much different.

The Hungarian reform which started in 1968 slowed down in the early 1970s, because – in an unchanged power structure, with the maintenance of the earlier economic development strategy, and an insistence on ossified ideological doctrines – it could not reach beyond establishing a centralized indirect system of control and management. The potential for the development of this system had been exhausted by the second half of the 1970s. Yet this was due to happen, since the originators of the reform conceived this as a transitory phase. They were probably wrong, however, if they assumed that further progress was at all possible or likely to be successful within the limits they had set.

As for the problems facing us today, the lesson to be learned is that it is not possible to break out of this long-lasting state of stagnation and slow degradation by some "second edition" of the 1968 reform, i.e. by a clever modification of the regulatory system in the broad sense, leaving the limits and restrictions of 1968 as they were. To break out, the dividing line must be drawn and discontinuity admitted.

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# IN AGREEMENT AND AT ISSUE

I. T. BEREND

I have been involved in professional debates on many occasions, but never before have I made such stir with any of my writings.

What was the cause of this stir, and why are opinions so extreme? The reason is, obviously, that this recently published chapter of my book, which discusses the history of the Hungarian reform from the intellectual events preceding it up to the present, tackled the most topical and painful issues. These issues, at the centre of public interest, had for long been hushed up and handled as taboos. However, I actually named the processes and even the actors involved. Thus I have been careless enough to neglect Voltaire's wise

advice: the historian must not concern himself with the living. Yet I am glad about the stir. I think it is only through such debates that one can clarify positions and make progress in obtaining a deeper understanding of the present situation.

### The substance of the debate: the causes

The excellent contributions by *László* Antal and László *Szamuely* both centre their attention on the causes which led to the halting of the reform in the 1970s. Both come to similar conclusions. According to Antal: "It would of course be tempting to trace these changes back to the general repression of reform efforts in the socialist countries, the atmosphere created by the feeling that "we are alone"... This is, however, painly, not the truth... The real causes were domestic ones... (p. 140) Szamuely recognizes that "We have no reason to doubt that such direct or indirect pressure was there..." (p. 151), and formulates the same idea in the following: "Is it not also fair to ask whether references to adverse external conditions and alleged international requirements and constraints had for long decades served as suitable excuses covering up failures, delays, passivity and resignation in Hungarian public life? " (p. 151)

I, too, consider internal factors to be of decisive importance, and it is certainly fair to question the attitude that seeks excuses for the delays. Yet I see it as I said in my article: "it became quite clear that the further development of the solitary Hungarian reform and a consistent assertion of its principles were hardly feasible." (p. 110) The pressure was clearly present and not only in the didactic and reprimanding tones of *Kommunist, Neues Deutschland* or *Rudé Pravo* and their direct or abstract reproaches. Although mistakes and even deliberate exaggerations could easily occur in sizing up the risks, one cannot exaggerate the extent of defencelessness. Infringement of the norms of interstate economic and political relations based on equality, the so-called Brezhnev doctrine, and the Czechhoslovak events of 1968, (the year of introduction of the Hungarian reform) were all tangible signs indicating that "friendly warnings" must be taken seriously. It would be good to read sincere recollections as well as the minutes of meetings which took place at that time. This is, however, not possible at the moment. The debate is, therefore, more on the level of hypotheses. I think that this is the main determinant of the Hungarian reform, just as it was back in 1957. The role of *internal* factors can be interpreted only on this ground and it is also there that it becomes decisive. (Since the emergence of Gorbachev's reform conceptions, the conditions have changed exactly in this field. In today's situation, the reform in fact depends on us alone, i.e. on the internal power factors.)

Let us look at the *internal causes.* Both Antal and Szamuely see the main causes of the turn of the 1970s in the retrogressive automatisms that became effective as a consequence of an incomplete reform, and in the unchanged institutional and political structures.

László Antal brilliantly explicates the logic of the "quiet turn", resolving the problems he poses to himself, one after the other:

"The question is, whether it was a concentrated political counter-attack, or the predominance of large enterprise interests that led to the turn, or perhaps it was due to the fact that the reform model was, from the outset, of a destabilizing nature... Was the reform itself ambiguous? ... producing the counterforces which subsequently started the recentralization processes." (p. 140)

Antal gives a clear answer:

"I think that the unchanged institutional-organizational structure, and the survival of the enterprises' hierarchic dependence... involved, from the outset, the possibility of the turn that actually occurred, what is more, it was a necessity... The survival of the hierarchic dependence allowed the interests reproducing this system to be organized and asserted, so that sooner or later the reactionary process was able to start... That is why no outer force or initial impulse was needed to ensure ... that the process of retrogression started at first slowly, and hardly noticeable, should accelerate."(pp. 145–146)

László Szamuely says the same thing, with convincing force: "... what could have been the internal cause of the "retrogression"? In my opinion, it is to be looked for in the reform itself, i. e. in its *partial and limited character.*" (pp. 153–154) According to him, the answer is to be found in what the reform *did not do:*

"The Hungarian reform which started in 1968 slowed down in the 1970s, because – in an unchanged power structure, with the maintenance of the earlier economic development strategy, and an insistence on ossified ideological doctrines – it could not reach beyond establishing a centralized indirect system of control and management." (p. 158)

What the originators of the reform conceived as transitory made further progress impossible.

I agree with both authors. They pinpoint the problem exactly in their explications. It is the weak point of my article (which has become clear in the light of their contributions) that those aspects are not given enough stress. The reason for this is that the article is a chapter from a book and the preceding chapters discuss, beside the historical significance of the reform, exactly its compromises and incomplete character. I accept, therefore, the two authors' reasoning, but there still remains a difference of emphasis in our explanations. I feel, for example, that their explanations concerning the retrogressive automatisms are insufficient. Though true, they do not give the reason why, after five successful years and with preparations for further progress underway, retrogression should occur. In such explanations, retrogression could only have followed in the long run. As for the 1972 turn, however, there was indeed an accelerating "initial impulse". Of course, it would have been quite possible for it to unfold at such speed within the framework of the unchanged structure and political mechanisms described by Antal and Szamuely. On the ground of the automatisms, however, the political attack was determinant. As in the reform, so also in the anti-reformist turn, the political factor played the primary role. The "quiet turn" was not so quiet, after all. My hypothesis is that it was like a "court revolution" aimed at reversing and thwarting the liberal-reformist

line of politics. If the popular personality of János *Kádár* was unattackable, fire then had to be opened at the supporters of the reform, in order that the first secretary could be "freed from" the leading figures of the reformist wing of the party. (For, let us admit, it is inherent in the logic of a one-party system that there are different trends in it or, as *Gramsci* put it: if there is only one party, there will be more parties within it.) The unchanged political structures facilitated the organization of such forces.

While it is true that things got blurred, and the fight was not between "the good" and "the bad", or the "black" and the "white", and obviously, not everybody knew on which side they were standing, or did not even perceive the existence of different sides, there were real fronts, all the same. The fighters were motivated by many different intentions. Among them were, of course, the genuine anger about the "excesses." About this László Antal says:

> "What matters in this case is not the judgement of each action, but that the actions taken against the small enterprises or complementary cooperative workshops, and . . . against household-plot farming, were biassed, namely, they were to prove that incomes "disproportionate to work" were earned characteristically in these fields, and that these. . . were the hotbeds of profiteering which came near to, or in fact violated, the law. However, abuses committed in other fields were also known (let us just think of. . . the preferential sales of plots of land. . . Everybody knows. . . that the gentry attitude, snobbery, and abuse of office are just as dangerous. . .)" (p. 146)

The "excesses" and instances of profiteering were, however, rarely attacked in the press. There were some who intended to defend the reform even at the cost of compromises and there were others who feared for their own interests and privileges. I do not deny that a role was also played by the commitment to protect interests. Recently, Sándor *Gáspár* passionately refused "to call the trade unions and the opinions held by them to be anti-reformist", stressing that now, just as earlier, their programme was to protect their members' interests. I hold this to be indisputable and natural myself. What is more, the clear expression and formulation of different interests is a primary social need.

I shall quote Antal's words again:

> ". . . enterprise managers earlier considered successful and reliable. . . feel that, though there is no trouble yet, their situation has grown somewhat unstable. . . In this so far unchanged atmosphere, which is imbued with uncertainty, the idea necessarily arises that something is wrong, . . . especially in those who feel they are the potential losers. It is not extraordinary, either, that they do not refer to their own interests, but to abstract interests, and even to the values, of society." (p.147)

However, although intention is important in judging a man's action, it becomes uninteresting on the scale of history. It would be all too simple to quote the saying that "the road leading to hell is paved with good intentions." It is a more realistic statement that objective historical processes originate through individuals' action, which are based on many different intentions and conceptions. Hegel recognized:

"In world history, man's actions result in something other than what he intends and achieves, or what he knows of and wants directly. He attains what is in his interests and thereby brings into existence something that is inherent in them, but which was not in his mind or purpose."*

Let us, therefore, not argue about intentions and motives. The quotations taken from the press of the period are not for condemnation. Those opinions were guided by many different motives, obviously quite often by that of "defending a just cause." But we must not be so shy as to suppress the fact that there was indeed anti-reformism as well.

In the final account, the strong impulse for anti-reformism was provided by the activity of those who were highly interested in retrogression, aspiring thereby to attain power. There were others who had an indirect interest in retrogression, as well as those who had quite different aims: to fight against genuine corruption and protect real or assumed interests (yet they, too, objectively served retrogression).

It is on the grounds of the decisive role of the external factors, of the objective conditions of internal structures and retrogressive automatisms, and of the determinant political motive of the attack against the reform line, that the turn of the 1970s should be interpreted.

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To conclude, I wish to offer thanks for the inspiring debate. It can – just as I hoped my original article would – contribute to the clarification of the vital issues of today. It is my conviction that it is useful to call things by their names: to speak of what exists in reality. The revealing of the processes involved may indeed help to ensure that the reversal of progressive processes "must not happen again", to use the words of the title of László Antal's study.

## Reference

1. Hegel, G. W. F.: *Werke in zwanzig Bänden. Band 12.* Vorlesungen über die Philosophie der Geschichte. Schuhrkamp Verlag. Frankfurt-am-Main 1970. pp. 42–43.

*"Der oben angedeutete Zusammenhang enthält ferner dies, dass in der Weltgeschichte durch die Handlungen der Menschen noch etwas anderes überhaupt herauskomme, als sie bezwecken und erreichen, als sie unmittelbar wissen und wollen; sie vollbringen ihre Interesse, aber es wird noch ein ferneres damit zu Stande gebracht, das auch innerlich darin liegt, aber das nicht in ihrem Bewusst sein und in ihrer Absicht lag." [1]

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# REVIEWS

## A DISPUTE ON THE CHANGES IN PROPERTY RIGHTS

M. SZÉNÁSI

The meeting of the Economic Panel of the Central Committee of the Hungarian Socialist Workers' Party, held on March 28, 1988 put on the agenda the discussion of papers* that present the development of, and the desirable directions for, further progress of Hungarian ownership relations.

The most important opinions expressed by the authors of the five studies, mentioned in the foot-note can be summarized in a thesis-like form as follows:

A historical analysis of Hungary's economic performance shows that under the condition of socialist relations of production – which have been developed since the elimination of capitalistic property rights – the suppression of small-scale production and the collectivization of agriculture in the extensive stage of development (i.e. when mainly workplaces were created) increased dynamically. However, in the following period the improvement of performance halted. For the sake of a more efficent functioning, the economic reform of 1968 removed the compulsory directives and the central allocation of inputs. It also declared the necessity of the development of trade, the price system and financial control; it regarded openness with regard to the external market as an important factor, and encouraged the strengthening of workplace democracy. The resolutions on the reform of the macroeconomic management, nevertheless, hardly touched upon the issues of the general conditions of efficient production and of the legal problems of property rights. In addition, they did not deal with the necessity of coexistence of and competition between state, cooperative and private property, nor did they deal with the transformation of the organizational and property systems. The inherent contradictions of the new economic system later led to a situation in which the reform – although it was able to partially eliminate the physical approach of traditional central planning and non-demand-driven, wasteful and useless production – could not create a sound basis for efficient development. The system of central development objectives was maintained, and the struggle for access to development funds continued along with the bargaining procedure

*Márton *Tardos:* A gazdasági szervezetek és a tulajdon (Economic organizations and property); György *Matolcsy:* Az állami tulajdon lehetséges új formái, versenye (The possible new forms of state property and their competition); Gyula *Tellér:* A szövetkezeti tulajdon (Cooperative property); Péter *Halmai:* Mezőgazdaság és tulajdoni reform (Agriculture and ownership reform); Teréz *Laky:* A magántevékenységek helyzete (The conditions for private activities).

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concerning the regulators. The often unrealistic financial conditions mostly favoured the large firms, and the polarization of enterprises did not reflect the real differences in efficiency.

Drawing on external financial resources, the Hungarian economy developed continuously until 1978, but the expansion of production was cyclical and its efficiency was low. From 1979, the top priority became the restoration of external and internal equilibrium, primarily through the improvement of the adaptability of the economy. To this end, several significant measures were taken, as a result of which the circle of enterpreneurial ventures grew wider: the property rights of the new market-oriented organizations were delegated to the bodies of employees; economic associations and affiliates were established; the issue of securities began; the provision of commercial credit, the issue and negotiation of commercial bills of exchange, as well as overdraft credit facilities were introduced; a legal framework was elaborated for the liquidation of loss-making firms; and a two-tier banking system was established. Although these steps were necessary, they were still insufficient to activate the controlling function of money with respect to the competitive sector, since not even in its new role could money be the instigator of the necessary restructuring of the economy. The Hungarian economy has continued to be unable to adjust itself to international economic tendencies. This can basically be explained by the mismanagement of social property – that is, by inappropriate property decisions. This is because an owner can only be efficient if he is directly exposed to the consequences of his decisions and, furthermore, if he is in possession of the abilities and tools needed for the making of appropriate decisions. In the present system these requirements are not met.

A state or administrative organ cannot be a good owner, since its decisions are simultaneously influenced by the considerations of an owner and an authority. However, enterprise employees cannot be good owners, either, because they are above all interested in increasing their wages and safeguarding their jobs – not in increasing enterprise assets. Even the appointed management of a firm may be more interested in decisions resulting in the increase of enterprise profit rather than the increase of enterprise assets.

This is the reason why, within the scope of state property, organizations and persons making ownership decisions – in the absence of long-term interest in the increase of enterprise assets (capital) – often make inappropriate and inefficient decisions. This may involve such strategic issues as the establishment, reorganization and liquidation of ventures, as well as the determination of long-term business and capital allocation policies.

The above findings also hold true, in a special way, for the theoretically collectively-owned cooperatives, This is because the majority of traditional cooperatives are not genuine cooperatives, since the rights attached to cooperative property are actually not exercised by the collective. Namely, important decisions (e.g. on fusions, de-mergers, investments, the choice of partners, incomes policies, the selection of managers, etc.) are born in a reconciliation procedure which involves extra-cooperative organs that do not have to take the risk associated with these decisions. In the course of the development,

such cooperatives have been formed in which the membership has been detached from its property – as indivisible property has become dominant – so that the members have practically slipped into the status of employees, while the managers have got into the employer's position. As a result, the decision of the membership are hardly influenced by property considerations, and the collective is primarily confined to the improvement of its own income and performance position. The only exceptions to the above cases are represented by the new small industrial cooperatives and the specialized agricultural cooperatives. In the cooperatives, therefore, the problem of the contradiction between short- and long-term enterprise interests, or the institutional stimulation of the increase of assets, has to be solved basically in the same manner as in state enterprises – although, in some instances, specific measures are needed for problem-solving.

The long-term interest in the increase of assets can only be created in such a way that within the state and "large cooperative" sectors the management of asssets is made the basic responsibility of independent organizations. In turn, behind the independent proprietory organizations, the private individual might present himself as the interested subject of the efficient managament of property. This may eventually guarantee an efficient form of operation, too.

A group of independent proprietory organizations has already been developed in the economy: insurance companies, banks, and – in a narrow circle of state enterprises and cooperatives – holding-type organizations running affiliates and partnerships. Through a further decentralization of these organizations and the encouragement of their transformation into one or another form of limited liability companies, it should be possible to increase the number of independent ownership organizations, as well as the circle of participants in the capital market.

Within the framework of the properly rights form, beside the mentioned forms, an important role may be played by these new social security institutions (pension funds). These, vested with the interest of insurants in the increase of assets, would be able to control the management of property through the securities of companies functioning in the competititve sector. As typical forms, joint stock companies and asset-managing centres (holding companies, business concerns) would be needed in the prevailing circle of large state firms. These, in possession of the securities of the collaborating units in an association form of a large firm, would exercise proprietory functions, i.e. they would assert long-term interests in the increase of assets (capital). According to the conception submitted for discussion, a more marked ownership role should also be played by local (village, town), and county self-governments (councils) as well as by nonprofit-making institutions (trade unions, universities, hospitals, etc.).

In the proposed communal ownership model the dominance of state property is eliminated, and the transition to the new forms of public property is completed. Thus it is not private property that replaces state property. The transition to the new property rights model may be carried out by a discretionary political and administrative decision, but it may also be the result of a longer process asserted by market forces. The proposals support the latter version, which would be promoted by a new legal framework,

preferences being defined in a government programme, along with other indirect "catalyzing" tools.

In small cooperatives the interest in the increase of assets can almost automatically be created, since these are not hierarchic organizations and function on the basis of divisible property. New forms of property rights could be established for the cooperative membership through the issue of ordinary and special certificates of proprietorship, membership credit and credit for special purposes. Such measures would take into account that these tools would primarily attach the members to minor autonomous units. In large multi-profile cooperatives, current accumulation and accumulation stemming from the activity of former members should be treated separately, the former as collective and the latter as external property. This solution would leave cooperative assets indivisible, but in the long run collective interest relations could be established with those former members who actually accumulated the indivisible property.

It would be necessary to move towards a more diversified structure in the case of cooperatives, too. Beside the establishment of new ventures, the independence – or the loosening of connections to the parent company – of the individual units of existing firms should be facilitated. On the other hand, viable larger organizations could be developed from small ventures through association or cooperation.

In the spirit of the ideology hostile to private property in the early 1950s the only activities which were allowed, in the small businesses of the private sector, were those needed neither by the large state enterprises nor by the cooperatives. However, the organizational structure of modern economies, beside large establishments serving the needs of mass production, cannot dispense with an extensive network of small organizations. In this respect, the organizational modernization initiated during the 1980s – despite the declared objectives – did not bring about a tangible change, either: the large organizations did not permit the separation of smaller or larger units capable of independent functioning. Also, for private individuals the establishment of independent businesses and capital investments remained an overly uncertain and risky perspective.

Both the steady and considerable shortages of consumer services and the job-creating capability of these small organizations justify the widening of the scope of independent entrepreneurs and the support of their activities. These activities should be re-directed into that organizational form which is the most adequate for their performance. Namely, into an individual or family work organization, or forms of partnership. In the case of the partnership forms it would be necessary to relax the rule concerning the members' unlimited liability, because this calls forth distrust and impedes capital investments. A regulation warranting the viability of the privately owned small organizations is also indispensable, because the economy requires many more economic units with an interest in the increase of assets than there are today.

*In the course of the dispute the participants expressed the following views:*

The fact that in the past twenty years the Hungarian economic system – even though it proved to be capable of functioning – did not become competitive is first of all explained by the neglect of the existence of capital in the economy. This has become an obstacle to the efficient management of capital. A change of conception is badly needed, and it is necessary to find the ways in which some form of socialist capital management and capital market can be developed. The specific feature of socialism is a market economy controlled by a macroeconomic plan. To this end, a socialist-type mixed economy should be developed. In such a system many types of proprietory function simultaneously, yet the dominant form is the public property. However, this must not be considered as being identical with state property.

It was agreed that, with respect to competition, neutral conditions should be established for private property. In this respect, the participants pointed out that the apparent dynamic development of the private sector in recent years may be deceptive, since it has deliberately been stimulated, while within the state sector a restrictive policy has been pursued. Consequently, the results of the private sector can only partly be attributed to the more direct interests associated with this form of property, as the role played by the regulation itself has been at least as important.

The idea of introducing joint stock companies emerged in the course of the preparatory work for the 1968 reform. However, at that time it was raised as a tool for facilitating capital flows, rather than for the reform of property rights. The joint stock company form has by now become an organic part of the ideas which relate to this reform. The participants in the workshop's dispute agreed that the new association law should provide an opportunity for enterprises to be re-established as joint stock companies if those companies see a better development prospect in this form. They warned, at the same time, against a campaign-like implementation of this form and drew attention to the fact that the elaboration of up-to-date forms of property cannot be a substitute for the improvement of interest in production and for the development of interest in production and for the development of other ways of responsible management. To this end, it is necessary to examine why the enterprise collectives have proved to be incompetent in the task of increasing assets (capital).

The opportunity enabling traditional state enterprises to be re-established as joint stock companies raises the questions of the enterprise councils' survival. The establishment of enterprise councils was designed as a response to the demand of society for a far-reaching democratization. In other words, the development of workplace democracy took place instead of any substantial progress in the development of political democracy. Nevertheless, although a bargaining procedure about regulators has become general, it has not been favourable for the functioning of enterprise councils in line with the original intentions, nor has it produced a genuine participation of the workers in them. The latter problem may be effectively addressed by the joint stock company form – provided that

the shares are subscribed to by a wide circle of employees, rather than by a privileged group. On the other hand, it is only in a real market environment that enterprise councils are pressed to make real decisions; the condition for their proper functioning is the strengthening role of the market.

The efficient management of a mixed economy and the extensive application of monetary tools in the control of economic developments require the establishment of capital market. The participants emphasized that they regard the establishment of a real, non-simulated capital market, with a lesser degree of freedom than that of the commodity markets, as an organic part of the reform process. This is also a condition for the legal channeling of private property into production and for the flow of capital towards successful ventures.

The more efficient management of economic developments urges a change of conception in planning, too. The planning of the management of social capital should be made an organic part of both short and long-term (strategic) planning.

Cooperative property was qualified by most participants as a form that incorporates the elements of the community ownership conception of Marx and Engels to a greater extent than state property. According to one opinion, the cooperative is an association of persons, and it would be a mistake to transform it into an association of properties; at the same time, it has to be distinguished from self-governing state ownership as well. By the application of the joint stock company form, the cooperatives would lose their cooperative character. This, as it actually happened with the creation of the mammoth cooperatives, may lead to a halt in dynamic development. The group of participants holding this opinion believes that the most important task is to restore the "human scale", and to re-establish the cooperative character of the oversized cooperatives. According to the other view, it is practically a wage-earner attitude that has developed in the cooperatives, and this is the reason why, despite spectacular successes in production, productivity is not satisfactory. The advocates of this latter opinion hold that the objectives to be sought in the development of cooperative ownership are the same as those that have been formulated by the reform conception of ownership relations with respect to the national economy in general terms: namely, that it is necessary to establish medium and small-size economic units to strengthen ownership responsibility, providing a greater-than-prevailing scope for private ownership and for auxiliary (complementary) activities.

Several participants drew attention to the fact that the elaboration of conceptions concerning the reform of the various segments of social and economic life is being pursued separately. This makes it difficult to consolidate the various elements in a uniform scheme. They deemed it necessary that the changes in property rights be incorporated in the framework of the overall socio-economic system.

*The Panel eventually adopted the following standpoint:*

So far, despite every reform experiment, no adequate forms have been found for the efficient management of state property. Therefore, in the future it is necessary to clarify – without being over-ideological – a number of basic theoretical problems. At the same time, it is vital to point out that the socialist economy will, for some duration, necessarily continue to be characterized by the coexistence of several forms of property. In order to function more efficiently, the "no-man's property" existing today should be transformed into public property. It is expedient to support, and strengthen, the proposal that a part of the state property be entrusted to insurance funds, social security institutions, local self-governments, and other nonprofit-making institutions. With respect to property rights, a mixed economy is needed, but dominance should be given to the socialist forms of property. To this end, a set of conditions has to be elaborated such that the integrating function of money would have a main role. Thus the basis would be laid for an economic approach which sets wasteful enterprise behaviour not merely against economy but against venture itself. Also, it would register not only actual losses but missed opportunities, too.

The implementation of the decisions concerning the restructuring of the economy requires more capital. This could be acquired by the attraction of foreign capital to Hungary, the reallocation of capital withdrawn from weak enterprises to profitable areas, and the investment of household money savings in production.

The new association law has to provide a stable framework for the development of both small private ventures and joint ventures with foreign participation. In the case of small private ventures, this means the conclusions of the debates about their right to exist, whereas in the case of direct foreign investment, it means the unambiguous formulation of the guarantees and the scope of activity. While maintaining the specifics of cooperatives, the law should also provide an opportunity for the further development of cooperative property.

The workshop also cited a number of questions which need to be clarified in the course of the preparatory work underlying the association law (which also serves the property rights reform):

– Who or what institutions would exercise property rights, and what is the most expedient mechanism to be applied, in the case, for instance, of the re-establishment of an enterprise in the form of a joint stock company?

– How can the functioning and the rights of social organs be fitted into this system?

– How is it possible to create an economic regulation which would ensure neutral conditions for competition, irrespective of sectoral status as well as of ownership and organizational form? Specifically, how can such an internal incentive scheme be introduced which would call forth a stronger-than-today interest in production? What mechanisms and institutional framework should operate the centrally controlled capital mar-

ket? How could the development of market forces, representing a condition for the capital market, be promoted?

According to the workshop, the historical parts of the studies under discussion are onesided, and a more accurate analysis is needed in the case of the cooperatives and small private ventures, too. It recommends the continuance of critical analysis and, on this basis, the preparation of a deeper summary. The workshop feel that it is necessary that – considering the importance and the complex socio-economic interrelation of the issue – the reform committees be completed by a further committee whose responsibility would be the elaboration of the further development of property rights.

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# BOOK REVIEWS

INOTAI, A.: *Az NSZK a változó világgazdaságban* (The FRG in the changing world economic environment). Közgazdasági és Jogi Könyvkiadó, Budapest 1986. 260 p.

It has been beyond dispute for over thirty years that the West German economy is capable of outstanding performance. This opinion was further confirmed when in 1974, the year following the first oil price explosion, the country's balance of trade showed the largest ever surplus in its history. To many observers, this might give the impression that the FRG does not even need an active policy of adjustment to the world economy, the fast adjustability of its microsphere making successful reaction even on far-reaching world economic changes almost automatic. The West European – mainly French, and to a lesser extent, British – economic literature on foreign trade of the late 1970s often set up the economy of the FRG as an example to be followed. In a few cases the West German example even eclipsed the Japanese one, as various factors of the Japanese "economic miracle" are, for political and social reasons, not applicable in Western Europe.

András *Inotai* starts his analysis of the West German economy with the last few years of the 1970s, when the general picture of the exemplary success economy began to be disturbed by contrary phenomena. The trade balance surplus fell conspicuously in 1980, remaining in the forefront of international technological development became difficult in certain sectors, and the economic leadership could not cope with the worsening unemployment problem. Undoubtedly, the trade balance surplus grew again considerably in the early 1980s, yet the other economic policy problems showed no genuine improvement. A thorough analysis of the West German economic results of the last 5–6 years is important in Hungary not only because of the lessons of adjustment they provide, but also because the FRG has by now become the second-largest foreign economic partner of Hungary, so that the West German growth prospects may strongly influence also the Hungarian policy towards various markets.

Inotai's book relies on extensive factual material in its attempt to summarize information that is important in respect of the West German economy of the mid-1980s, and indispensable for a detailed evaluation of the economic results. The author's approach is expressly a "positivist" one, and one must agree with it, as the issue of the various fields of the West German economic development may be used in various systems of arguments in the economics disputes of Hungary – not always of purely economic content. There are, in the West German economy, several such phenomena which are rarely occurring simultaneously, in an international comparison. From this aspect, the policy of subsidies is of special interest: it is clearly stated in the book that the West German economic policy set a trap for itself by its generous subsidies of earlier years, in which it is now caught up, while making efforts at restraining budgetary spending. Namely, budget incomes can only be increased between extremely strict limits. Whereas the cutting of expenses in other fields, such as employment policy, the central incentives for technological development, etc., spoils the chances of asserting state priorities. The West German experience of subsidy policy may support – of course, in a one-sided interpretation – the arguments of the adherents to both the "liberal" and the "interventionist"

budgetary policies. The former may point out the poor economic results of the large state-owned servicing enterprises (railways, postoffice), their chronic efficiency problems, and the loose relationship between subsidies and results, as well as the employment situation which is now worsening almost independently of economic prosperity or depression. On the other side, the latter may venture that the West German economic achievement is partly due to the large volume of exports of certain industries (for example, the motor car industry) which could surmount their earlier financial difficulties with the help of the state, or, that the successful assertion of an active adjustment policy demanded the state's increased financial role in other countries as well (for example, in Japan and in Sweden).

It cannot, of course, be asserted, that both opinions can be true regarding one and the same issue. Therefore, the author's effort at providing a detailed analysis of the West German adjustment policy, a branch of increasing importance within West German economic policy, is especially welcome. It is not only in the case of the FRG that it is expedient to definitely distinguish between the active and the passive measures of adjustment policy. One must keep in mind, namely, that a state intending to pursue a deliberate adjustment policy may do it with a view to loss-minimization, defensively, for it believes that adjustment can only be made without any serious shock to the domestic economy. The passive adjustment policy does not make it impossible that the viewpoint of world economic adjustment be widely asserted in the economic policy. By its deep-going analysis of the West German experience with passive adjustment policy, the book has a lot to say also to the reader interested only in the Hungarian economic policy questions. It makes it quite clear, namely, that even the pursuers of a not too resolute adjustment policy have quite a rich economic policy armoury at their disposal.

Inotai calls attention to the "tension treatment" nature of the passive adjustment policy, as well as to the growing rate of individual elements in macro-economic regulation. "From the late seventies, the increased number of forced elements in adjustment have led to ever more individual measures aimed at reducing (or eliminating) the damages or expected losses of the West German economy, and at increasing the flexibility of the economy. The primary motive of the measures was the reduction of expenses (costs), which is not only the peculiarity of short-term and often short-sighted responses to "unexpected" events, but it was well embedded in the traditional West German system of economic policy objectives. Cost reduction necessarily led to the realization, also stimulating a more active economic policy, that an adequate response to the challenge can hardly be found without changing earlier income proportions. (. . .) it had become clear that structural adjustment is basically hindered by questions of distribution and, therefore, the distribution sphere must be strictly separated from the economic policy sphere."

In the case of the FRG, therefore, the passive adjustment policy is significant only insofar as it could be well coordinated with the traditional West German economic policy objectives, while it also gave help to laying down the grounds for active adjustment. Of course, the transitory phase between passive and active adjustment may be rather long: in various sectors, first of all in public services, the state will regulate access to the market, and the volume of trade, it will influence price formation and it operates some other supply-constraining regulators as well.

According to the evidence of Inotai's book, the well-known slogan of "social market economy" is today somewhat one-sidedly asserted in the FRG. Ever since 1983, the Kohl-government has deliberately been aiming its economic policy at an increased assertion of market conditions, not only through limitation of the scope of regulation, but also through transformation of the social welfare rules and labour law to be blamed for the tensions and inflexibility of the labour market. In the deregulatory economic policy of the road leading to an active adjustment policy, these are the two elements upon which the third one is built, which is the attempt to put the state budget on a sound basis.

The analysis of adjustment policy is just one of four important chapters of the book. *Chapter 1* analyses the recent facts of the West German economic development in detail, pointing out the significant role of changes in the exchange rate of the DM in the excellent export results through

long years and thus also in the favourable development of several other macroindicators of the West German economy, by far the most open one among the leading powers of the capitalistic world. On account of the DM, through a long period undervalued in comparison with the dollar, the foreign economic result appeared to be better than what was expected in consideration of the processes of domestic economy. *Chapter 1* calls attention to a few aspects of domestic economic development which are less known in Hungary. It may sound surprising that a North-South division is taking shape in the FRG. The Southern regions (Bavaria, Baden-Württemberg) display a higher-than-average dynamism: incomes are higher, the employment situation better, and the capacities of several leading industries are increasingly concentrated there. The coastal region of the North Sea and Northern Rhineland-Westphalia are, on the other hand, increasingly suffering from economic and social difficulties. It is characteristic that the average salary in Munich is today 15 percent higher than the national average and surpasses the average earnings of the traditionally industrial regions by yearly DM 1000–3000.

*Chapter 2* discusses the system of objectives and the armoury of the adjustment policy and the highly useful lessons taught by the experience of particular interest to the Hungarian economists. This is, however, by far not a question of macroeconomy only; referring to sectorial and enterprise cases, *Chapter 3* offers an overview of the efforts taken in the microsphere at adjustment and structural transformation.

The most successful version of the adjustment is, in the final account, of a defensive nature, as it primarily contributed to the reduction of costs, and not to the increase of incomes or to the dynamical development of the most efficient sectors of the productive sphere. All the same, the extensive rationalization (conservation) process undertaken in the energy economy also proved to be successful to an almost unparallelled extent: between the years 1973 and 1985 the energy consumption of the economy was hardly growing, while the energy-intensity of production fell from 0.35 to 0.29. The change is due not primarily to direct state control, but to market processes partly orientated by the state which, relying on the cost-sensitivity of the microsphere, were not concentrated on non-recurrent savings and restriction of consumption, but instead, on the transformation of the excessively energy-intensive industrial structure.

Structural transformation in the manufacturing industry was neither fast nor smooth. It is true, though, that structural transformation was hindered by the "optical illusion" caused by the good export results, "making industrial performance appear in a favourable light when the outputs were still embodied, and to an increasing extent, in products representing a lower degree of structural development." The "optical illusion" was fortified by several external circumstances, such as, among other things, the dynamical demand of the CMEA region, the traditionally good reputation of the West German products, the servicing and commercial background adding to the competitiveness of the products, all of which made exporters as well as importers forget about the deterioration of conditions of reproduction in the domestic economy.

The responses of the manufacturing industry to the structural challenge were different in each sector. Examples of clearly successful adjustment are found in the chemical and the textile industries. In the engineering industry, a key sector, the picture is ambiguous. Only three of its fifteen subsectors (motor car industry, aircraft manufacture, computer technology) could increase the number of jobs between 1970 and 1984, which also gives an indication of the ratio of the subsectors successful in adjustment. A lag behind the leading international field of technological development is found, for example, in electronics and electrotechnics, in which those products could keep earlier West German positions on the world market which were in the medium field of technological development level.

Problems of competitiveness arose, as a rule, in industries with an overwhelmingly large-enterprise structure. In an active adjustment policy, therefore, the supporting of small and medium enterprises' development efforts is increasingly important, especially because in recent years small enterprises have to an increasing extent contributed to maintaining the dynamism of economy, by intensifyng their international relationships and by their attempt at effectuating

structural adjustment through paying more attention to foreign economic demands.

*Chapter 4* relies on an extensive statistical material in its overview of the development of the foreign economic positions of the FRG between 1973 and 1985. The freshness of the book's data deserves special mention, as most of the numerical information provided can be considered as currently valid, though this is not the case, as a rule, in the Hungarian literature, except for periodicals, though this is certainly not always the authors' fault.

The chapter on foreign economy discusses several such questions in more detail which were mentioned earlier, in connexion with other subjects, but the detailed explanation of which is more justified in the summary evaluation of the economic performance. The processes of competitiveness faithfully reflect the sectorially widely different adjustment results, and the changes in the foreign economic positions support the fact that the FRG is losing ground in the international trade of products of the leading industries. This is most conspicuous in microelectronics. It seems, therefore, that the West German economic policy will have to make up for the lag primarily not by increasing redistribution to the benefit of the progressive industries, but by improving the general economic environment that applies and adapts research results. This is to be promoted also by the recent measures aimed at driving the West German economy toward increased openness in trade policy as well as in the international flow of capital (direct investment).

It cannot be said yet, in which direction, and at what rate the West German economy will carry on with the process of active adjustment, which has not consistently been pursued for any long time as yet. The American opinion quoted at the beginning of the book as a matter of curiosity, comparing the FRG to a rushing car, is by all means exaggerating. According to this opinion, the car has accelerated so that it rose into the air, but it will soon fall, inevitably, and disappear in the deep sea. The long-lasting and well-founded growth process of the FRG may be justly compared to a motor car. For some years, however, this car has not been threatened by excessive speed, but at most by the ageing of some of its structural elements, whereas its results still justly rouse envy in most of the competitors.

Á. TÖRÖK

WALLACE, W. A.–CLARKE, R. A.: *Comecon, trade and the West.* Frances Pinter (Publishers) Ltd. London 1986. 176 p. + index

This is a well-written balanced survey of a contradictory and comprehensive topic: problems and prospects of the East European countries in their international trade involvement. The authors distinguish themselves from the currently fashionable unqualified quest for "originality" that tries to invent novelties even at the cost of factual evidence. Their measuring rod is rather traditional: the degree of correspondence of their findings with facts. It is the substance of the statements rather than sensationalist figures or "findings" that makes this book worth reading also for East Europeans. Needless to say, the authors view CMEA developments from outside, i.e., from a different angle, than we do it. This might, however, also be an advantage since, especially at times of restructuring, similarly to companies, countries and groupings may also profit from learning the outside expert view (even if they do not necessarily follow those conclusions).

Writing on the nature of CMEA the authors correctly note that, historically, the economies of the region were never meant to be integrated in the sense EC members are (pp. VII–VIII). On the other hand, the state and performance of CMEA is a relevant factor also from the Soviet policy point of view, in the context of plans to reinvigorate and accelerate growth. And, conversely, it is also an East European interest that the Soviet policy renewal should succeed, otherwise a seclusive policy and an enfeebled economic potential is anything but helpful for the small CMEA countries.

The history of CMEA is surveyed in a quite condensed manner. This is an advantage but, inevitably also implies that – alongside a number of to-the-point formulae – a series of subjective reading of available evidence is there. While agreeing with several statements I still miss a fact,

whose explanatory power is not irrelevant: the withdrawal of Soviet troops from Czechoslovakia in 1947 and from Romania in 1958.

*Chapter 2* analyses tensions and discussions in the early 1980's. The method chosen by the authors is instructive: they try to answer the question who has what to contribute to integration from among the member-states. Therefore, a brief comparative analysis of these countries is presented. This falls short – I presume, intentionally – of individual country studies, but presents a generally correct overview of why there are no "good boys" and "bad boys" in the CMEA. Each country has its own share of difficulties which make a docile, subservient attitude – often attributed to one or more of them in the Western media – practically impossible. This explains why the attitude of each CMEA country has become more critical *vis-à-vis* their integration; on the other hand the Soviet attitude of those years tended to interpret complex issues somewhat mechanically (p. 38). This was explained – as it turned out from the following chapter – by the fact that the then emerging international political and strategic controversies dominated an already slowed down decision-making, therefore issues of longer-term planning and cooperation have been pushed to the background. The coordinatory procedures and the various positions of the participants are characterised with skill. However, I do miss an analysis – and even mention – of the 1984 Economic Summit, whose documents do represent the common body of various interests thus setting the framework for what is attainable in the medium run through integrational policies.

*Chapter 4* analyses impacts of the 27th Party Congress of the CPSU on the CMEA. The situation is characterised by the authors as a strain between the acknowledged difficulty of the overall situation and the ambitions embodied in the plans. This also holds for the CMEA Programme for Scientific and Technological Progress until the year 2000. They also underline the enhanced role of direct inter-party top-level meetings as a method of overcoming frequent stalemates emerging on CMEA fora. Their conclusion (p.65) is that for an offensive foreign policy improved economic performance is absolutely necessary, therefore overcoming the resistance to restructuring of entrenched bureaucratic interests also of CMEA organs is an important Soviet interest, not sheer propaganda.

Then CMEA and the Common Market are compared. While in the former attempts at reneval have in practice brought rather more than less "armchair administration", in the latter stagnation in integrational developments at the state level has been followed by widening political cooperation and growing interfirm contacts during the eighties.

*Chapter 6* on development of the CMEA member states and their integration presents a statistical analysis of major macroeconomic processes, a "necessary outline sketch" (p. 101), for presenting the problems and the alternative solutions as described in the following parts. A brief outline is, by definition, full of omissions as size prevents the authors from going into many of the details. In dealing with the subjects those living in the area subject to daily discussions, therefore also their value judgements range extremely wide. It seems useless to stray into areas where my reading of the facts would differ from that of the authors, instead I should like to draw attention to an important finding. Writing on growth performance on p. 86 they correctly underline the fact that, owing to pecularities of national statistics, officially produced data differ from those calculated with standard Western methodology to a varying degree in CMEA countries. While in the case of Hungary the difference is mostly negligible, in some countries it might add up to as much as 2–3 percentage points annually. Therefore, extreme precaution is required when comparing real performances of CMEA countries on the base of officially reported nominal growth rates – emphasize Wallace and Clarke. This conclusion should definitely find an echo in international comparative economics, as it is a regretfully common practice of some prestigeous research institutes and even international organisations and banking circles to take every figure at face value.

Not only far-reaching conclusions are being inferred from a perfunctory first glance at official statistics, but in some cases these inhomogeneous data are even averaged (!), which is a methodological nonsense and frequently compromises elaborate econometric studies. The recently un-

folding debate in the USSR over the methodology and reliability of the reporting of the Central Statistical Administration of the Soviet Union lends extra weight to this point.

*Chapter 7* focuses on main problems of CMEA countries in the last decade or so. These are in many ways parallel, since the economic systems and in part also economic policies profess a remarkable degree of similarity. Although the need to switch over to "intensive", i.e. less factor-intensive growth has been a commonplace since the mid-sixties, the "extensive" (factor-intensive) character of development has rather increased since then. Inherent systemic features impeding endogeneous technological change have also perverted the policy of importing technology. The latter is especially true if the above-mentioned systemic factors are not to be changed, but to be preserved – and this was a main priority in the 70's. Comparing Polish and Hungarian agricultural performance indicates (p. 130) that the proprietory relations explain the outcomes only in part. The crux of the problem is that agriculture is very unsuitable to bureaucratic management, therefore – as Soviet experience indicates – increased physical inputs can not really compensate for the lack of interest of the producer.

Then follows a chapter on the comparative analysis of economic reforms, in terms of dualism of relaxed and rationalised administratively planned economy *versus* socialist market economy. The authors are quite right (on pp. 138–139) when they generalise the thesis that none of the modifications that fall short of abolishing each and every compulsory indicator may eschew a relapse into the old mechanism. The Polish WOG reform of 1973 is the best practical evidence of the ways how gradualism as a method inevitably thwarts meaningful change in practice (and this also applies to experiments). Surveying pressures for and limits to reforms – including vested interests of the bureaucracy and popular discontent with the phenomena that are inevitable fellow travellers to any economic readjustment – they come to a rather pessimistic prognosis as far as prospects for genuine reforms are concerned. Turning to the inernational political aspects of the issues they contest the fashionable view of a large part of the Republican Administration that increased military competition is conducive to reforms. Major systemic changes always entail risks and uncertainties, which are quite unacceptable in political terms when a country is like a fortress under siege, when the issue of control always comes first.

*Chapter 9* deals with intra- and extra-regional trade. The problems are described in terms of turning inwards – turning outwards as well as the planner and marketeer concepts. The authors correctly stress (on p. 160) that reorientation of commercial relations to the CMEA, that actually took place in the first half of the 1980's, runs contrary to the members' interest in competitiveness and in technological modernisation. Discussing extreme scenarios they correctly conclude that a default of existing debts by one or more CMEA countries is out of question within the forseeable future. They are also quite right in stressing: problems of East–West trade are structural, and not determined by the political climate (p. 163). As a concluding remark, the authors underline that East–West trade is not a one-way street, although further efforts are needed on both sides to avoid its further marginalisation in the world trade.

All in all, Wallace and Clarke have written a very useful, condensed and balanced overview of CMEA even if the reviewer would not share each of their conclusions. The volume may also serve as a textbook without being didactical or spoon-feeding. It is a serious book equally suited for the specialist and the general public, written in an enjoyable style, with an unmistakable British flavour that helps in developing an understanding for the conflicting aspects and even paradoxes of the reality of CMEA.

L. CSABA

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*We acknowledge the receipt of the enlisted books. No obligation to review them is involved.

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# AUTHORS

Tibor ERDŐS, b. 1928. Corresponding member of the Hungarian Academy of Sciences. Scientific adviser at the Institute of Economics of the Hungarian Academy of Sciences, formerly professor at the Karl Marx University of Economics, Budapest. Author of "Long-term and short-term goals for development" (UNIDO, Paris 1988) and several books in Hungarian among others "Growth rate, growth path" (Budapest 1986).

Márton TARDOS, See Vol. 39, Nos 1–2.

dr. Marek DĄBROWSKI, b. 1951. Assistant professor at the Institute of Economic Science of the Polish Academy of Sciences, Warsaw. Author of "Institutional forms of state influence on economic life" (Oeconomica Polona, 1984, No. 4) and books in Polish on the conditions of economic efficiency of self-managed enterprise and on the economic consequences of labour management.

dr. András HEGEDŰS, b. 1922. Cand. of economic sciences. Author of "The structure of socialist society" (Oxford 1975) "Socialism and bureacracy" (London 1976) "Im Schatten einer idee" (Zurich 1986) and several books and studies in Hungarian.

dr. H. W. HOEN, b. 1960. Research assistant at the Department of Economics, Rijksuniversiteit Groningen, The Netherlands.

dr. H.–J. WAGENER, b. 1941. Professor of economics at the Rijksuniversiteit Groningen, The Netherlands, formerly researcher at the Vienna Institute for Comparative Economic Studies and the Osteuropa–Institute at Munich. Author of "Wirtschaftswachstum in unterentwickelten" Gebieten" (Berlin 1972), "Zur Analyse von Wirtschaftssystemen" (Berlin 1979), "The economic law of motion of modern society" (co-author: J. W. Drukker, Cambridge 1986), "Elémenten van economische orde" (Groningen 1988) and numerous articles.

dr. János GÁCS, b. 1948. Cand. of econ. sci., head of main department at KOPINT–DATORG (Institute for Economic and Market Research and Informatics), formerly visiting scholar at Wellesley College, Mass. and University of California, Berkeley (1987). Athor (co-author: Mária Lackó) of "A study of planning behaviour on the nationaleconomic level" (Economics of Planning 1973), "The conditions, chances and predictable consequences of implementing a step-by-step liberalization. . ." (Acta Oec. 1986) and several other studies in Hungarian on shortage, restriction on imports, enterprise adjustment, etc.

Iván BEREND T., b. 1930. Member and President of the Hungarian Academy of Sciences. Author of "The Hungarian economy in the twentieth century" (1985), "The crisis zone of Europe. An interpretation of East-Central European history in the first half of the twentieth century" (Cambrige University Press 1986) and several books on Hungary's place in Europe, on crisis and recession, on socialism and reform in Hungarian.

László ANTAL, see Vol. 38, Nos 3–4.

László SZAMUELY, see Vol. 39, Nos 3–4.

dr. Magdolna SZÉNÁSI, b. 1947. Political worker at the economic policy department of the Central Committee of the Hungarian Socialist Workers' Party. Formerly scientific research worker at the Economic Research Institute.

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# DISCUSSION ON SOCIALIST MARKET ECONOMY

## ANSWERS TO AN INQUIRY

In the wake of the wave of reforms taking place in the East-European countries —first of all in Hungary, Poland and the Soviet Union—the term "socialist market economy" is frequently heard. The term itself is not new; in fact it has recently emerged in the course of the reforms of the sixties, primarily referring to reforms taking place in Czechoslovakia and Hungary. For a long time, the term was a target of ideological campaigns, and using it counted as heresy. Ideological and political liberalization has again brought the term to the surface. Such reforms have been put on the agenda as development of a capital market and this makes it timely to examine whether we are dealing with no more than a political slogan, or whether the term actually has a real content; if it does, under what conditions. These considerations have led *Acta Oeconomica* to put the following questions to about 30 Hungarian and foreign economists:

1. *What is, in your opinion, a socialist market economy?*

2. *Is a socialist market economy, as defined by you, workable, and if it is, what kind of social and economic conditions are necessary for its functioning?*

Not every individual who was asked the questions has returned his or her opinion, yet more than twenty answers have been received, arranged in alphabetical order and published in this issue. We are grateful for the answers to Aleksander *Bajt*, Leszek *Balcerowicz*, Charles *Bettelheim*, Henk C. *Bos*, Jozef M. van *Brabant*, Wlodzimierz *Brus*, Ellen *Comisso*, Béla *Csikós-Nagy*, Tamás *Földi*, András *Hegedüs*, Róbert *Hoch*, Branko *Horvat*, Béla *Kádár*, Peter *Knirsch*, Ferenc *Kozma*, Mihály *Laki*, Marie *Lavigne*, László *Lengyel*, Gennadij *Lisichkin*, Paul *Marer*, Tamás *Nagy*, Alec *Nove*, László *Szamuely*, Márton *Tardos* and Hans-Jürgen *Wagener*. The titles of certain contributions were given by the Editor. Not everyone who answered kept himself to the questions asked. Some of them voiced personal reminiscences, others gave their answers in a strict theoretical and logical framework, and others referred to the history of theory. It would have been foolish to insist on uniformity. Yet although this diversity makes it difficult for readers to get quick information abouth the different standpoints, it makes a thorough study more enjoyable. A short summary of the discussion that follows the answers was written by György *Petőcz*.

# SOCIALIST MARKET ECONOMY

A. BAJT

According to the prevailing interpretation of *Marx*, socialist (communist) society would be a non-market one with production and distribution regulated by the plan. As in *Lenin*'s view "small-scale production incessantly generates capitalism and the bourgeoisie, every day, every hour, with elementary violence and in massive proportions" (*Soĉinenija* 31,7-8) and as socialist society was regarded an antithesis of the bourgeois one, liquidation of the latter presupposes elimination of the market ("small-scale production").

Lenin was wrong. Markets had existed for thousand of years before capitalism and the bourgeoisie appeared on the historical scene, but they had not brought about either capitalism or the bourgeoisie. The *post hoc* lags are simply too long to be accepted for *propter hoc*. Xue *Muquiao* endorses this fact as a valid argument against the antisocialist character of the market (*China's socialist economy*). As for Marx, his *Grundrisse* periodization of economic systems relegates non-market "future society" far into the future, leaving us with the reality of the socialist phase of the "modern society" (the early phase being the capitalist), wholly based on market and money.

It can easily be shown that the market is a sheer mechanism or technique, similar to any machine or device, and that from the point of view of relations of production it is entirely *neutral*. It can be paralleled with an analogy involving a mirror. If an ugly face can be seen in the mirror, the culprit is the face not the mirror. That is, in societies with bourgeois relations of production, market expresses them in the form of bourgeois exchange relations—as exploitation in Marx' sense. Since in the Russia of Lenin' times markets did generate capitalism and the bourgeoisie—Lenin may be trusted on this—the relations of production must have been bourgeois or capitalist. The same holds for the present socialist economies. In general, whatever production relations exist in an economy, the market discloses their character via exchange relations (in this *Capital* III, Ch. 51).

Elimination of the market from socialist economies amounts therefore to breaking the mirror; in fact, it amounts to more than just breaking it—it implies the construction of a new mirror reflecting all faces as if they were Taylor's (no matter whether of Robert or Elisabeth). Exchange relations, that is relative incomes of factors, are forcibly restructured to what is believed to be socialist. This is done directly, by establishment of an *uravnilovka* payment system, or indirectly, by nationalizing factors yielding "capitalist" incomes (that is land and capital and based on Marx' equation *Productionsverhältnisse* = *Eigentumsverhältnisse*), or both directly and indirectly, as in the case of entrepreneurship and innovation. In all these cases the property rights of the owners of factors get violated, for these are prevented from appropriating the values of their products.

Results were not only predictable but were in fact predicted: *Mises* and *Hayek* had warned us in advance. My estimates show that efficiency of Yugoslav investment reaches only 70 percent of that of the comparable OECD countries and that, with the efficiency of the latter, the Yugoslav GNP in 1980 would have been more than twice as high as it actually was. A. Bergson's estimates (*AER*, June 1987) show a 30 percent lag of the socialist net productivity of labour behind that of capitalist countries, with the Soviet Union being the worst (and Hungary coming second worst).

Unfortunately, socialist reformers are not really aware of these gaps. Even in 1980, Yugoslav economists still believed in the superiority of their self-management system, both over the capitalist economy and administrative socialism. Their point was high rates of growth. Yet when, because of the ending of the high foreign debt growth, they started to look for reasons for the growth, they found them in all but the very essence of their socioeconomic, that is socialist, system. In other socialist countries deficiencies were generally identified with "over-centralization", "shortage" and "soft budget constraint" (*Kornai*). In other words, they were all misled into believing that only some "technicalities" were needed to remedy them. The bringing of consumer goods prices to more reasonable levels (typically by abolishing the dual prices system), rationalization of relative prices, extension of these innovations to producer goods prices, and the giving of limited autonomy to enterprises, appear to be the reach of their early economic reforms. They did not help.

In my view, neither simulated product prices—that is, the "market" without the corresponding independence of enterprises—nor reintroduction of genuine product and factor markets such as capital, money, foreign exchange—that is "hard budgets"—nor even labour markets, make much difference. What really matters is not so much inclusion of enterprises into product and factor markets but exposure of all individuals and their families, their skills and value productivities, from their births on, to competition for their working places and their corresponding incomes. This applies not only to labour in the usual sense but to doctors, professors, managers and politicians as well. Marketization of enterprises, that is rigorous metering (*Alchian* and *Demsetz*) of inputs and/or outputs, and strict linking of earnings to it is just one part of this process. The really relevant point is *generation* of factors—new knowledge and skills in all fields of people's activity (human capital). This is a process involving education in families, schooling from the elementary level up to university, learning by doing, and personal competition at all levels. It implies dismantling of all non-economic promotion mechanisms (those of a political form in the first place) and of all distribution schemes that violate market valuation of productive services. Only in such a way will property rights be reintroduced in socialist economies and hopes for more efficiency become warranted.

Obviously, this amounts to a complete reversal of what Marxists believed to be the essence of socialism. Yet, as it is obvious that without markets there is no

efficiency, the question arises whether and how the market can be reconciled with socialism.

Of course, all depends on the definition of socialism. There is no doubt that today's capitalism is very different from that of Marx's times—namely, it is less capitalist and more socialist. For instance, consider such things as obligatory free schooling, highly progressive taxation—both goals of the *Manifesto of the Communist Party*, and implemented in modern capitalist countries. Consider also the much lower earning differentials in highly developed compared with less developed countries. Somewhere during this process people will discover that their system has evolved from being capitalist to being socialist. As with the evolution of capitalism (*Sombart*), this may happen at rather late stages. Suppose, we accept the welfare state, e.g. of the Scandinavian brand, as socialism. In this sense, market socialism is certainly a workable and also efficient social system.

Not many marxists in power in the East would accept this kind of definition of socialism. They would prefer sticking to social (state) property as the means of production. Since I am writing as an economist, I have to accept this ideological social property constraint. From the point of view of the existing socialist economies, the Soviet Union included, this appears to be quite a realistic position.

This brings me to the following formulation of our question. Can an economy based on social property be made economically efficient? My answer is affirmative, although it by no means implies that efficiency could be as high, let alone higher, than in capitalist economies.

The following appear to be the main preconditions for an efficient socialist economy. Its enterprises (banks etc. included) should be *independent*. This implies that the economic functions of the State (Central bank included) be confined to those exerted by the modern capitalist governments (e.g. stimulating and stabilizing monetary and fiscal policy, encouraging initiative, coordination and/or direct intervention in infrastructure, antimonopoly and externalities legislation) and that the communist party completely withdraws from the economic sphere.

Independent enterprises imply the existence of product and factor markets. In fact, these are an unavoidable result of enterprises' independent decision-making. The social property constraint hands sovereignty in decision-making to the workers. It is hoped that in order to secure high wages they would hire managers, entrust them with the necessary competences and limit their own decision-making to control (in a similar way to shareholders), with the only difference that wages rather than dividends would be their control variable. Existence of the labour market together with marketization of the internal organization would break the dependence of wages on the level of firms' incomes per worker (so typical of the present Yugoslav set-up) thus providing the opportunity for savings. Efficiency wages and similar incentive systems are not ruled out by this. As for managers, complementary to high pecuniary rewards, high independence in decision-making, growth, expansion (including predatory take-overs), and high social status (inclusive of opportunities

to shift to politics and assume formal social control), would be the main arguments in their utility functions.

Implied in this is a radical redefinition of self-management. Instead of managing processes in which workers are employed, with distribution and allocation of firms' incomes included, the essence of self-management should be allocation of one's *own product*. This means that which is currently produced and also, more relevant in fact, that which is saved and invested. In other words, there should be allocation of one's own *capital*, both of the firm and of the individual (i.e. the worker's and the manager's).

With smoothly operating factor markets, and with labour managerial as the decisive factors, there would be no room for deciding on distribution. Moreover, as wages are earmarked for consumption (inclusive of consumer goods investment) and profits for (productive) investment, allocation is not a free-choice process for workers and managers. As has been said, payment systems such as profit sharing, are not ruled out by this. Moreover, dividend payments on workers' and managers' privately owned shares, although a *corpus alienum* in the system, would contribute to the market character of distribution.

Quite a few questions pose themselves. Will workers be ready to delegate enough authority to managers so that managers can provide efficiency? If not, private property or inefficiency are the only alternatives. Could the system achieve efficiency at least similar to the capitalist? Separation of ownership and management (*Berle* and *Means*) and its formalization by the theory of agency, theory of modern corporation (*Galbraith*) of the managerial enterprise in general (*Marris, Baumol, Simon*) and its labour-managed variant (*Atkinson*)—all these give theoretical support for optimism. As for the practice, during the '60s in Yugoslavia the largely independent enterprises and managers and, as a result, relatively high efficiency, together with the Slovenian superiority over the low Yugoslav average (based mainly on less state interference and more independent and capable management) seemed to be encouraging.

A weak link in this solution is very high managerial incomes. Tendencies towards investment would push the system towards privatization. For the time being, I adjourn discussion of this issue. State or parastate (*Tardos*) ownership control over managers could alleviate this phenomenon. However, with state-dependent managers efficiency would be much the same as it is now. *Liska*'s solution avoids this handicap. The real problem with it is not so much its quite strong privatization tendencies but, above all, its economic non-viability.

# ON THE "SOCIALIST MARKET ECONOMY"

L. BALCEROWICZ

The search for models of a market economy in the socialist countries with the relatively most reformed economic systems (Hungary, Yugoslavia, Poland) reflects the disillusion with their performance. They are rightly considered to be basically non-market systems, and this is thought to be the main reason for their disappointing results. On the other hand the adjective "socialist", if it occurs at all in the reform debates, is then usually used to denote that the proposed market system should be different in some respects from capitalism. Thus we get the first approximation of where to locate a "socialist market economy". It should depart even further from the traditional Soviet model (i.e. further than the presently most reformed socialist economies actually do) but not as far as to fall within the scope of capitalism.

The second approximation is obtained after specifying what changes in the relatively most reformed socialist systems are necessary to transform them into "market economies". This obviously depends on what is meant by the term "market economy". In my view it is an economy where the market mechanism is the dominant mode of coordination in the sphere of private goods, i.e. such goods which can be distributed among individual users. A market mechanism is, by definition, a horizontal mode of coordination between supply and demand. This rules out any administrative interference in the terms of specific transactions, e.g. administrative prices or administrative rationing. The demand is thus not constrained by any official quotas and its changes can freely express themselves in prices. Furthermore, the supply is free to adapt to a changing demand, both in the short and in the longer run. The latter presupposes that the investment decisions are largely decentralised. Assuming that the decentralized investments cannot (and should not) be wholly financed out of the enterprises' retained profits, we conclude that the market mechanism includes some form of capital market, i.e. market for longer term loanable funds.

There are still many elements of the most reformed socialist economies which are in clear contradiction with this description of the market mechanism, e.g.:

— the remnants or substitutes of the command–rationing mechanism, e.g. predominantly administrative allocation of foreign exchange, open or disguised administrative intervention in the structure of production and foreign trade,

— pervasive price controls,

— bureaucratic restrictions of enterprises' entry into new markets,

— massive inter-enterprise redistribution of financial means via the budget,

— party–state "nomenklatura" with respect to the managers of enterprises, banks etc.

The transformation of the present socialist systems into market economies must, therefore, involve the elimination of these elements.

The third approximation is obtained after determining in what respects the socialist economy is different from the capitalist one. There is no unanimity on this issue. The differences largely stem from the varying propensities of different authors to stretch the concept of socialism in such a way as to be able to—seemingly—invalidate the criticism of it, or its earlier versions; at the same time, they often propose some radically new arrangements while claiming that they are still within the—suitably enlarged—framework of "socialism". The former tendency is usually motivated by the unwillingness to concede defeat in the debates over the possible performances of socialism and capitalism. The latter often reflects the desire to neutralise the ideological attacks against the proposed changes. Muddling the concept of socialism is probably thought to be a price worth paying for the—hopefully—increased chance of introducing new arrangements. I have some understanding for the motives behind this tendency. However, I still think that in the interest of conceptual clarity there should be some limit to the arbitrariness in using the concept of socialism, at least in the theoretical discussions. (This should not be confused with the limit on proposing changes with respect to the present socialist systems.) An additional reason for this restraint is that it appears doubtful whether the strategy of pushing all kinds of changes under the suitably enlarged shield of "socialism" can be effective, as it probably overestimates the possibility of fooling opponents.

In order not to be arbitrary in the attempt to limit the arbitrariness in defining socialist economy, I propose the following mental experiment: one should stop widening this concept at the point where its further expansion would provoke the greatest surprise among the most prominent early theoreticians of socialism, if they were alive. On this principle most of us will probably agree that socialism is *not* based on the classical private ownership of the means of production, i.e. an ownership whereby an enterprise is solely or largely owned by private persons other than the people working in it.

There are a number of models which appear to respect the above formulated restriction and which, at the same time, could be market systems. I can here only mention the main ones.

1. *Illyrian socialism*, or in other words genuine labour self-management of the Yugoslav type. "Yugoslav" means that workers' rights to control an enterprise are not based on their shares in that enterprise, while "genuine" emphasizes that—as distinct from Yugoslav practice—there is no hidden party-state control over the enterprises' managers (especially no nomenklatura).

2. *Workers' property.* Enterprises in this model are not only controlled by their employees but are also wholly owned by them, i.e. there are shares which

belong entirely to the people working in a given firm.[1] Hence this is *property-based* labour self-management. One of its variants is cooperative socialism: the workers' enterprises take the form of classical producer cooperatives, where each member has equal formal rights in running the enterprise regardless of his share in its assets. Cooperative socialism is an old idea advocated by some prominent socialists (especially Ferdinand *Lassalle*) in the 19th century. It was, however, sharply criticised then by self-proclaimed "scientific socialists" (*Marx, Engels* and their followers). Another variant of workers' property would allow the voting rights to rise with a worker's share in the enterprise's capital. However, this "intra-enterprise capitalism" may be found to overstep the boundary of socialism.

3. *Leasing the "social capital".* In this model natural resources and fixed assets are formally national property but are placed against the payment of rent at the disposal of private individuals or groups of people;[2] these people are then supposed to act as independent entrepreneurs. Such a concept of market socialism was already proposed in 1922 by Boris *Brutzkus*, an outspoken critic of Marxism. [1] Tibor *Liska*'s "entrepreneurial socialism" is another example. [2]

4. *Capitalist institutions without private capitalists.* This refers to the conception of an economic system in which enterprises would have the legal formof joint-stock companies owned by some non-private institutions. There would also exist a stock exchange on which the latter could buy and sell shares. Depending on what institutions are to be shareholders we get some more specific models. One of them heavily emphasises the role of state holdings.[3] Another proposal additionally admits non-administrative institutions like banks, municipalities, universities etc. [3] One can envisage still another variant, where each enterprise is predominantly owned by some other enterprises, a minority share belonging to its own personnel as represented by the workers' council. Each enterprise would have a board of directors which, among other things, would nominate the professional management and which would represent the enterprise's shareholders, i.e. its own personnel and other enterprises. Each enterprise would derive some income from the dividends paid out by other firms, and thus would hopefully pressurize them for increased profits. In this way profit-orientation could perhaps be installed in non-private firms.

5. *Mixed systems.* The above are pure models. However, one can also combine them in many different ways, e.g. by having workers' property and leasing in different sectors of the economy. Another type of mixed system is obtained when one allows the private sector to enter the scene. Yet the assumed concept

[1] The shares, however, cannot be freely traded, as this would turn the workers' property into classical private ownership. The stock market with its various motivating and information functions has, therefore, no place in this model.

[2] These groups, however, do not have to be identical with the enterprise's personnel. Otherwise the leasing solution would fall within the scope of Illyrian socialism.

[3] This solution has been advocated by Márton *Tardos*.

of socialism condemns this sector to a marginal role, although it is impossible to say precisely at which point a further growth of this sector is already incompatible with that concept. In any case, if we accept it, then we are justified in being surprised when the economic successes due to the enlargement of this sector in the still predominantly socialist economies are attributed to socialism.

Space permits me only a few general remarks on the above-mentioned models. Let me first suggest that three questions be posed.

First, is it possible to pass from present socialist systems to these models, and what should the transition path be like? This question includes such important issues as how to overcome the resistance of those vested interests which are against a radical economic reform, or how to get rid of shortages without relapsing into high open inflation.

Second, if it were possible to introduce the envisaged systems, could they last? To put the question another way, do they not have some in-built tendency to transform themselves into some other system? I would venture a guess that these systems could last if their conceptions were suitably completed. This means, for example, that they would have to include a ban or at least severe restrictions on the foundation and development of enterprises with different legal forms than the ones on which a definition of a given system is based. The envisaged systems are thus characterised by what may be called a *closed* or *monopolising* domestic property law.[4]

Finally, if these systems could be introduced and if they could last, how would they perform? Here one should first of all point out that it is difficult to make firm predictions, because the envisaged systems do not have any real counterparts so far. The propositions one can formulate are based, therefore, on very imperfect analogies with some parts of capitalist economies (i.e. the state holdings in Italy's public sector), on theoretical models which cannot be falsified for lack of empirical data (see the vast literature on Illyrian socialism), or finally on simple intuition and common sense. Interestingly enough, one can make much firmer predictions on how the presen socialist economies, with their relatively high human capital, would perform under capitalism. There are enough comparative studies (e.g. Czechoslovakia–Austria, Hungary–Austria, GDR–FRG) to warrant the conclusion that the overall efficiency of these economies, and consequently the average standard of living of their population, could be much higher than under their present system—albeit at some social cost, especially the danger of open unemployment.

However, one can still offer some conjectures on the performance of the envisaged schemes, assuming they could be introduced and that they would last. Each of them requires a separate treatment. Here I can only make a few points. It seems possible that at least some of these schemes could raise the overall efficiency of even

[4] For more on this see: [4].

the most reformed socialist economies. Such schemes would increase the autonomy of enterprises and create more scope for competition. However, these potential gains in efficiency appear to be lower than those achievable under capitalism. This is primarily due to the above-mentioned closed nature of the domestic property law under the envisaged schemes. This would limit the flow of the new enterprises (founded independently of the state and of already existing firms) and thus also limit the introduction of new ideas and new competition.[5] It is worth noting that in this respect the workers' property fares better than Illyrian socialism or leasing. This is because, in the former case, private persons would be able to found an enterprise at their own risk and on their own behalf, albeit only in the prescribed form of a workers' enterprise. This constraint would probably still limit the supply of entrepreneurs as compared to that possible under the open property law, where the would-be founders can freely choose between various legal forms of enterprises, including the private ones. For, under the form of a workers' enterprise, a potential founder might lose control over his own creation; therefore, maintaining control is probably an important consideration for would-be founders.

Apart from these (and other) general relative deficiences, each of the envisaged models might display some specific ones. For instance, Illyrian socialism is likely to face the problem of how to induce the enterprise's personnel to forgo the increases in their current income for the sake of intra-enterprise investment. The state holdings being the sole or main shareholders of enterprises might be the channel of the continued political interference into their affairs, etc.

Finally, one should mention that at least some of the deficiences of the capitalist market economy are likely to be present under the socialist one, too. This applies first of all to the danger of open unemployment. Indeed, under some market socialist schemes (especially Illyrian socialism) this danger might be greater than under capitalism.

Against this background and in the face of the grave economic problems in the CMEA countries, one wonders whether the search for the model of the market economy should be constrained by the adjective "socialist".

February 1989

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# WHAT MOTIVATES MANAGERS?

CH. BETTELHEIM

The concept of a "socialist market economy" is particularly important today, as it raises fundamental theoretical and political problems. In this paper I will discuss the reasons why the objectives implied by this concept seem correct to me, and analyse the conditions that a "new economic system" should meet in order to secure a growth that would satisfy social needs as best as possible. For lack of space, I will present propositions without demonstrating them and I will not discuss the important problems of transition. These propositions are formulated on the basis of my previous works dealing with the countries of Eastern Europe and the USSR and with the reform projects discussed there.

1. One of the main reasons which make the replacement of the "present economic system" of the Eastern European countries justified, is its inability to satisfy the increasing social needs of citizens, and especially of the working people. This is confirmed by historical experience, which indicates that such a system (even partially transformed) is but a modified form of the stalinist system, born out of the "war waged against his own people" by Stalin and his followers after the end of the 1920's (to use an expression borrowed from the critical soviet historians).

2. The existing system has never been able to practice a distribution of income which would conform to the principle "to each according to his work". Even if such a principle is not immediately and possibly not completely enforceable, I think that it represents a socialist objective which one should strive for.

3. The existing system has allowed high economic performance (in terms of growth rates) only insofar as initial possibilities or easily obtainable reserves were not exhausted. Among these initial reserves the following can be mentioned: an underemployed labour force, the (partly political) possibility to increase accumulation at a cost of lower consumption, and through an increased exploitation of the working people, abundant natural resources. Brutal methods of "previous accumulation" have induced high economic and social costs and become counter-productive once initial reserves were exhausted.

Consequently, when the exhaustion process of these potentialities intensifies, a reduction of growth rates becomes manifest in the countries where the ancient system is in force. Another cause of a reduction of growth rates is the contradiction between the growing complexity of the economy and the possibility of a realistic compiling of a detailed and imperative economic plan. Non-radical economic reforms allow but a temporary stimulation of growth (when they do), as the ancient system produces a great number of unintended negative consequences, which have led to the present structural crisis.

Among such consequences are the following: a peculiar opacity of economic, social and political conditions, leading to a move away from the *reality principle*; an *anarchy of production* resulting from the bureaucratic character of a planning process searching for an *a priori* and detailing fixation of too large a number of targets; a tendency to overaccumulation which multiplies shortages and bottlenecks, reproducing the characteristics of a *sui generis* war economy (as Oskar *Lange* observed); a growing irresponsibility and lack of initiative among economic agents; a slow technical progress and a slow progress in labour productivity; a low capacity for innovation and replacement of obsolete machinery, thence a "phoney full employment" leading to new unintended consequences and vicious circles.

4. The "new system" proposed by many economists in order to overcome the crisis caused by the ancient system is often pictured as a "socialist market economy". In my view this expression is not proper for characterizing the desirable objectives nor the means required to reach them. I mention below the main systemic changes which seem to me necessary for a sufficient and lasting recovery of economic growth.

5. A general remark before discussing the main features of a "new system": among the conditions for the transition from the old to the new system, and for a positive functioning of the latter, there is the adaptation of the new system to the specific situation of each country. Taking into account the great diversity of initial situations, I shall deal only with the main elements which would be common for all the countries.

6. For economic growth to be maintained at a sociality acceptable rate, and in the least erratic way possible, the new system has to satisfy two basic conditions:

— it has to ensure a largely self-regulated functioning for current operations;

— economic development in the medium- and long-term must be influenced by a plan which should be elaborated in a democratic way and put into effect mainly through economic incentives with a minimum of administrative measures.

7. For the new system to be mainly self-regulated, it has to stimulate economic agents (workers, enterprises, consumers...) to act mainly according to their own motivations (which are influenced by the economic, social, political environment) and in such a way that the social demand would be satisfied. This implies an emission by the system of "signals" able to guide the economic agents' actions.

In the present state of productive forces, relations of production, mentalities and socio-economic knowledge, the above-mentioned conditions can be satisfied, in my view, only through the functioning of a plurality of markets (for commodities, labor force, services, capital and credit). In this way the existence of market, wage-labor and capitalist relations will be openly acknowledged, those relations that the ancient system had not abolished but repeatedly negated verbally while accepting their *de facto* existence. The open acknowledgement of these relations is a "step backward" only in imagination; it actually means a necessary "step forward" towards the *reality principle.*

8. In order to eliminate previous mystified relations, their roots have to be criticized: an important one is the identification of production organized under state ownership with a production under a "socialized ownership" in the sense of *Marx* and *Engels.* In a marxian approach one has to admit that the juridical state ownership of the means of production maintains the capital, that is to say the separation of immediate producers from their means of production and the necessity for these producers to sell their labor force to the state or to the managers of capital for wages. In the ancient system where the state or para-state ownership of means of production dominates and where the capitalist relations have been reproduced (partly under modified forms) in the labour, production, circulation and distribution processes, the bulk of social capital belongs economically to the agents of power and management who control the means of production and the surplus value on a global scale. These agents are respectively bearers of "ownership-capital" and "function-capital".[6] The fusion of state power and of ownership (as Marx often noted) combines the political power's domination force with the exploitative power of capital; it includes a despotic form of power and exploitation.

9. To contribute to the elimination of such despotism and to the development of a genuine competition for products, services, credit, and capital (which is necessary for the production of "signals" expressing approximately the situation in production, stocks, circulation and consumption) the new system ought to diversify forms of ownership and to accept their coexistence.

10. In order to stimulate a genuine competition and to avoid forms of "dictatorship over needs" which result from monopolistic positions, it is necessary to fight against gigantism in production and to promote the division of production processes between a large enough number of different enterprises. This is a question where state intervention and a medium- and long-term plan (democratically elaborated) are necessary, contrary to the dreams of the followers of economic liberalism.

11. The creation and survival of different enterprises should not depend on the sole criterium of profitability. A small number of unprofitable firms can be

[6] Cf. B. *Chavance*, [8], pp. 263-304. These bearers of capital constitute the ruling class in socialist countries. The womb of this class is the ruling party's apparatus (cf. Ch. Bettelheim [3], vol. 4).

maintained for social reasons, in this case subsidies will be granted to them. In the new system, however, enterprises with mainly economic purposes ought to be able to increase the value of their capital through the realization of profits. This "valorization of value" (as Marx called it) should be effected either in the current period or in a medium-term time horizon and, except in a few cases, it should depend on prices formed in different markets. Profitability will allow self-financing of the enterprise's increased production and technical renewal. If its profits are bigger than its own needs for financing, the surplus will be used by other enterprises or by the state. The expected profitability of enterprises will be the basis for an evaluation of its borrowing capacity on the capital market or from the banks.

12. It follows that the new system will not introduce a pure (and utopian) "market economy". It will include a plan (and therefore a planning apparatus) which will draw the main directions of the socially possible and desirable social and economic development. This plan, which should be flexible, will be implemented mainly through "economic levers" (determination of certain prices, fiscal measures, subsidies, etc.) and, when necessary, the regulation of some markets, some production and consumption decisions, etc. These cases should be exceptional. Necessary steps should be taken to have such regulations accepted by a large majority of the population. Without the confidence on the past of the citizens, even the best policy may fail.

The planning organ will have to see to it that no contradiction appears between the creation of new firms and planning forecasts. Nevertheless, quantitative or qualitative changes in demand and supply will have to be taken into account to adjust the plan's objectives.

The main objective of the plan will be an increased standard of living, due mainly to technical progress. One of the main current tasks of the planning organ will be to avoid duplication in investment, to stimulate a growth compatible with internal and external equilibria, or, if the latter are questioned, to act in favor of their restoration while seeking as much as possible to ensure full employment, namely by creating incentives for a sufficient volume of promising investment. The plan will have to contribute, maintain, and improve the eco-system's situation, and to take measures in view of using a part of the social accumulation fund for investment in totally or partially non-market-produced goods of services (such as services for education, health, communication, housing, etc.). The test for an adequate management of these activities is the best relation between cost and quality of produced services.

13. The labor market should not be treated as the other ones, as its functioning directly determines the standard of living and the living conditions of the majority of the population.

The wage-labor workers will have the right to join independent trade-unions which will be granted the right to agree on collective contracts with the employers or the state. They will have the right to strike and, as citizens in general, will enjoy

freedom of speech and of opinion, freedom to communicate, freedom to move inside and outside the country, and other democratic rights.

14. In this short paper, it is not possible to define other characteristics of the new system, concerning the organization of production, the transformation of property forms, scientific and technical research, innovation, foreign economic relations, credit and the monetary system, etc.

15. According to its main features, the new system—as the present or "ancient" system—cannot be called socialist. However it may represent a form of a "regulated market economy evolving towards socialism" (if this term is to be retained despite an unfavourable connotation it has suffered from).

Among the conditions for such an evolution I see—if social and political forces are in favor of it—a progressive transformation of enterprises into firms managed by collectives of workers and citizens. They could take the form of social enterprises or cooperatives, or depend on local administrative organs. A socialist form of production, distribution and social life might develop in this direction (but we have no science for the future). Only action and experience acquired through this process will decide whether such a form will arise and what its concrete features will be.

Paris, April 3, 1989

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# ON A SOCIALIST OPTIMUM ECONOMIC REGIME

H. C. BOS

The editor-in-chief of this journal has invited me to answer three questions: what is, in my opinion, a socialist market economy? Is it workable? And, if so, what are the social and economic conditions necessary for its functioning? These precise questions may seem simple and suggest that they can be answered with the same preciseness. This is of course misleading. The questions actually concern very complex and fundamental issues of which only a few aspects can be dicussed here.

To begin with, my answer to the first question could be that, for reasons that will become clear later, I do not use the expression "socialist market economy", except when referring to this term as used by other authors. This would absolve me from answering the other questions and leave the task of defining a socialist market economy to those authors that do use the concept. But to be satisfied with this reply would not be helpful for a discussion of the real issues behind the three questions. Let me, therefore, give the following, preliminary, reformulation of the question I shall discuss: what are the essential features of an economic system that is workable and which could be called a socialist market economy?

"Socialist market economy", "market socialism" or similar expressions have been used both as a theoretical concept and to indicate, sometimes even officially, the character of the economies of Yugoslavia after 1965, Hungary after 1968 and the People's Republic of China after 1978.

As a theoretical concept, Oscar *Lange*'s ideas on the functioning of a socialist economy based on market principles through trial-and-error procedures for the determination of equilibrium prices are most well-known. Most important in Lange's analysis is the recognition that a socialist economy cannot function efficiently without proper guidance by prices of products and factors of production. However, his proposals for a socialist market economy cannot be considered as workable, i.e. applicable in reality in a sustainable way, because of the oversimplifications and the static approach.

The fact that such widely differing economies as mentioned are still brought under one heading illustrates that the qualification "socialist market economy" concerns a broad category of economies, though with common characteristics. Discussion of these can only be at a general, fairly abstract level.

## Defining an economic system

What are the essential aspects to be considered in defining a socialist market economy?

In the literature at least three elements are distinguished:

1. the degree of centralization or decentralization of economic decision making;
2. the ownership of the means of production; and
3. the choice of policy objectives.

A market economy (socialist or non-socialist) is usually considered as characterized by a high degree of decentralization, a socialist economy (market or not) by public (state or collective) ownership of the means of production. The specification of socialist policy objectives is not always made explicit or even distinguished, and some comments on these will be made later. According to this classification, a socialist market economy combines public collective ownership and a high degree of decentralization; a western (capitalist) economy combines private ownership and decentralization; and a soviet-type economy public ownership and centralization. The fourth possible combination (centralization of decision-making and private ownership) could apply to a western economy under war conditions.

Each of the three elements distinguished deserves further analysis.

## Centralization or decentralization

The most important aspect in defining an economic system is, in my opinion, the degree of (de)centralization. The theory of welfare economies provides the basis for the choice of an optimum regime (system).[7] This theory shows that an optimum level of welfare for the population is obtained by full decentralization of production decisions, except for those production processes with (positive or negative) external effects and/or with indivisibilities (fixed cost leading to large economies of scale). Another condition is that the initial income distribution among consumers is equitable or made equitable by an income transfer. Also the government may evaluate the consumption of certain goods or services higher or lower than the private con-

[7] Professor Jan *Tinbergen* has developed this link in the most explicit way see [1], [2].

sumer: merit goods (e.g. health, education; they also have positive external effects) and demerit goods (e.g. drugs, alcohol). Decisions on the production of such goods and services (with external effects, indivisibilities) should be taken at a higher level where those effects are taken account of. The market is an institution where full decentralization applies. The alternative is not necessarily decision-making by the (national) central government, but depending on the extent of external effects or indivisibilities, a local or regional authority. In some cases the optimum level of decision-making may be at a supra-national level (e.g. for certain environmental effects, or industries requiring multinational co-operation in order to be efficient).

This approach of the theory of welfare economics results in recommending a mixed economy as an optimum economic system, i.e. many decisions are made in a decentralized manner by individual producers, through the operation of the market; but when external effects or indivisibilities occur production decisions are made at a higher (not necessarily the highest) level. This also applies to the production of (de)merit goods.

## Ownership

As mentioned before, public (state or collective) ownership of the means of production is usually, especially in socialist countries, considered an essential characteristic of a socialist economy. In my opinion, this must be considered a dogmatic or ideological assumption, without sufficient economic justification. Several reasons for this view can be given.

First, already J.*Schumpeter* has pointed out long ago that in a modern economy ownership and management in large corporations are separated. Stockholders have hardly influence on the management process, and the manager (or often the members of the managerial board) is (are) on the payroll of the corporation, without necessarily sharing in the profits (or losses!) made.

Second, ownership has no longer a specific and direct impact on the income distribution. Fiscal policies (direct and indirect taxes on labour and non-labour income or capital, subsidies, social payments, etc.) can redistribute incomes in such ways that an equitable distribution of incomes is obtained.

Third, private ownership rights in Western countries have been limited or eroded by various types of legislation by local or national authorities: child labour, old age pensions, working hours, environmental rules etc. This has led the Swedish economist *Adler–Karlsson* to introduce the concept of "functional socialism", which is not based on socialising individual branches of industry, but certain functions which cannot be left to individual producers. [3]

Finally, the choice is not between the extremes of private and state ownership, but there is a range of possible types of mixed enterprises (parastatals), corporations

with a majority or minority share of local, regional or central authorities, but operating mainly as private firms.

These remarks do not imply that the kind of ownership is under all conditions irrelevant for the efficiency of an economy. It has been argued, for example, that at the micro-level the kind of ownership (property rights) affects the productivity of a firm. This aspect certainly requires further empirical research. A pragmatic rather than a dogmatic approach to the choice of form of ownership must be followed.

## Socialist policy objectives

Policy objectives have been included as a third element determining an optimum economic regime. Much less attention has been given to this element compared to the previous ones. Relevant are of course only the fundamental objectives.

With due recognition of the dynamic aspects a maximum or optimum welfare of the population would seem to be for any modern society the most fundamental policy objective. In concrete terms, this may be expressed as an optimum rate of growth of income and consumption. Other policy objectives could include full-employment of labour and capital, and equitable income distribution, stability of the general price level. We also have learned more recently to recognize that an optimum rate of growth should be sustainable in the long run, i.e. to take account of environmental effects.

The important point to note is that there seems to be no basic differences between the explicit or implicit social and economic policy objectives of socialist and non-socialist economics, though it would be fair to say for a socialist economy more weight is given to the objectives of full-employment, an equitable personal distribution of incomes and social security.

## Conclusions

The following conclusions can be drawn based on the previous analyses.

Instead of trying to define a "socialist market economy" it would be preferable to aim for an optimum economic system which is based on socialist policy objectives. A satisfactory rate of growth, a high degree of employment, a fair distribution of income and social security would probably be among these objectives. Public ownership of the means of production cannot be considered as an essential requirement for a socialist economic system.

An optimum economic system would be mixed economy. Most production decisions would be taken in a decentralized manner, through the market. But where external effects and indivisibilities (economies of scale) play a large role

centralization of decision-making at the appropriate level would be required. This may also be the case when not efficiency but equity and security objectives have to be guaranteed.

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# MARKET SOCIALISM: ITS MEANING, FEASIBILITY, AND BEARING ON ECONOMIC REFORM

J. M. VAN BRABANT

## On the meaning of market socialism

As a subject of heuristic investigation, market socialism consists of two multidimensional components, each of which is circumscribed by a single word that undoubtedly belongs in the core catalog of weaselwords *par excellence.* Inasmuch as 'socialism' is an exceedingly complex notion with multiple tangents and 'market' itself is not unambiguously defined, the combination of the two yields a concept whose meaning is even less transparent. The researcher with more than a causal bent for the drift of what is currently being debated under the label of market socialism, particularly in the context of centrally planned economies (CPEs), has two choices. He or she can, either select a workable definition simply to proceed or abandon market socialism for an apter connotation on the ground that the former is much too tainted to be molded into an operational concept, even if only for analytical purposes.

Whether to choose one or the other alternative can only be decided very pragmatically. To isolate a clearly defined area for constructive inquiry, I have found it on occasion instructive to utilize the notion 'market socialism' but only with an unambiguous reference to the essence of a 'market' in any functional sense, namely the indirect coordination of decisions preferably of many actors—producers as well as consumers—in the pursuit of some acceptable objective(s).

In reverting to the essence of economics, which is the maximization of some function consisting of singular or a combination of, possibly conflicting, objectives subject to limited material, capital, and human resources, the core task of market socialism needs to be derived against a different background than the habitual market setting in at least two respects. On the one hand, market socialism provides the overall environment that ensures the coordination of this economizing with the purpose of reaching certain objectives that differ from those found in orthodox market economies; some must by necessity exhibit specifically 'socialist' attributes. Furthermore, the pursuit of this objective function with multiple arguments may be instituted by utilizing certain policy means—policy instruments as well as supporting institutions—that for various reasons are not tolerated in a traditional market economy. That is to say, indirect coordination proceeds under certain guidance rules and in an institutional framework, as in a contemporary market economy, but with a philosophy that has distinct socialistic tints.

## On the existence and feasibility of market socialism

The operationality of market socialism as a concept depends very much on whether the link between resource allocation and the maximand can be erected in a justifiable way, that is, without imposing intolerable losses in static and/or dynamic efficiency. What is 'intolerable' in this context depends, of course, on society's precepts that crystallize into an objective function according to some criteria. It also depends in good measure on whether the maximand is sufficiently homogeneous, transparent, and capable of being firmly fixed for policy makers to act upon. This holds even if central policy makers determine the maximand. It would have to be a societywide objective function in which subgroup—possibly individual—components do not exhibit core preferences that are grossly at cross-purposes with those posited for society as a whole. In other words, there would have to be some societal consensus, which may be hammered out through alternative modes of political interaction.

Among the elements of the maximand of market socialism that differ from those found in a stylized planned or market economy are property relations, the extent of the involvement of the state or the vanguard of the socialist society in economic decision making, and fairly well defined priorities with respect to the dispersion of incomes, the allocation of social revenue for particular purposes is concerned with ensuring the best allocation of resources through instruments and institutions for the purpose of maximizing a set of preferences that allot a considerable weight to societal preferences set through some form of consensus.

I consider the Dickinson-Lange-Lerner-Taylor type of market socialism as belonging among the stylized models of economic theory. It is, therefore, not a

blueprint that, say, reforming CPEs could realistically attempt to emulate. The model has been useful in separating pure economics from managing economies and in elucidating the features of a different setting from that assumed in neoclassical theory anchored to the *homo oeconomicus*. In particular, the original model stressed that ownership *per se* is separate from exercising property rights. The former may be an element of the objective function but the latter is a potentially critical element of the policy instruments and institutions put in place to foster the best allocation of resources. Also, the Lange-type model emphasizes that 'markets' need not be confined to actual physical interactions between demand and supply.

However illuminating and instructive these stylized models may have been, I feel rather uncomfortable about proposing any variant for implementation through revolution, evolution, or steady mutation from within an existing context. To give one example: The pricing board in Lange-type market socialism is presumed to be omniscient, solely concerned about ensuring efficient pricing, and capable of processing two-way information flows almost instantaneously and nearly costlessly. Further, it also assumes that bids are not rigged, that is, that both demand and supply are formulated atomistically under guidance of the planning center in an effort to elicit a social dividend from greater efficiency, the capturing of external rents, remedying other market failures and perhaps faster growth than attainable under private-incentive driven economies. Neither is a realistic setting for the reforming CPE. I consider it therefore fruitful at this stage of the debate to discuss market socialism not in the abstract but with reference to the dynamics of an evolving economy. More specifically, I believe the concept may usefully be invoked in the debate on how to transform the existing traditional CPE or any of its modifications adopted since the mid-1950s, including in Hungary, into a more productive and efficient social organism that may perhaps also succeed in satisfying some objectives that heretofore have tended to receive short shrift in the policy debate.

To place market socialism as an operational category in the reform debate of the CPEs, then, one could view it as something at which reform is to be directed through incremental changes in development strategy and, more important, in the economic model of the CPE. Under the latter I include all the policy instruments, institutional infrastructure, behavioral rules, and macroeconomic policies required to operate an economy. Many issues could be tabled here. In what follows, I shall try to clarify some aspects of economic coordination, the objectives and means of economizing that are typically socialistic, and the transition phase of moving from an existing social organism to an economic arrangement where coordination is organized indirectly. I shall do so largely from my perspective on reform in existing CPEs.

## Indirect economic coordination

One of the more striking features of the reform process in CPEs—and Hungary has been no exception—is the rather casual way in which the problem of coordination decisions, including their institutional infrastucture and requirements on policy instruments, has traditionally been treated. Even at the height of the reform debates of the 1960s, how to ensure proper coordination of decentralized decisions was rarely examined comprehensively. Moreover, even when placed in a fairly rounded context, the leadership of reforming CPEs has rarely pondered these topics in an *ex ante* fashion. Inasmuch as reform is by definition a process spread out over time and therefore associated with a transition phase, how to ensure coordination during the transition phase is a legitimate issue that may differ from the task of implementing a coherent coordination mechanism *per se*.

Yet, it seems to me that coordination is central in devolving decision making from the higher to the lower tiers of the economic hierarchy in the expectation of thereby enhancing the efficiency of resource allocation under the given constraints, as noted earlier. This entails, among others, moving away from rather inflexible, if not necessarily rigid, central planning to an environment that is expected to correct the perceived shortcomings of implementing the "centrally planned" design. In the former system, a triad of hierarchical operational levels is in fact postulated, namely: (1) a nucleus at the political apex that sets priorities in various socioeconomic, political, and strategic spheres; (2) a small group of highly qualified planners grouped into the planning center as one critical component of the governmental bureaucracy; and (3) economic agents in the production sphere simply carrying out centrally set directives and concrete input and output targets according to a highly mechanistic view of the clocklike central regulation of economic processes. All those assumptions have to a smaller or larger degree been removed from reality both when the CPE is examined with respect to its evolution over time as well as when cross-country comparisons are being inspected. It was precisely these gaps in the coordination mechanism entrusted to the central planning agency that first called for introducing reforms of some kind.

## On the transition phase

Reforms are rarely viewed holistically, formulated into a clear blueprint (comprehensive plan if you wish), and then implemented according to schedule by the political leadership. Instead, they are essentially a process of learning even at the highest level of Party and government. Hence the prevalence in all reforms of instability and sometimes outright vacillation in rules and regulations; disagreement or divergent views on what is to be done and how changes should preferably be carried out; and willingness quickly to intervene in the direction of recentraliza-

tion rather than tolerance for the zigzagging that may be inevitable in any societal transformation process. In any case, there appears to be one constant: regardless of the reform's ambitiousness, it invariably falls short of the goals envisioned at the outset.

In appraising the consistency and potential of economic reform toward market socialism and evaluating the reform's performance, it is essential to gain a proper perspective on the evolution of how the tasks of coordination are being viewed by economic agents and the degree to which measures are taken to correct outcomes that do not correspond to the reform's intentions. This may require frequent socioeconomic engineering, that is, the periodic fine tuning of policies, institutions, and instruments in response to assessments of how the process is performing and to bring the reform back on track. By advocating such professional and technical appraisals, I am not positing that politics should be subservient to economics or even that all technical economic details can be realized at a cost inferior to pursuing another reform format. All I desire to point out is that it is incumbent upon the economist concerned about the reform process to clarify technical matters pertaining to the inevitable disruptions and adjustment costs implied in such a decision. Whether these are acceptable is a matter that derives importantly from political precepts. But technically competent advice phrased within the context of market socialism as something to be strived for should in principle be one critical input into the decision-making of the socialist political leadership.

In this connection, the question arises of what statewide economic policy market socialism should be all about. Clearly, differences between social and private preferences need to be bridged by 'guiding' or 'intervening' in purely privately motivated decisions; sociopolitical preferences need to be safeguarded centrally, though implemented according to new—reformed market-type—rules of the game; the nonmaterial sphere remains largely under central control; and certain infrastructural and large-scale projects need to be initiated at the top level, though not necessarily through Lange-type competitive bidding and certainly not in an economic vacuum. More on this issue is provided in the next section. There may be wide agreement about this division of priorities and responsibilities. But rarely is it realized that such a new constitutional arrangement has to emerge from the organism in place, rather than in a vacuum.

In this respect, it is critical that those managing the transition to market socialism institute comprehensive monetary and fiscal policies to guide the behavior of individual agents as producer and consumer, and in addition impose proper incomes and price policy to enhance the realization of social priorities. In economies that wish to integrate themselves into the global economy to strengthen the degree to which wants can be satisfied with given limited means, these macroeconomic policies will need to include active exchange and commercial policies. All this may sound easier than it really is for traditional CPE has not been very much concerned about this particular infrastructure.

## Ownership and property rights

The original *raison d'être* of market socialism was to overcome exploitation of labor by owners of the means of production without overly encroaching upon economic efficiency. It has therefore been axiomatic to distinguish between ownership and property rights. However, inasmuch as this is the case in virtually all CPEs, it may as well be assumed that the capital stock in place at the inception of reform toward market socialism is state ownership. Whether this should be maintained is a different matter. Market socialism certainly does not necessarily imply full socialization. From a technical economic point of view it is neither necessary nor sufficient for proper resource allocation. But there is no sound technical economic argument that I am aware of that justifies privatization as a better alternative to social ownership. There are probably instances in which it would be advisable to encourage private ownership if only because the cost of ensuring proper allocation of user rights associated with state property would be horrendous. On the other hand, precepts on income and wealth distribution and access to a certain social dividend, as Lange referred to it, may well counsel maintaining state property of basic sectors of economic activity. But that does not necessarily mean that it would be justified to have the state exert its property rights. Custodial rights over the use of social property could be traded in functioning capital markets. Can such a market for the usufruct of capital be entertained and, if feasible, can it possibly be efficient or at any rate lead to a more effective allocation of scarce resources than under the preceding system? An answer can usefully be constructed by first looking at the stationary state and subsequently at one where there is positive growth of the capital stock possibly combined with shifts in its structure.

With a stationary state, macroeconomic policy needs to ensure that capital use does not eat into the social capital stock though proper charges and safeguards. In principle, it is entirely feasible to let economic agents bet on the right to access society's capital, to institute a control mechanism to ensure that the capital stock remains intact from the profits that the usufruct's rent yields over and above the charge to be paid to society, to let firms unable to pay the net charge for the usufruct out of profits fail, and to ensure that bankruptcy does not entail the destruction of society's wealth by having in place a broadly based insurance scheme to be purchased by users of the usufruct. Of course, a social safety net needs too be maintained and, under the circumstances, improved.

In a growing economy, questions of how additions to the capital stock and its replacement are decided upon loom large. These problems revolve around the *problématique* of facilitating exit and entry as well as steady upgrading of the capital stock. Both additions to the capital stock and replacement of the existing stock could be handled through exit and entry by entrepreneurs bidding on access to future assets. This can be organized in two conceptually different ways. The more preferable one would involve the development of full-fledged capital mar-

kets, including for forward transactions. Entrepreneurs would simply explore with commercially viable financial institutions how best to allocate society's savings, including amortization funds and state savings proper. There is plenty of room for the purely technical exploration of the alternatives from which society may then choose without raising objections to social ownership of the means of production provided. The focus of attention could usefully be directed at the critical assumption to the the effect that proper capital markets, including forward markets and insurance schemes to guarantee risk, can be instituted in a relatively costless fashion. Given the complexity of ensuring such efficient markets even in mature industrial market economies, it is hard to see how the reforming traditional CPE could quickly realize fully functioning capital markets within a comparatively brief period of time. In fact, multiple ownership forms in combination with the gradual emergence of capital markets for the bulk of society's capital may well be the more desirable way of proceeding. But such dilution of property rights would be based on technical economic considerations under the given environment rather than on the ideology of the distribution of material wealth.

24 February 1989

# FROM REVISIONISM TO PRAGMATISM. SKETCHES TOWARDS A SELF-PORTRAIT OF A 'REFORM ECONOMIST'

W. BRUS

This paper was prepared as a contribution to the conference on "Plan and/or Market" organized by the Institut für die Wissenschaften vom Menschen in Vienna in December 1988. The main objective of the conference was to discuss the peculiarities of "reform economics"—how it developed in socialist countries, what is its relation to "mainstream economics" etc. My contribution refrained from attempts to examine "reform economics" as such, presenting a personal story instead. It seems to me that, despite the fact that the text has not been written specifically in reply to the questions posed by the editors of *Acta Oeconomica*, it contains some elements of an answer to these questions as well.

1. The first signs of my, let us call it "reform attitude", came in late 1953 when not only the "new course" after Stalin's death got under way, but also the first somewhat more genuine picture of the actual state of the economy emerged. The stimulus was thus provided by economic reality. Also the direction of the postulated change—modification of the institutional set-up, of the "system", and not only in the economic policy priorities—was derived from the evident inefficiencies at the micro-level (which were easier to observe) caused by informational and motivational

failures. Hence the emphasis on better incentives, structures and conditions for more rational choice at the enterprise level. These were to be realized through elevation of "synthetic" indicators (e.g. profitability), reduction and later abolition of obligatory target planning and physical allocation of resources, activation of the money-price mechanism, and other things known today under *Kornai*'s apt term of "hardening of the budget constraint." The conviction that these requirements did not stem from specifically Polish circumstances was strengthened by my own experience as an enterprise planner in the Soviet Union during the war and by gradually developing contacts with economists from other communist countries (György *Péter* of Hungary in the first place, a conference in East Berlin in 1955, and the first of Liberman's articles in the same year etc.).

There were ideological influences too. I was perhaps particularly susceptible to some sort of "market orientation" because of the lingering memory of frank discussions of the topic in Leningrad University during the war (after the publication of the famous article 'Some problems of teaching political economy' in 1943), and this was later reinforced by Stalin's peculiar rehabilitation of the law of value under socialism in 1952. As far as Oskar *Lange*'s celebrated model of "market socialism" was concerned (at that time I knew it only from its partial publication in the Polish theoretical journal *Ekonomista*), it was not for me a source of inspiration in any sense—probably both because its neo-classical methodological foundations were far removed from my own Marxist ones, and because its author himself clearly underplayed the significance of his essay. On the other hand, I was a firm believer in central planning as an indispensable tool for the full utilisation of resources (particularly labour) on a macro-scale, harmonious growth with proper anticipation of the necessary structural transformations, and the development of human and material infrastructures etc. This belief was probably strengthened by the influence of Michal *Kalecki* (both through better acquaintance with his writings and through close direct contacts); however, it was essentially derived from long standing Marxist convictions—one could say from a Weltanschaung. That is why, even at the height of the ideological turmoil of the days of the 'Polish October' in 1956, when radical reassessments were often the order of the day, I tried to defend central planning (in a reformed system) against those whom I regarded as extreme supporters of laissez-faire solutions. As developed more fully in my 'General problems of a socialist economy' ('The market in a socialist economy' in English) written in 1959–60 and first published in Polish in 1961, central planning had to change—namely, had to become planning in the real sense as opposed to detailed management of all actions in the economy; however, it had to remain the superior force in resource-allocation, with the market mechanism as an indispensable tool—a better instrument than commands, but an instrument still. In conjunction with the view that state ownership of the means of production should retain its dominant position—notwithstanding the recognition of the desirability of greater scope for genuine cooperatives, some private sector outside agriculture and

renunciation of all coercion in developing collective forms in agriculture—this was a clear revisionist stand reflecting the belief in the full viability of socialism as an economic system, provided it could be effectively cleaned of Stalinist deformations. I was aware of the "Austrian" (*Mises/Hayek*) criticism, but I accepted that its theoretical thrust was ill-founded, and that the new system of "central planning with regulated market" would create propitious conditions for solving numerous practical difficulties (which were explicitly acknowledged—thus the naiveté rightly pointed out by Kornai in his 1986 article is to be interpreted in relative terms).

2. The process of my gradual evolution as a "reform economist" began with the defeat of the ideas and hopes of the 'Polish October'. The political system of the one-party state ('mono-archy' in my preferred terminology) survived and allowed the power elite to push back, step-by-step, the incipient reform—both in the economic sphere proper (independence of enterprises, profit-based incentives, price reforms) and in the sphere of socio-political relations (in the first place workers' councils). It would be wrong to say that political change had at the time not been perceived, by myself and others, as a part and parcel of the economic reform, but too much was taken for granted and had therefore not been postulated explicitly: intra-party democracy accompanied by radical curbs in the size and power of the party apparatus (the idea of merging the departments of party committees and transforming them into the staff of representative commissions, apparently pursued now by Gorbachev, seemed to have been put into practice in Poland then), changes in the electoral law, regeneration of the non-communist parties, wide legal powers for workers' self-management, unprecedented freedom of press and association etc.—all this made the process of democratization look unstoppable for a while. This—and not any consciously felt political constraints—provides, in my opinion, the main explanation why in major programmatic documents concerning economic reform, and certainly in my own writings of the time, the political factor did not occupy the place of prominence it deserved.

The defeat of the 'Polish October' affected my attitude profoundly. The interaction between the economic and political change gradually became one of the main concerns in my brand of "reform economics". My party membership required, from time to time, tactical compromises in political activities (including university politics); up to 1966–67 I still regarded the possibility to act "from within" as an advantage. This, however, has hardly been a factor influencing my intellectual position. I came to regard political change—i.e. pluralisation of the political system—not only as an obvious condition for introducing meaningful market components into the economic system, but as an indispensable element of a rational economic system of socialism as such. Macroeconomic choices are by their very nature political, and without a pluralist polity they will always remain arbitrary: I thus tried to include the political element in the very notion of rationality of economic decisions. Together with the expected impact of democratisation on popular attitudes towards decisions taken centrally—that is, towards decisions scrutinised

openly from the view point of social interest as perceived by the people, or "disalienation" in the form of genuine socialization of ownership of means of production as opposed to mere statisation—this, and only this, could refute in practice the assertions of socialism's inability to solve economic problems, and only this could secure the necessary balance between responsibility and risk-aversion. When I look back now to identify any outside sources of inspiration for this higher politicisation of my "reform-economics", first to come to mind are discussions with my Czechoslovak colleagues, among others with Ota *Sik*. With regard to Ota Sik, these were not so much linked to his reform-designs of the time, but to his PhD ("candidate") dissertation on "The economy, interests, politics".

This was the way I moved the ownership problem to the centre of the reform stage: the existing type of ownership of the means of production is faulty not because of its integrated nature but because integration has been accomplished through the alienating machinery of bureaucratised power, instead of through a socialised state. It was from this point of view that I criticised the Yugoslav concept of self-management socialism in 'Socialist ownership and political systems' (1975): its logic leads to unlimited fragmentation of ownership of the means of production, and to fully fledged group ownership, whereas I advocated the ultimate right of the community as a whole to decide about the level of accumulation and the allocation of the main stream of investment, and to determine at least the general rules of the distribution of incomes etc. My attitude towards self-management was that it should operate within the confines of a centrally planned economy with a regulated market mechanism, in which the centre is subjected to popular control through a pluralist political system ("polyarchy" in *Dahl-Lindblom*'s term). Again, looking back I cannot find any traces of political constraints determining my position. Besides, by that time all remnants of my previous links with any type of establishment in Poland (including the academic one) had been broken, and the politicisation of my "reform economics" had become the principal target of attacks; consequently, since the end of 1972, I have lived and worked in Britain. Nevertheless, at least until the end of the 1970s I still held on to the ideas briefly described above, as witnessed among other things by the presentation of my "reform economics" in China during my first visit there in 1979–1980. Therefore, I do not see the ground, in my case, for a possible "sociological" explanation of the persistent tendency to keep some elements of the traditional perception of a socialist economic system.

3. The next stage of the evolution of my thinking came with an absorption of the evidence emanating from the reformed socialist economies—Hungary and Yugoslavia. It was not simply a matter of examining the actual economic performance but mainly of finding the link with foundations of the system of functioning of the economy. The nut was very difficult to crack. Take Hungary, for instance: the introduction of NEM brought about (or coincided with?) a number of positive phenomena in the economy, particularly in comparison with other communist countries. Then came the disappointments—but why? External circumstances—

the 1973 oil shock etc.—could not be easily eliminated from any assessment. As far as systemic factors were concerned, the practice of NEM gave increasingly good reasons for criticism; however, was it because the concept itself (the "half-way house") was wrong, or because it was actually never properly introduced? The Yugoslav case seemed to me even more tricky: apart from the specific national problems and the hypertrophy of self-management, could not the alarmingly growing setbacks in the economy be attributed to excessive marketisation of the system, particularly to the decentralisation of investment after the 1965 reform? (I must admit that I overestimated the scope of the genuine operation of the market in Yugoslavia after these reforms, especially when the system began to undergo yet another change in the early 1970s.) Moreover, both Yugoslavia and Hungary failed to fulfill the political condition: the 'monoarchy' survived intact, despite some degree of cultural liberalisation; according to the concept referred to above, this in itself should provide a substantial element of explanation for the malfunctioning of the economic system. As late as 1983 I entertained the possibility that the pressure for more consistent marketisation observable among Hungarian economists was a reflection of their pessimistic evaluation of the chances of pluralizing the polity: if one cannot bring the centre under popular political control one is compelled to look for ways of weakening the power of the centre by extending the scope of the market-determined economic decisions to the investment sphere as well.

However, closer analysis convinced me that I was wrong. The expectations connected with the introduction of the product market (both for consumer goods and for producer goods) could not materialise for a number of reasons: allocation of the main bulk of investment through a vertical planning mechanism requires necessarily a strong administrative centre which tends to extend its powers into other areas as well; development of competition and entrepreneurial behaviour is unlikely without free entry and exit, requiring in turn the possibility of horizontal movements of capital; the lack of the latter also hampers the disciplining function of the market because it makes it very difficult to distinguish between genuinely unviable firms and those which become unviable owing to closed opportunities to diversify, to acquire new technology etc.—hence the legitimisation of the bargaining process with administrative holders of the keys to resources. This topic could obviously be expanded—both with regard to the capital market and to the labour market—but there is no point in doing it here. What I wanted to show was merely the general direction of the evolution of my thinking under the influence of a closer scrutiny of the experience of the reformed economies. A study tour in Hungary and Yugoslavia in 1983 undoubtedly contributed to a better understanding of the matter.

Letting the capital market into the system represents, in my opinion, an important step on the road from revisionism to pragmatism in "reform economics". Of course, it would hardly be warranted to seek a firm watershed between reform-thinking within and outside some *a priori* defined socialist framework, but should

such an attempt be undertaken, the admission of the capital market would be a strong candidate. (In the past I myself thought it to be *the* watershed.) Capital market impinges upon all the major pillars of a socialist economic system:

— on central planning as an *ex ante* design of the future physical structure of the economy;

— on the mechanism of distribution, both in the sense of aggregate division of national product into consumption and accumulation, and in the sense of legitimizing the non-work factors of income distribution among individuals and groups;

— on the ownership relations.

The latter issue becomes particularly complex, as I was soon to recognize. The matter could no longer be handled within the framework of the social nature of integrated state ownership—the very question of the viability of the integration of property rights on a national scale had to be posed: even apart from the need to separate strictly the state as a political, administrative and regulatory body from the state as the owner of business capital (I leave aside here the area of infrastructure), the distribution of property rights between the state as owner and the enterprises appearing on the capital market, bearing risk and responsibility, must be completely re-defined. The separation of the state from the enterprises has to go along with the full separation of enterprises themselves. Then the problem arises of whether, or to what extent, state owned entities are at all suitable for acting in the capital market. Whatever the general answer to this question, I share the nowadays widely accepted conclusion that the change from, again using Kornai's terminology, bureaucratic (direct or indirect) to market coordination cannot be based on the absolute and unchallenged dominance of the state sector, even if the conditions of separation mentioned earlier are met. A mixed economy with a sizeable non-state sector of cooperative, private and quasi-private (all kinds of leaseholds, contracting-out etc.) enterprises competing on equal terms with the state ones seems to be the necessary condition of a consistent reform. I now see political pluralism not as a factor of rationalisation of the superior role of the centre—as in my model of a "centrally planned economy with a regulated market mechanism"—but as an indispensable element of transition from the old to the new economic system, and as a guardian of the continuous existence of the latter. This does not mean, in my view, that a consistent market-oriented reform excludes the pursuit of values habitually associated with socialism—mitigation of inequalities, a major concern for full employment, social care, opportunity for developing talents etc. Not all aspects of socio-economic life must be subjected to market coordination, and where they are there is a substantial scope for macro-economic policy, including that which can even aspire to the designation of planning—provided it does not impair the general logic of the operation of the market. In other words, my position is still not identical with the laissez-faire one, as I retain the belief that the notion of the interest of the society cannot simply be reduced to the sum-total of individual self-interests. Whether or not such system may be called socialism

('market socialism') seems immaterial; it is to be an open-ended system capable of flexible change in line with pragmatically validated requirements.

4. This is, in short-hand, the story of my own "reform economics" over the years. It shows a gradual, one may even say—reluctant, evolution in the direction of marketisation primarily under the impact, so I think, of real experience. The degree of admissibility of this story as evidence, and even more so its wider relevance is—needless to say—subject to discussion.

October, 1988

# PROPERTY RIGHTS IN FOCUS

E. COMISSO

1. What is, in your opinion, a socialist market economy?

Generally, I have always understood the term "socialist" to refer to an ownership system. In a socialist economy, assets are not owned by private individuals, but by publicly (or socially, if you wish) owned entities. Consequently, individual incomes are return to labor. Income from property, in contrast, falls into the public domain, i.e., it belongs to society.

The advantages (if one may call them that) of socialism are consequently not absolute equalization of incomes. Income is distributed "according to work," and wages and salaries may vary considerably, depending on the marginal product of different uses of labor. On the contrary, what the socialist economy does prevent is concentration of wealth in the hands of private individuals. The consequence of this is thus a more—but again, far from absolutely—egalitarian distribution of income than under capitalism (where income distribution becomes markedly skewed only when incomes from property are added to incomes from labor) along with the absence of the very great concentration of property in individual hands. In principle, the result ought to be a significant increase in the level of *political* equality since no private person can influence communal/governmental decisions by his or her control over assets. In theory, then, governments ought to be able to be more responsive to the demands of popular majorities insofar as they do not face a "veto" power of private owners whose decisions to disinvest can easily subvert even the most popular and socially necessary acts of legislation. (If you don't believe me, just follow thew attempts to impose stricter standards for automobile emissions here in the United States...).

How much and in what way private ownership of assets is restricted may vary, but if an economy is socialist, some restrictions are always present. To the degree socialism is conceived according to the lines sketched above, as simply an

economic system designed to secure the traditional democratic end of maximizing political equality in the context of an industrialized, nonagrarian society, it would appear that small private businesses, in which "profit" is little more than a return to the owner's labor as entrepreneur and manager, are entirely permissible. Certainly, when such small businesses are started up after a long period in which such activity is illegal, a significant portion of their earnings intially will be monopoly rents. However, as long as barriers to entry do not appear (be they in the form of local political leaders refusing to grant licenses to new competitors or in the form of discriminatory taxation against private businesses), that portion should gradually, even rapidly, diminish.

The key question then becomes how large a private sector can be or more precisely, how large any private enterprise can become, before the economy moves from being a socialist one into the "mixed" economy category. Although I am well aware that for many, a rapid movement of this sort would not be an unwelcome development, I am assuming for the purposes of this analysis that our hypothetical economy is to stay firmly within the "socialist" type. It follows that the size of private businesses would have to be restricted in some way.

Now, the traditional socialist response has been to limit the number of employees a private firm can employ. While this can certainly be an effective restriction, it is also a rather arbitrary one: after all, why 10 employees and not 11? Why 100 employees and not 120?

Frankly, it seems to me (although readers should bear in mind that I am not myself an economist) that there are far less arbitrary methods available to a socialist economy for remaining socialist while allowing a small private sector to exist and flourish. Given that private enterprise can assume an enormous variety of forms—family businesses, partnerships, cooperatives, joint stock companies, holding companies, etc.—all that the government need do is simply not grant legal sanction to the ownership arrangements required for large concentrations of private capital to exist. If, for example, limited liability of private persons is not recognized in a court of law, and owners are personally liable for the debts incurred in the course of operating their businesses, it is extremely doubtful that the kind of private capital/wealth concentration characteristic of the corporate capitalism era would occur. Instead, when highly successful small businesses found themselves starved for capital, they could turn to stateowned venture capital banks. Such banks could supply capital for expansion and use it to acquire equity in the enterprise itself (equity that would be publicly owned). Obviously, such a scheme will dampen private incentives somewhat, but it would not kill them altogether, and it would allow public property to remain the dominant form of ownership without simply expropriating successful private entrepreneurs.

As far as a socialist "market" economy is concerned, I have always understood a "market" to be an *allocation* system, that can operate somewhat independently of how ownership is distributed. I am well aware that Ludwig von Mises and Margaret

Thatcher would disagree, and as we shall see below, they may be quite correct. As an allocation system, a competitive market is characterized by numerous buyers and sellers of all commodities and factors of production, insignificant barries to entry and exit on all markets, perfect information, and all actors seek to maximize their utilities. Prices represent aggregate supply and demand, and all transactions involve mutual benefits.

There is thus an important sense in which the "socialist market economy" may be a contradiction in terms: if capital cannot be owned by anyone wishing to purchase it and possessed of the financial means to do so, there is clearly a major barrier to entry on capital markets. Moreover, if only the government, understood here as a single agency, owns capital, then clearly there cannot be very many buyers and sellers, either, at least insofar as the capital market is concerned. It is here that we arrive at the second question.

2. Is a socialist market economy, as defined by you, workable—and if it is, what kind of social and economic conditions are necessary for its functioning?

Frankly, I really don't know if a socialist market economy is workable; I hope it is, but we all know that the road to hell is paved with good intentions, too. Let me first examine some of the economic problems that would have to be solved (hopefully, by someone more competent than I am) and then turn to look at the kind of political infrastructure that such solutions would require.

The first problem, as I suggested above, is finding a way to allocate publicly owned capital efficiently. Presumably this requires some sort of capital market, but if only one entity owns capital, there isn't very much of a market in a real sense. The only solution, it would seem, is to somehow "pluralize" the public owner. The scheme proposed in Hungary by Márton *Tardos* presents one rather creative possibility here: a large number of public institutions would have "endowments" consisting of shares in public companies; they would "manage their portfolios" in a way that they would seek to protect the value of their assets while maximizing the returns from them. The income streams thereby generated would then go not into the pockets of individuals, but into various funds spent by the institutions for the purposes under which they were established be it pensions, university education, scientific research, or what have you). Tardos, of course, would also allow individuals to purchase shares, an aspect that would probably make the plan more practicable, but also less socialistic, at least according to the definition given above.

Yugoslavia's solution (in the days when Yugoslavia can be said to have had a solution) is another possibility. Assets were owned by "society" and controlled by labor managed cooperatives (a scheme which probably would have worked better had Alexander *Bajt*'s proposal to allow workers to purchase nontransferrable shares in their enterprises been adopted) while investment was performed predominantly by banks nominally controlled by their major (socialist) depositors. There were numerous flaws with the Yugoslav scheme when it was in operation (during the brief

1966-72 interlude), some of which are correctible by appropriate policy measures, but some of which appear to be fatal.

The fact that Yugoslav banks ran up against a ceiling on interest rates and so were basically lending money at a negative rate could presumably be remedied by letting interest rates float. Likewise, the fact that the banks frequently bowed to political pressures and made unwise loans could also be remedied in principle by, for example, not allowing the local government representatives to sit on the Bank Board of Directors. The real problem with the banking solution, it seems to me, concerns the fact that in a small country there will be but a limited number of banks, and so the lending strategy of any one of them will have a major impact on the entire allocation of capital. If a bank chooses to maximize the possibility of gain or if a bank chooses to minimize the possibility of loss, different types of economic activities will be preferred. Thus, exactly what lending rules a bank employs would be highly controversial, and it's not really clear who "ought" to make them. If it's the government, credit allocation will necessarily be politicized; if it's the bank management, its own individual motives and private goals will play a critical—and not really legitimate—role.

The other problem with the banking solution, as Tardos has noted, is even assuming banks are efficient lenders, mobilizing capital through banks alone does not provide enterprises with incentives to protect the value of their assets. Worse—if rates of return are the main criteria banks employ to evaluate projects, managers may actually have an incentive to run down the assets.

Thus, although the banking solution does, in principle, allow for capital mobility and although banks have played key roles as capital mobilizers in many capitalist developing countries, it's not clear they are the best institutions to do this in a socialist economy.

Meanwhile, it is clear that any proposed solution is not going to work if socialist sector enterprises (and by this we include socialist investors and lenders as well) can never fail. In short, if there's going to be a market, there has to be "exit." Now, the usual view is that the prime reason behind the lack of socialist bankruptcies is that political leaders refuse to let it happen and always manage to bail out the firm, through the state budget, if necessary. The question, of course, is whether or not these annual bailouts occur simply due to a lack of political will, or whether or not they may be a rational response to that other great failing of the socialist economy: the absence of opportunities for entrance.

My own personal belief here is that the fundamental obstacle to the creation of self-regulating markets in socialism is precisely the lack of provisions for entry into the socialist marketplace. Significantly, this is not a problem in capitalism, since individuals risk their own money, and it's not even a problem in state socialism, where the government founds new ventures. But in market socialism, where capital is publicly owned but the state is enjoined from playing an entrepreneurial role, it is an extremely serious one. Nor is the socialist stock market a solution. For one

thing, if socialist institutional investors behave like their capitalist counterparts, they are likely to be very cautious; most new businesses fail, and I doubt Karl Marx University would want to see its endowment disappear with them. In addition, it is very rare for a new venture, even a reasonably large one, to start out with the issue of stock that can be purchased by outsiders. This step is usually undertaken only after it is already quite successful and its capital needs are too large to be financed through other channels.

One could, of course, expect foreign companies to establish new ventures, but then one has a serious social equity problem: why should private individuals from abroad be allowed to earn money on assets when a country's own citizens are not permitted this opportunity? Note that one cannot expect existing firms to run around founding entirely new ventures either; they may well take over or acquire shares in existing ventures or expand and diversify their own activities, but transaction cost analyses suggest they will generally not seek to set up entirely independent suppliers, distributors, or operations in fields unrelated to their own.

How then does a socialist Magyar Alma (Hungarian Apple) get started? Are new competitors all going to come from the private sector and then be laundered through state-owned venture capital banks into grown-up socialist enterprises, as suggested above? Should a series of government bureaus be set up entrusted with the task of finding opportunities for new undertakings and, after sufficient market research were done, supply capital and hire a management through some sort of competitive recruitment process? If so, what should the incentive structure for employees in such bureaus look like? Should the trade unions act as coordinating committees for worker cooperatives? Could local governments start firms and somehow be barred from protecting the homegrown product against competitors form the outside area? Would local governments be willing to allow such local firms to merge with enterprises based in another town?

As should be clear, I myself have no answer to the question of how mechanisms for entry onto a socialist marketplace can be constructed. But my sense is that unless one (and hopefully several) is created, it is going to be extremely difficult to enforce bankruptcy laws no matter what is on the books. And again, if there's no entry and exit, there's no market, regardless of who owns the assets.

Clearly, providing for a capital market and for the entrance of new competitors are critical for a socialist market economy to function. They are not the only economic problems that would have to be solved, but they are the only ones I will mention given time and space constraints. Let me now touch on some of the political changes that would have to take place for market socialism to operate.

A key requirement for market socialism is an efficient property rights system. Three conditions appear to be essential in this regard: a) property rights must be lodged in the hands of actors with purely economic responsibilities. In capitalism, this means they are lodged in the hands of private individuals. In socialism, it presumably means they are lodged in the hands of publicly owned enterprises and/or

their shareholders; b) property rights must be enforced by a neutral third party. In both capitalism and socialism, courts bear this responsibility; and c) policymaking authority—by which I include the ability to specify what kinds of activities the bearer of a property right can engage in—must be in the hands of institutions that themselves neither exercise ownership rights nor enforce them. This is normally the role of the legislative branch of the government.

Satisfying these three conditions does not require "democracy," but it does require a change in the current role of communist parties from a "leading" to a "governing" one. Currently, even socialist enterprises do not have real property rights, because actions that they are permitted to take under the law frequently cannot be taken in practice because they conflict with current party priorities, whether at national or local levels. Those priorities are often quite justifiable in terms of social concerns, but however justified they may be, requiring the bearer of property rights to be bound by them means that property rights are not being exercised by an actor with primarily economic responsibilities. Instead, they are jointly exercised, with one of the exercisers necessarily having primarily political and social objectives in mind. Understandably, such a system of property rights cannot be efficient.

Further, in current socialist practice "neutral" third parties are but marginal enforcers of property rights. Rather than courts adjudicating contract disputes and the like, the tendency is for ministries, interministerial commissions, party heavies and the like—all agencies very much interested in the outcome and so not "neutral" at all—to settle conflicts between claimants, often by issuing new decrees and regulations—or their equivalent, if it is the party that is involved—altogether. Again, the result is that *de jure* property rights are continually being modified *de facto* depending on what the political winds are—or how powerful an enterprise's allies happen to be. Likewise, no matter how negatively a ministry decision affects an enterprise's operations, it is difficult to imagine the firm "suing" the ministry for damages.

The judicial solution, in contrast, not only provides a "neutral" force, but it also encourages disputants to settle with each other without appealing to superior authorities; when enterprises face uncertain results through litigation, they have great incentives to avoid it altogether. Obviously, this condition cannot be satisfied if the courts are governed by current political winds also. It is consistent with judges being nominated by the party (in the United States, virtually all judges are, in the last analysis, political appointees), but once they take office, they have to be independent of party rules and priorities, not subject to removal if they give a "wrong" decision, and bound by legal procedures and the laws applying to the case at hand.

The third condition is also not satisfied in the contemporary socialist systems, since the party's role requires it not only to specify property rights but to enforce them and participate in its exercise. Conceivably, if it did not perform the latter two

activities, it could continue to monopolize the legislative function of determining what the laws regulating property rights are. If it does so, however, it must also be bound by those laws. This, in a word, requires abandoning a "leading role" in favor of simply controlling the government of a market socialist system.

Such changes would not create what is conventionally regarded in the west as democracy by a long shot. Specifying and enforcing property rights is by no means equivalent to granting freedom of assembly or speech; requiring a dominant party to abide by the laws it alone promulgates is far from equivalent to requiring it to engage in electoral competition. Likewise, limiting and dividing the power of the government does not necessarily involve allowing the population to control what the government does with the power that is still left to it. But as the examples of Taiwan, South Korea, Chile, and virtually all of Europe during the nineteenth century suggest, efficient markets do not require universal suffrage, competitive elections, or even civil liberties.

The latter, however, are highly desirable for non-economic reasons. As noted at the outset, the chief rationale for replacing capitalism with socialism is, in fact, that the latter is potentially more capable of maximizing political equality among all the citizens in a given population. Clearly, that goal cannot be achieved if political power is confided only to a carefully selected but necessarily limited segment of the population. Ironically, it may well be the case that the institutions associated with majority rule and minority rights may be more necessary to efficiency in socialism than in capitalism.

## PERSONAL COMMENTS ON THE SOCIALIST MARKET ECONOMY

B. CSIKÓS-NAGY

I was one of the first (if not the first) in Hungary to realize that in this socio-economic system there is no rational alternative to a socialist market economy. The model of the centrally planned command economy, which I referred to as the "bloodless planned economy" in works which I wrote before 1945, captured my attention for only a short period (I have in mind the years 1949–51). In my opinion, it was good that the party and the government took action against over-bureaucratizing tendencies in 1954. I was at the time a deputy of the Minister of Light Industry, Árpád Kis. He appointed me head of the Light Industry Rationalization Committee. Relying on the available documents, György *Földes* judged the activities of the Committee as follows: "It is a clearly radical train of thought: it refers to the influencing of household consumption and agricultural production by indirect means, such as price policy, reserves, etc. (in practice only

partly effective); with reference to these, it suggests a combination of plan and market elements in this field, as well as in industry, and thereby in the whole of the economy. This amounts to demanding the transformation, i.e. reform of the economic mechanism based on plan directives. It is further remarkable that the "technical" assertion of the market (commodity relations) emerges as an instrument against bureaucratic over-centralization." [Egyszerűsítés, mechanizmus és iparirányítás, 1953–56 (Simplification, mechanism, industrial management, 1953-6.) *Párttörténeti Közlemények*, 2.1984.]

After that, it hardly surprised those acquainted with the affair that after Béla Szalai [8] had been appointed Minister of Light Industry instead of Árpád Kis, I was qualified "unfit for leading position" and dismissed from the Ministry. Prior to that, the Political Committee of the Party made the qualification of my activity an item of the agenda of a meeting. József Bognár, then minister of Home Trade, was invited to assist at the meeting. (Was it perhaps an indirect warning to him?) Mátyás *Rákosi* formulated the case in the following words: "Béla Csikós-Nagy wishes to transform Hungary into a country of small artisans." After my removal, my case was brought before the Control Committee of the Party, which examined all my writings published before the war. I was expelled from the Party, and a week later, for reasons unknown to me, my "punishment" was changed into a "last warning".

That is the first part of the story which motivates my personal comments on the socialist market economy. The second part is exactly the reverse of the foregoing. Immediately after the formation of the revolutionary worker-peasant government in early November 1956, István Kossa telephoned me to say that I was needed in the economic policy leadership. After a short series of negotiations, I was allowed to form a new office: the National Price Office which had been wound up in 1949. However, my first interview published in the official party periodical was simply not understood. I said I wanted to work so as to render such an Office superfluous. In fact, that was my manifestation on the subject of the socialist market economy. I even took the trouble to translate into Hungarian, for István Dobi and István Kossa, *Böhm-Bawerk*'s study "Macht oder ökonomisches Gesetz?"(Power or economic law?) which I hold to be one of the best ten works on economics up to this day. I wanted to make clear, by means of that study, the economic philosophy I regarded as exemplary. In it, the famous polemic with Stolzmann was summed up.

Böhm-Bawerk reasoned in purely economic categories. His opponent *Stolzmann*, a socialist, laid emphasis on the social categories. The polemic was carried on in the ebbing phase of the German dispute on methodology. The arguments presented by the German historical school and by the exponents of "university" socialism made it impossible to doubt the significance of social categories in the

[8] Then member of the Political Committee, HSWP—Ed.note

processes of commodity distribution any longer. It had to be recognized first that distribution was different—formally as well as substantially—in the socialist and in the capitalist socio-economic systems. Therefore, the point of the debate could not centre on anything else but whether the social categories exerted a determinant, or at least an essential, influence onthe law of demand and supply, i.e. of distribution. The way Böhm-Bawerk put the question was: did the central power wish to exert its influence according to the law of price, or against it. The object of his examination was: does official power cross or fulfil the law of price in its actions? His investigations led him to make distinction between "economic power" and "physical force" and he related these to the possible ways of asserting non-economic motives.

Thus what is involved is no longer a classical interpretation of the pure theory which endowed economic laws with the force of nature, against which human will is impotent. Economic laws exist, and human will cannot make them ineffective, but it can use and influence them. That is to say, the functioning of the law of price and the natural order of distribution go their separate ways. I do not think that I now need to prove further that the socialist market economy has a deep significance for me.

The model of the socialist market economy has never been formulated and described in all its details. Whatever the case, it cannot be basically different from that of the *modern market economy.* Consequently, Marxist economists are interested in investigations which inquire into the special characteristics and improvement of efficiency of the market economy. These investigations lean towards the issues raised by the ground gained by public goods and by the emergence of the environmental products. These have no market, and thus their distribution can be regulated—as distinct from that of individual products—only through a political mechanism.

There have always been—though much less then now—public goods; economics, however, referred their examination to the sphere of finance. On the other hand, environmental products represent a new area. It has turned out that natural resources, earlier believed to be unlimited, can be damaged and even destroyed by man. This is because the environmental pollution caused by the manufacturing technologies adopted in mass production, as well as by certain products, go beyond the self-purifying capacity of air and water.

The greater the share of the *public goods* in the social product, the more significant it is to find out—from the aspect of consumer sovereignty—what role society plays in shaping political preferences. That is why in today's society the interrelated questions of the political institutional system and consumer preference have gained in importance in the examination of economic processes. Moreover, the greater the *environmental pollution*, the wider the gap between the social judgement of welfare, and economic growth as measured by traditional methods.

Both the socialist and the capitalist society must take into account the particularities resulting from the three provincees of goods belonging to the sphere

of economy. Their regularities are revealed by the science of market economy, the economics of public goods and environmental economics. Today, the general equilibrium theory of economy can only be based on the integration of those three spheres of economy, since the quality of life is expressed by the material and spiritual well-being which we can assure through a smoothly functioning mechanism, gradual democratization, and protection of the natural environment.

## ON SOCIALIST MARKET ECONOMY—FROM A CZECHOSLOVAK VIEWPOINT

K. DYBA

In answering your questions[9] I prefer to think above all of Czechoslovakia, that is, what kind of reform measures are needed to reverse a relative longer-term economic decline in the Czechoslovak economic performance *vis-à-vis* the developed Western countries (which in the 80s gets more pronounced). So my definition of a socialist market economy may sound as a blueprint for a market-oriented reform in the concrete Czechoslovak case.

When listing the basic set of mutually related reform postulates one should keep in mind the past experience with reforming in Czechoslovakia as well as in other socialist countries, most notably Hungary and Poland. At the same time some of my inspirations come from the experience of the developed market economies, especially the small ones, as well as from my knowledge, albeit a limited one, whatever the reasons for it might be, of mainstream economic theory and the works of Western specialists on socialist economies.

1. To establish a market economy requires the dismantling of central planning as a set of rather detailed physical input and output commands to enterprises. It implies that planning discipline has to be replaced by a market discipline, i.e. by reasonably functioning market structures. To achieve that, some essential market attributes such as freedom of choice, free entry and exit, well defined rewards and penalties, etc. must be established. A contemporaneous existence of all markets, i.e. the market for goods, labor, capital and money must obtain, as all of them are indispensable parts of any market economy. They have to be real markets (not just simulated ones) and prices have to adjust to clear all of them simultaneously.

In a small economy like the Czechoslovak one a market discipline cannot rule unless the economy is more or less fully integrated into the world economy, that is, with those socialist countries, which pursue the course toward a market economy as well as with the rest of the market economies in the world.

[9] Personal views only.

In other words, a market discipline to replace inefficient and anti-welfare-oriented planning discipline cannot really exist in Czechoslovakia without full contestability of domestic markets by foreign economic actors. To achieve this, administrative controls in external trade and capital movements have to be liberalized, and ultimately, more or less, cease to exist.

In this process domestic currencies will, hopefully, become fully convertible into domestic goods as well as foreign currencies. Furthermore, a fully monetized economy will ensue.

A market economy requires an appropriate organizational as well as institutional set-up. In relation to what we have presently in Czechoslovakia it entails a resolute upgrading of the role of monetary and financial institutions at the expense of the Central planning commission and sectoral industrial ministries.

In fact, the latter organs, to the extent that they will not be abolished, should be stripped off of any operative functions, and they should deal mostly with analysis, longer-term forecasts, etc., that is, to serve as advisory bodies without, more or less, real economic power. Their staff should be drastically reduced, and a hard budget constraint imposed. Needless to say, there should be other institutions to strive to preserve reasonably competitive market structure by means of enforceable antimonopoly laws. Similarly, there has to be a competitive commercial banking separated from central banking functions, full and active membership in international institutions such as IMF etc.

Obviously the issue of property rights has to be tackled as well. Essentially, I would argue that experience has shown that a well functioning mature market economy requires that all possible forms of ownership compete on equal terms, that is, in a "mixed" economy set-up. Here the issue of privatisation (to what extent and how) is open.

All this does not mean the abdication of economic intervention by the reorganized government. On the contrary, the government must be very active in setting the usual indirect instruments of monetary policy (interest rates, reserve and liquidity ratios etc.), exchange rate management, taxation and budgetary policies. There will have to be well developed infrastructure and policies for dealing with employment (unemployment) issues, externalities, etc., including indicative planning activities in the center.

In a real market, environment planning by means of market conformable tools and institutions to overcome some of the market failures has, of course, a different meaning and is efficiency-enhancing. Here it fits in a structural policy designed to achieve very limited set of strategic preferences and to improve functioning of the markets.

A socialist market economy in Czechoslovakia has to be above all a market economy both functionally and institutionally; hence it can hardly be substantially different from market structures of the small, open, developed, mixed economies in the West like Austria, Sweden, Finland etc. The real content of the attribute of

socialist should probably be looked for mainly in a special mix of socialist policies followed under market socialism and only partly in special institutional arrangement though as concerns the latter there must be some genuine institutional innovations[10] to make traditional socialist policies work, hopefully, better than under market capitalism.

To give a brief example I am again thinking more of Czechoslovakia. Under market socialism I would expect a larger share of public and cooperative ownership (not only because of legacies of the past 40 years but of longer-term socialist inclinations), a rather low upper limit as concerns unemployment, more industrial democracy and some forms of profit sharing, stronger commitment to equality, etc. These are all known ingredients of socialist policies applied elsewhere which, however, in a proper mix with some institutional innovations can make for a qualitative difference.

A socialist market economy in Czechoslovakia will suffer from similar problems most market economies suffer from, yet it should be able to return the Czechoslovak economy to a more efficient, welfare-oriented, and sustainable higher-level growth path (which is impossible to achieve with the system of mandatory planning).

2. In a relatively mature industrial and broadly developed country like Czechoslovakia for a market to function properly, a fully developed pluralistic political system is needed in order to substantially reduce direct political interference in enterprise matters (abolishing "nomenklatura") and thus make the managers more autonomous and, above all, market-responsive.

Full political democracy is needed to allow, *inter alia*, for more open and rational settlements of any conflicts of interest in a stable and predictable manner within more dynamic market economy.

An appropriate legislative, social, cultural, etc., infrastructure which incorporates basic elements of market ethics and of liberal ideas in general is also indispensable and it replaces the one with paternalistic and authoritarian attitudes inherited from the heydays of mandatory planning of the 50s.

[10] For examples of innovative thinking on these issues see: Nuti, D.M.: Economic planning in market economies: scope, instruments, institutions. In: Nolan—Paine (eds): *Rethinking socialist economies.* Croom-Helm, London 1986.

# AN ACTUAL REVERSE MOTION?

T. FÖLDI

1. The questions put by the editors reflect at least two kinds of uncertainties. First: what is socialist market economy, and is an economic system conceivable that can reconcile the demands raised by the attribute "socialist" with those arising from the essential character of market economy? Second: it is hard to ascertain whether Hungarian economic policy and the Hungarian economy can make the way—whichever way it is—from indirect economic management to socialist market economy.

2. Does the socialist market economy exist as an economic system? At present, only one country, Yugoslavia, is sometimes deemed as such. The essential feature of the Yugoslav socialist market economy consists in that the self-regulating units—established on the basis of social property—react to market signals while there is also socio-economic planning of an indicative character. Analyses of the Yugoslav economic system make it clear, however, that non-economic factors play a hardly lesser role than in the planned economies of indirect economic management. The market economy is suffering under the dual pressure of political power and self-management. Therefore, contrary to the earlier ideological criticisms, the market economy character of the Yugoslav economy is much more questionable than its socialist nature.

The Swedish economic system is as a rule not called a socialist market economy. Notwithstanding, my opinion is that, if the concept has any real content at all it is the Swedish (and partly also the Austrian economy) that can be considered as such, more than any other economic system in existence.

3. The attribute "socialist" has undergone a great many changes of meaning in the course of history, such that it has now been completely relativized. As a consequence, it is totally uncertain which kind of socialism it is that should be reconciled with market economy. Although what I have said above makes it clear that I very much doubt if the socialist market economy can be at all defined, I will make an attempt at describing it: the socialist market economy is a kind of mixed economy in which social control based on social security principles is exercised over the utilization of social capital and the distribution of incomes. It differs from the social market economy in that the authority of the indirect or direct social control extends beyond distribution to a considerable part of the utilization of social capital. However, this control can only be efficient if it is in harmony with the efficiency principle; that is to say, neither the control over a given part of the social capital, nor the redistribution can be of such degree as to encroach upon capital formation incentives for enterprise, upon competition, and upon the individual's economic motivation. An indispensable condition of the socialist market economy is wide

democracy, which guarantees democratic control of social property and encourages the social responsibility of the individual. Therefore, the socialist market economy must be based on the primacy of private ownership, the assertion of efficiency criteria through economic competition (including international competition), and a democratic social and political system. It is upon such grounds, and depending on historical traditions and social intentions, that the way and extent of the control over the market, and its socialist character, can be developed. In this sense, the socialist market economy ought to grow up on the grounds of market economy without attribute. The difficult question facing us is whether we can reach that state through a process of historical retrogression. Can we restitute private property, and introduce a form of competition which is free of preferences, and of national and social prejudices—namely, is democracy feasible in Eastern Europe?

4. Is it in fact retrogression that is involved? Whether one considers the analogy that Béla Kun and others drew between socialism and feudalism as realistic or superficial, it is beyond doubt that the Marxian conception of socialism, as it has been practiced in Eastern Europe, deprived the less modernized societies of the motive forces and mechanisms that were and still are behind the incredibly fast development of capitalism: e.g. proprietary interest, economic competition, money, and a number of other characteristics of the modern market economy. In a certain sense, therefore, real socialism was retrogression for Eastern Europe, and now the road of progress must again be sought. There is, however, one aspect where the analogy fails: feudalism had an adequate ideology that held the hierarchical order of society to be a divine order and suggested that all should be content with what they received within that order; happiness would come in the next world. As against this, socialism promised continuous advances in the material as well as in the intellectual sphere, it promised equality, and finally perfect happiness in this world. Under this programme, extensive social security was provided especially in the phase of neo-stalinism (the feeling of security also existed in feudalism). It was realized, however, at a low level of supply, for the above-mentioned reasons. The programme of socialism has exerted a serious influence, and not only in Eastern Europe, exactly because it expresses man's natural wishes. However, opposed to the market economy, and denying it, this programme has turned out to be unfeasible. In this light, it may be asked whether the dynamic of market economy and the requirement of social security can be brought into harmony. The Swedish and the Austrian case referred to above shows that they can, though only under rather special conditions. Whether those conditions can be reproduced in other countries, I do not know.

5. My other doubts are connected with the specifically Hungarian difficulties of providing an answer. It seems that today's official Hungarian interpretation of the attribute "socialist" has been reduced to three essential elements: the unconditional acknowledgement of:

— belonging to the socialist community, i.e.: to the Warsaw Treaty, coupled with a more or less intensive participation in the CMEA;

— the leading role of the Hungarian Socialist Workers' Party as the determinant element of the existing power structure;

— the primacy of state and cooperative property.

The present-day general conditions of developing the socialist market economy are to be sought in the existing Hungarian economic situation on the one hand, and on the other hand, in the factors I mentioned as the defining elements of today's Hungarian interpretation of socialism.

The strained economic situation in Hungary today does not provide many chances for a painless way of management. Due to a lack of sufficient reserves, the necessity of coupling with economic stabilization and reform, could create rather serious conflicts; yet the former is not feasible without the latter. The two versions of the Hungarian government's programme reflect the inconsistencies of the situation.

As for the general conditions of a genuine change, it seems that the "softest" element of the conception of socialism as outlined above is the interpretation of ownership. A social consensus may be reached on the question of an organic development of private property based on small- and medium-scale industry.

The second question is concerned with the adaptability of the existing power structure. It seems that the party-, state-, and economic apparatus has now got rid of its ideological constraints and is fighting for its direct interests. It is an open issue whether the reform policy can further transform the power structure and bring over the worthy part of its representatives to the new structure, including the new structures of economic power. As the reform period of the last century showed, this kind of development is possible. If, however, this opportunity is not taken soon, a situation may develop in Hungary similar to that in Poland in 1988.

The political aspect of the third question is whether Gorbachev's reform policy continues. More specifically, from its economic aspect, the question concerns how much the fact of belonging to the Warsaw Treaty allows real detachment from the CMEA and development of organic relations with the West. This latter also includes the prospect of a large-scale capital injection, without which the development of market economy is inconceivable.

September 1988

# MERELY A BEAUTY-SPOT

A. HEGEDÜS

My opinion on the socialist market economy is that in this relation the attribute "socialist" is meaningless. There exists a very wide sphere of social phenomena which cannot be qualified as socialist or capitalist ones. I do not only refer to such Stalinist nonsenses according to which separate socialist and capitalist belles lettres, music, fine arts etc. exist; by now it has become evidently ridiculous to use such distinctions.

At the same time there are several concepts to which—for various reasons—we still use the attributes: "capitalist" and "socialist". In addition to a certain conservatism, there are also some political considerations which might play a part—namely, gilding the pill. In my opinion, for example, such is the distinction between capitalist and socialist democracy, where the content of the adjectives is merely catchword-like and impossible to interpret.

I also regard market economy as one of these, since for me the distinction between a capitalist and socialist market economy seems to be factitious, and the latter to be hardly more than a mere beauty-spot; let us see what can be understood by it:

First of all we might deem the social and economic environment prevailing in Eastern and mid-Eastern Europe as determinant and, although it is far from being homogenous (let us think abouth the differences between reform-socialism and Stalinism) we still call it uniformly socialist. (By the way, I have no objection to referring to it in that way; it is a matter of common consent. On this basis—if certain current political interests prompt us to do so—we may also call the systems dominant in, say, Romania or North Korea socialist.) On this basis, socialist market economy is the market economy developing in such environments.

However, the afore-mentioned socio-economic environments do not change the market economy into something fundamentally different from what has developed in capitalism. Insofar as—owing to the environment—it is different, it is no longer a market economy but some kind of a cross-breed between market economy and a centralized bureaucratic economic management system.

Another possible explanation of the attribute "socialist" may be based on the assumption that there may be such a market economy which realizes socialist values; in other words, the processes taking place in the market economy are motivated by socialist values.

I think that both assumptions are unrealistic; both of them are contradictory to the *sui generis* particularities of a market economy.

The main motivation of a market economy is the utilization of the products produced at appropriate prices for the sake of making profit and/or the transformation of the product structure and services so as to achieve this goal. The market

is governed by the principle of competition, which constitutes a ruthless fight for influencing the decision of the customer. (Where, owing either to monopoly positions, or to various kinds of manipulation, competition ceases to exist, this injures the viability of a market economy.)

A market economy cannot take into account socialist values, such as egalitarianism, support of the outcast, the handicapped, many-sided development of the individuals' faculties, or the formation of genuine communities based on individuality etc. Market economy is insensitive to such humanistic goals, so the realization of these has to be the task of some other institutions.

The second question really is whether a market economy can operate under the socio-economic conditions prevailing in Eastern and mid-Eastern Europe. (I have already mentioned in the foregoing that the realization of socialist values is the function of other mechanisms and not that of the market economy.)

With regard to this question we cannot, of course, set out by treating the region in question in a narrow-minded way—namely in a homogenous manner. The uniform socialist system is today no more than the wish-dream of certain politicians; however, reality unambiguously contradicts such a dream. Basically two extreme groups have to be distinguished: the countries where Stalinism has been continuously maintained or where a rearrangement in this direction has come about; and those where reform-socialism is dominant, or where society is at least moving in such a direction.

In the countries belonging to the first group there is no place for a market economy. By the way, the leaders of the afore-mentioned countries leave no doubt whatsoever concerning this question. Recently, in the GDR—where a certain rearrangement towards neo-Stalinism is going on—it has been officially declared that market economy is inconsistent with socialism. The same standpoint has been expounded by Ligachev in the city of Gorki in his speech delivered in August 1988. This is in sharp contradiction to everything said by Gorbachev in his various writings about the necessity of reforms and the revolutionary changes in the Soviet society.

In the reform-socialist countries market economy is gradually gaining ground, though it has to come up against the resistance of a very massive Stalinist bureaucracy still present in the power structure: Members of the latter feel that market economy, if it becomes dominant, will deprive them of the basis of their power, i.e. the control over economic life.

Looking at the three most obvious reform-minded countries—Hungary, Yugoslavia and Poland,—it is clearly visible that market economy grows dominant in economic life only with great difficulties. On the other side, this is the primary means for breaking down the neo-Stalinist resistance and the various ideas of rearrangement.

Though, as it can be seen from the foregoing, I think it essential to implement market economy in the countries of Eastern, or mid-Eastern Europe—and I deem it

possible, since everything can be said for it, and it is mainly conservative political powers that hinder its development—I still cannot avoid making two restrictive comments.

For the sake of asserting group interests, local viewpoints, environmental protection etc., public control over the operation of the market economy is needed. Public control, however, which is necessary both in the West and the East, must not be mixed up with the activities of a bureaucratic power apparatus which is a major impediment to the market mechanism.

In addition to the market economy, social movements and institutions destined to realize socialist values are also needed. However, assuming the existence of the market economy, they can be developed both in the Western and the Eastern regions; what is more, the opportunity for them is greater in the former one, since there the countries concerned are technologically more advanced and, as a result of it, richer as well.

# COMMODITY PRODUCTION WITH OR WITHOUT ATTRIBUTE

R. HOCH

The 1968 economic reform unambigously set the aim of developing socialist commodity relations. During the new reform wave, more precisely since the turn of the 1970s and 1980s, and particularly in recent years, the necessity of developing a market has again been a much debated subject. Yet the attribute "socialist" is now less frequently a prefix of the term "commodity production." Is the attributive construction at all justified? Does a socialist and non-socialist commodity production exist? I answer the question by saying "yes" and "no" at the same time, and not with the intention of circumventing the question.

Commodity production has existed and at present exists under widely different social conditions. It has a few generally valid traits, and these are independent of the specific circumstances. There may be small commodity production, there was commodity production in ancient Rome, in the mediaeval guilds, and we find commodity production also in the capitalist economies. Also, different forms of ownership are simultaneously present, even in the same market. In any case, the interactions between the basic market categories—demand, supply, price, profitability—together play the role of economic regulator. The relations between the commodity producers are those of competition, while integration and cooperation relationships are organized by the actors of the market themselves. In this sense, there is only commodity production, without any attribute, and there is no such separate thing as socialist commodity production. If there had been commod-

ity production in Hungary before 1968 (and indeed there had been, even if in a much constrained and distorted form), it would have showed the same features. In fact, it was the precise aim of the 1968 reform to shift those categories and relations from the periphery to the centre of economy.

On the other hand, commodity production and market depend on the dominating specific forms of ownership in whose framework they function. From this point of view, it is not only justified to add the attribute, but there is no commodity production and market without an attribute. For example, it is well-known that big differences exist between commodity production based on simple reproduction (practically unchanged through decades and even centuries), and modern commodity production based on extended reproduction, and on fast and permanent technical progress. In the same way, it is difficult to draw comparisons between commodity production regulated by guilds, and Adam Smith's and Ricardo's capitalist commodity production of the 19th century regulated almost exclusively by the interactions of the market categories. Also, commodity production and market may be fundamentally different under the different development forms of a social system determined by an identical form of ownership. In the country with the most conservative and liberal government of our days, and which follows Friedman with the greatest enthusiasm, the state's influence on the market is incomparably greater than that of the government adopting the most protectionist principles in the first third of the 19th century. And let us continue! The commodity production that existed before 1968, and the one we started to bring about in 1968 are entirely different. The former practically served to promote the functioning of the command economy. Enterprises were given a certain amount of independence (today Soviet colleagues call it a limited "khozrazchot" system) to choose instruments and methods, so that they were able to fulfil more orders efficiently. As follows from the preceding, this degree of freedom did not cover either the selection of suppliers and customers, or production, or price fixing, i.e. the basic market decisions; this was because such independence would not have been compatible with the logic of plan directives. The 1968 reform was exactly the negation of the system based on plan directives. Thus it changed an essential element of the prevailing forms of ownership (even more broadly: it changed significant aspects of the social and political relations). It is, therefore, justified to use the attribute "pre-reform" and "post-reform" in connection with commodity production. Unfortunately, however, we have yet another attributive construction: that is, we have to distinguish between commodity production emerging prior to the 1972 counter reform, and commodity production realized afterwards; the latter was streamlined, formulated in terms of money, yet it again served only extensive economic development.

All this amounts to saying that it is not only possible to qualify commodity production and market with an attribute, but that, without an attribute, we have to do with an abstraction which does not provide any orientation.

So far in this article, I have deliberately avoided the real question. It can be put in the following way: do the attributive constructions "capitalist commodity production" and "socialist commodity production" exist? The scholastic reasoning given above was only intended as preparation for the asking of that question. That the epithet "capitalist" as against "pre-capitalist" is justified need not be proved. What has to be clarified is its relation to the epithet "socialist." Or is it the case that history has ended and now only the former exists—therefore, no attribute is needed any more? Is it a true statement, or is it ignorance to say: there is no capitalist or socialist commodity production, just as there is no capitalist shoe or socialist shoe?

The beginning of the story is that, theoretically, socialism was born as the negation of commodity production. It is true that in reality (apart from a few exceptional years at the beginning), what people have come to know as socialism has always been commodity producing; it has been accepted as such, and it has even been considered as its natural form of existence. Pedants did not accept reality and refused to consider the existing system as socialism, although the majority considered it as such. On a highly abstract level, even the assertion of Ferenc *Jánosi*[11] can be accepted that the existing system is pre-socialism. For it is true that what has been established is quite different from what it possibly could be: namely, if a form of the system were to come into reality more or less simultaneously in the advanced industrial countries. Those sticking to the original doctrines do not accept the existing system as socialism, because there is a market in it. Following on with this train of thought, socialist commodity production is an "iron hoop made of wood", and any reform aimed at enhancing the role of the market would carry the system farther away from socialism.

Someone acquainted to some extent with the current ideological and political changes should not be surprised to find how often those confessing widely different or even conflicting views end up at a similar or an identical platform. Similar arguments may be used if, from the construction "socialist market", the attribute is considered to be an "iron hoop made of wood". Put another way: if it is accepted that commodity production is determined by the forms of ownership, and socialist commodity production does not exist, the socialist nature of ownership must be denied.

To continue the story: not very long ago, every manual on political economy confronted capitalist commodity production with socialist commodity production by decrying the former and praising the latter. In this confrontation, capitalist commodity production was a reality only of the 19th century or at most of the '30s of the 20th; on the other hand, the socialist commodity production was a combi-

[11] Ferenc Jánosi's study, which discusses this question, has been debated at the Institute of Economics of the Hungarian Academy of Sciences. This author is not identical with the internationally known author of the book "End of the economic miracle". Ed's note.

nation of relations which were set as a target, and of an idealized reality. Even the handicaps of the real socialist commodity production were presented as advantages or even as a form of superiority. For example, the faster growth of demand than of supply in socialism has long been proclaimed as an advantage. In fact, this implies that there is a shortage of goods—what is more, as it is formulated, it indicates that there is an increasing shortage of goods. *Stalin*, at the 16th Congress of the Communist Party of the Soviet Union, held in 1930, put this in the following terms: "This is why with us, in the Soviet Union, the consumption (purchasing power) of the population is constantly growing, and surpasses the growth of output, thus stimulating production, while with them, the capitalists, quite on the contrary, the growth of the consumption (purchasing power) of the masses does never overtake the growth of output, it always lags behind the latter and frequantly pushes production into crisis. [1]

Such a view may also be adopted that shortage is an essential feature of socialist commodity production, as is the quality deterioration partly attributable to it, etc. This standpoint can be taken on a specifically pro-socialist as well as on a specifically anti-socialist platform. It follows from the former that a reform aimed at the development of the market is wrong, and from the latter that socialist commodity production as such does not exist, but is necessarily concomitant with shortage.

In reality, the changes taking place following the reform have undeniably shown that such a market may develop within the framework of a form of social ownership which displays the initial signs of transformation from a seller's market into a buyer's market. The buyer's market offers an increasingly wide range of goods and stimulates an organic technological development. It is upon the basis of such a market that an economy can start to make up for its lag. At the same time, not only do the general standards of living begin to rise, but a deliberate social policy provides for the redistribution of the additional income that can be spent. Taken together these elements actually made up the "golden age" and provided the basis of the consensus marked by the name of János Kádár. The experiences of that era also convince me that it is possible as well as necessary to create a market whose character is determined by a reformed socialist ownership.

However, what is the difficulty in defining the special features of the well-functioning socialist market? The difficulty consists in that, in the greater part of this century, the two social systems have not simply coexisted, but have existed in interaction on the same globe—what is more, in the same Europe. In additon to this, the forces of production are of the same type in both systems; although they may be more highly developed in the advanced capitalist countries, they are less developed in the capitalist countries of the third world (comprising a significant part of humanity) than they are in the European socialist countries. Interaction is demonstrated by the fact that the socialist countries try to adopt and apply the new technologies and new products; in order to this, they also have to adopt

modern market relations to an increasing extent, not only in respect of foreign, but of domestic relations, too. Meanwhile, a number of doctrines concerning the socialist market and socialist commodity production must be denied because they are regarded as incompatible with socialism. They are indeed incompatible with a certain interpretation of socialism. Such are: the market does not regulate production, the enterprises do not become commodities, money does not grow into capital, etc. We had already started to deny these doctrines during the course of preparing the 1968 reform. (I have deliberately omitted the dictrine: "labour is not a commodity." As I have mentioned, a labour market also functioned under the system based on plan directives. Thus far, the commodity nature of labour was being asserted in that system.)

On the other hand, socialism exerted a significant influence on the capitalist states, and primarily on the advanced industrial countries during the 1930s and even more after World War II. This is an undeniable though often forgotten fact. The determining role of planning and economic policy, the markets created by the state, the so-called social economy joining the commodity producing economy, a considerable "grants economy", extensive "extra-market consumption", and the humanitarian welfare policy ran contrary to the nature of capitalism and the traditional bourgeois ideals. Attacks against these phenomena are repeatedly launched. From that angle, even the Keynesian social democracy seemed to be too red.[12] Yet although capitalism suffered a general crisis during the 1920s and 1930s, it was able to renew its forces and hold its ground because it accepted and realized the integration of certain elements alien to its nature.

Today, the socialist countries face a similar challenge: the integration of commodity relations into socialism is a vital question. Without it, the socialist system will not be able to function in accordance with the requirements of the present era. It is true that those relations conflict with socialist ideas in several respects. All the same, they in fact correspond to modern socialism. What kind of relations are commodity relations? They organize cooperation and integration not in a centralized, but in a decentralized manner. (I am aware that the term "decentralized" is far from the best. I would, however, find it rather funny to qualify an integration organized by a multinational company as "built up from below" or as a "local initiative.") It is exactly such principles of organization that we are trying to adopt, beside the economy, in the social and the political life; similar developments are also taking place within economy, beyond the market sphere. The social security fund is in the process of being separated from the budget. This is an essential part of the trend which social democrats in the West—first of all in the countries with highly developed welfare policies—define by saying: instead of a welfare *state*, a welfare *society*. This principle of integration and cooperation may be contrary to

[12] President *Bush* had accused *Dukakis*, his Democrat Party opponent in the presidential election, of representing social democratic views.

the socialism of the 'thirties, 'forties, and 'fifties, but it is in no way contrary to socialism itself.

Now let us turn our attention to competition, a characteristic feature of commodity relations. Competition has been present in the economy before—though not between sellers but between buyers. Shifting it from the latter situation to the former is contrary to the socialism of the above-mentioned period, now over, but it is not contrary to socialism in general. What is more: competition is something we wish to extend beyond the market and even beyond the economy.

Finally, because of the historical interactions, there is scarcely a single special feature of the socialist commodity relations which is not at the same time a special feature of the advanced industrial countries' commodity relations. Nevertheless, they must be considered as the characteristic features of the socialist commodity relations, even if some are reimported from the capitalist commodity production. The most important characteristics are:

— Economic and social planning, and an economic policy and social policy strategy linked with the market economy, conforming to it in objectives as well as instruments (i.e. radically reformed).

— Security of existence. Simultaneous guarantee of an adjustable economy, and full employment, by means of development, training, retraining, money, etc.

— Allowing high remuneration for intellectual achievements, enterprise, and a risk-taking attitude. At the same time, to keep between limits income and wealth differences; to compensate social groups systematically defeated by the functioning of the market; protection of those in any way handicapped.

— To reduce the existing, and in the future further increasing, differences of chances.

— Company staff, especially its most progressive group (intellectuals, skilled workers) should take part in the control of company management, and be given the right of decision-making in issues within their competence (for example, choosing the forms of occasional wage payment).

— Diversity of the forms of social ownership; holding to a minimum the state administration property.

— Mixed economy, providing for efficient functioning of the entire economy, including that of social property. Within the mixed economy, predominance of public property.

We are as yet very far from all that. It is our great historical responsibility to decide whether we want and are able to establish those conditions.

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# WHAT IS A SOCIALIST MARKET ECONOMY?

B. HORVAT

1. In answering the question, let me first expose a widely believed fallacy. It is often argued that market implies commodity production and the latter generates capitalism. Consequently, market and socialism are incompatible. The error in reasoning is easy to see. It is not the market that determines a social system; it is, on the contrary, the socio-economic system that determines the *type* of the market. Let us consider ancient Rome. Its economy was accustomed to such entities as money, foreign exchange, banks, credit, interest rates, and hired labour. It included markets for commodities, capital and labour; it even had a market for human beings. All essential market ingredients were present. If one wants to coin a suitable term, one may call it the Ancient Market Economy. It was embedded in the social system known as slavery. Similarly, the meaning of the Socialist Market Economy depends on the socio-economic system called socialism. Thus, the question posed by the Editorial Board is transformed into a more fundamental question: What is Socialism?

2. With reference to the question posed, I wrote a comprehensive book where the reader will find the argument fully developed (*The political economy of socialism.* Martin Robertson, Oxford 1982.) For the purpose of this article, I shall simplify the argument considerably in order to keep the text short. Socialism is most clearly defined in *juxtaposition* to other social systems. *Liberal capitalism* is based on private property, competitive markets and the division of political power. Since capitalism generates class exploitation, alienation and other evils, simple-minded socialist believed that all these evils would be eliminated if capitalist institutions were simply negated. Thus, Bolsheviks conceived their socialism as a society based on state property, administrative planning and the unity of power (one-party political system). Formulated in this way, it is immediately clear that this socialism is simply capitalism turned upside down and so it does not transcend the limitations of capitalism. Since the moving force of the system is the state, I call it *statism.* Socialism, as it has historically evolved through its numerous revolutions and movements, is a project which envisages an equitable society. This implies an elimination of all concentrations of economic and political power. In other words, it implies radical economic and political democracy and a distribution according to work. In terms of institutions, socialism is based on social property, market-cum-planning and political pluralism without parties.

3. Social property is not a formal or legal category but a social one. In other words, all legal titles given to property—private, cooperative, collective, state, mixed—are compatible with social property as long as two basic preconditions are approximately fulfilled:

a) capital is socialized in the sense that there is workers self-management, and

b) exploitation is eliminated in the sense that there is distribution according to work.

4. It is unlikely that a political system without any concentration of power—i.e., without parties—is immediately possible. Thus, two or more socialist parties may be considered as a first approximation.

5. In the environment described by 2–4, the socialist market economy is unequivocally determined. One should bear in mind that an economy is a system, i.e. a complete set of interdependent units. Being a system, it can be automatically regulated. The market is an appropriate device. Where the market fails, regulation by intervention is introduced—in other words, planning. Contrary to the traditional view, market and planning are not contradictory; they are complementary. The market is a planning device; without planning a market cannot operate efficiently.

6. It follows that an enterprise, with its self-managing work collective, is a fundamental unit of a socialist economy. It is fully autonomous and makes all its decisions—about buying, selling and investing, internal organization and the distribution of income, about hiring and firing labour and appointing managers. It does these things independently. Thus, a "socialist market economy" is a somewhat confused phrase: *without* market there is *no* self-management and therefore *no* socialism. An enterprise is also a holder of property titles in legal transactions. Consequently, the members of the society are the "share-holders".

7. The Central Planning Agency—which covers the government with all its economic policy and planning agencies—has, in principle, no administrative powers. It operates by making use of instruments of economic policy—monetary, fiscal, foreign exchange etc.—and general laws passed by the Parliament. It must solve three tasks:

a) It must equalize the initial business conditions for all economic agents. In other words, it must bring about the elimination monopolies and windfall gains and losses.

b) In order to solve the first task, it must establish short-run economic equilibrium.

c) In order to achieve 7a) and 7b) it must also establish long-run economic equilibrium. That implies full employment and fast growth.

8. The autonomy in decision making means that enterprises will be free to use the available first-hand information to solve the problems on the spot. National economic planning implies that all available macro-economic information will be accessible to economic decision makers. Thus, a socialist economy should be an *information* efficient economy. Next, entrepreneurial independence and distribution according to work generate individual and collective initiative and hard work. Thus, a socialist economy is a *motivation* efficient economy. Finally, the market encourages *allocational* efficiency and planning for *growth* efficiency. In short, a socialist economy is an economically superior economic system.

9. How can the conclusion reached in 8 be squared with the low efficiency and deep crisis of contemporary socialist economies? The answer is simple: the economies in question are not socialist. For that reason they cannot be efficient.

Zagreb, 12th December, 1988

# MARKET ECONOMY—HUNGARIAN WAY

B. KÁDÁR

1. Quite obviously, the concept of the socialist market economy has grown into a "magic word" in the present reform wave of the Hungarian economy. Even the spreading of the concept is an indicator of the conceptual and contentual development of the Hungarian reform process. In its period of preparation and implementation, the major contentual element of the 1968 economic reform consisted of the replacement of the physical plan indicators fixed in the plan by financial regulation. This referred to a combination of plan and market; at the same time the systems of social objectives and institutions were left practically unchanged. Relative to the indirect control and management system which stressed the unity of plan and market and which was intended to replace the system based on central plan directives, it is a considerable ideological development to announce the socialist market economy. It is, therefore, not surprising that resistance is levelled against the use of this concept on the part of both the representatives of the traditional ideology, and the earlier economic management. My own dislike of the concept is rooted elsewhere—in fact, it has several roots.

a) The distinctive marks which actually make the epithet "socialist" were never clearly revealed. Everyday experience found already in the 1950s that the attributive adjective "socialist" in the pairs of concepts: competition—socialist competition, labour discipline—socialist labour discipline, humanism—socialist humanism, patriotism—socialist patriotism, etc. rather deprived the original concepts of something. In this interpretation, the conceptual inheritance of the term "socialist market economy" is in no way inspiring, and the attribute casts a peculiar shadow on the word qualified.

b) No better basis is provided by the approach which starts from the theoretical and *functional particularities* of the socialist socio-economic model. In theory, it has already been raised in the Soviet Union as well as in a few Central Eastern European countries, that the phase of full development of the commodity and money relations, and of the modern forces of production integrated into the international economic relations, cannot be bypassed in the course of universal social development. It is only after accomplishment of this phase that the material conditions for the creation of a classless society can be established.

In this approach, the Soviet social formation is seen as a heritage having been distorted by the Stalinism and is regarded essentially as pre-socialism. From this theoretical approach, the main point of socialism can by no means clearly be identified. The past ideology and the model parameters are, however, also revaluated at a fast rate when looked at from the angle of the practical forms of the appearance of socialism. The existing Soviet, Chinese, Polish, and Hungarian socio-economic practices today allow even less to identify socialism with state property, central planning, earlier class structures and distribution conditions. The parameter value of belonging to the Warsaw Treaty or the CMEA is rather doubtful.

The concept has also been *interpreted according to a scale of values.* Such values as participation, solidarity, etc. were no doubt not general in the initial period of classical capitalism, yet they are strong in the Scandinavian model and in general, in the socio-economic environment of the Western welfare state. Therefore, they cannot be used as distinctive marks of the Eastern European formation. It is another question, whether in the period of accelerating the historically late modernization or of the development and spread of crises, such elements of the scale of values are likely to take root and be preserved.

2. With reference to the consideration set forth above, I do not hold the term "socialist market economy" to be appropriate to indicate the desired state to be achieved by means of the changes being effectuated in Hungary. Of course, Hungarian society and economic control and management cannot wait for the conceptual clarification of the image of modern socialism and of the attribute "socialist". As for the essential point of the question as I see it, what really matters is that the acceleration of the lagging and earlier distorted modernization process of the Central-Eastern European countries, the averting of the imminent danger of crises and of being pushed to the periphery, and the development of new growth paths, necessitate the strengthening of market mechanisms, and the strategical development of the systems of objectives, instruments, institutions as well as of the social and political environment of the market economy. This process differs markedly from the model based on central plan directives or on the indirect control which is part of the changes; such a process is based on *the motive power of development that grows to be determinant for the real (not simulated) market mechanisms.* The higher the sensitivity to foreign trade of the individual Central and Eastern European countries, and the greater the necessity of adjustment to the world market, the more intensively and the faster the elements of a market economy can be developed. This necessity is traditional in the sphere of competition and is beginning to spill over into the sphere of infrastructure. Namely, the servicing and infrastructural sector determine the performance of the technology-intensive economy to a growing extent making up 60–70 percent of the GDP in the advanced countries and this cannot be withdrawn from the effect of the law of value either.

At the same time, the potential model of the Central-Eastern European market economy shows, for quite a long historical period, marked differences from the

market economies that have developed in Europe, or in the Far East, or in Latin America. In some of the Eastern European countries, the difference is in large part a heritage of historical development, since the market mechanisms had been underdeveloped there even before the introduction of the Stalinist model. What is more important: the *heritage* of the Stalinist and post-Stalinist model of the former decades must be taken into account in shaping the economic control and management system and social environment of each Central-Eastern European country. The traditionally underdeveloped market mechanisms were suppressed, and the inefficient production and sales structures developed in most part isolated from world economic development and under the veil of protectionism; household attitudes evolved parallel with the decline of the competition mechanisms and of the value of performance; the levels of capacities, the impossibility to see through the social, economic, and political environment, and the engagements in foreign relations all represent a lasting heritage and a limited scope of manoeuvring which cannot be abolished in the short or medium run by any political decree or change of trend, (let alone the consequences of "Schumpeter's" creative storm of a hypothetical market destruction).

The Central-Eastern European socio-economic environment has evolved on the basis of the last few decades' image of socialism; now it is to be transformed, basically but not exclusively, into a system operated by means of mechanisms of a market economy— though not through copying the market-conforming management techniques and institutions developed within the framwork of the Scandinavian model. It is fundamental to outline an image for the future in a long perspective; however, from the aspect of the treatment of the heritage strongly affecting the present and the medium-term future, the characteristics of the economic management system(s) to be developed for the *transition period* of the "long march" toward that future are of key significance for the development of the individual countries.

3. In Hungary, the only market economy model which can be developed and *operated*, is that which integrates into its set of objectives the particular scope of manoeuvring conditions and requirements of the transition period. Also, it should fit into its management technique the constraints arising from the heterogenous social and economic development standards and capacities, and from the population's limited tolerance of conflicts, and further, expedient government objectives. The management system is not an autonomous objective, but a fundamental instrument for the improvement of the life of the countries, i.e. of their people.

The main task of the Hungarian economic strategy and economic management system is to put a brake on the unfavourable socio-economic processes that have grown strong in the last decades, to prevent an imminent crisis, to launch a modernization process—since it has been distorted before—and to start to catch up with European development. These tasks of historical importance necessitate a considerable shift of weight in production and supply, in foreign relations, and in

income distribution. All this should take place within the framework of a strategy of opening and adjustment to the world economy, in harmony with the country's growth potentials. A new development path shaped so as to renew the pattern of supply demands considerable additional resources. This necessitates the stimulation of intellectual and physical capital formation, recognition of capital returns, improvement of the functional efficiency of capital property, reforms concerned with ownership, and the development of mechanisms and forms of ownership enabling reallocation of capital. A small country's economy is sensitive to foreign trade and it cannot be operated for long without *advanced* forms of *competition mechanisms*. Consequent upon the necessity of modernization, the debt service, and the inevitable restructuring of markets, the chances of future development are determined by the success of the new foreign economic orientation. As a consequence of the monopolistic positions established on the domestic market, the purifying effect of competition is to be expected primarily from imports. The increase of imports is, however, restrained by export capacities and balance problems.

The insufficient impulses for improving competitiveness—due to the relatively backward state of the market relations—must be strengthened in the period of transition by coordinated measures taken in the *government sphere*, as distinct from the European market economies. A well-coordinated strategy of the following will be apt to create and enhance permanently effective propelling powers for a new, world-market-oriented Hungarian growth path and economic management system: in the passive sense deregulation, i.e. the abolition of the system of administrative rulings, legislation to influence economic processes, liberalization, restriction of the budget; and, in the active sense, a structural policy aimed at enlargement of supply, control of state property, technological development, training and education, foreign market development, infrastructural development, and market-conforming techniques such that they will also affect CMEA cooperation. Emerging competition mechnisms, and accelerating restructuring are bound to sharpen conflicts of interests, which in turn demand adequate mechanisms for the handling of conflicts. In the period of transition therefore, a strong and active government is wanted, with functions covering a much wider area than that customary in Western Europe.

The road leading to a market economy is by no means a growth turnpike but a narrow track with whirly streams and precipices on either side. The system of economic management that will be reached at the end of this road should not be qualified in any way as yet. A possible success of the belated modernization may largely depend on how much partial interests can be suppressed and made subject to the interests of the country: the *societas* of the entire nation, to "Hungary incorporated". It is in this sense that, in the period of global development, the economic management system, establishing itself in the course of the modernization process, can receive its apposite complement: market economy Hungarian fashion.

# THE SOCIALIST MARKET ECONOMY—MYTH OR REALITY?

P. KNIRSCH

In the field of economics, opinions vary considerably about the importance of formulating definitions that are as precise as possible and generally acceptable. Certainly efforts to develop clear definitions will always be regarded as an honorable scholarly pursuit, but the benefits are frequently very limited in comparison to the intellectual effort they demand. Furthermore, conceptual hairsplitting or individual ambition aimed at developing one's own conceptual system can even be a direct impediment to the acquisition of scientific knowledge.

The social phenomena that economic definitions are intended to describe can be very different in nature: Concrete facts, for example statistical measurements, can be defined and described in terminology that may differ for historical or cultural reasons, but conceptual clarification of such facts is still possible (even though this may require considerable effort at times). However, definitions of more complex economic phenomena that can very quickly be burdened with value judgements have a different connotation for each individual who employs them, depending on the respective social value system, and it is by no means possible to settle such conceptual differences by means of rational discussion: On the one hand, the structure of the phenomena themselves is usually too complex, while on the other hand the ideological preconceptions linked to such concepts are usually too strong.

The term "socialist market economy" obviously belongs in this second category—if it can be defined at all, this term can probably only be defined autonomously and more or less arbitrarily by each individual who uses it in accordance with his or her scientific interests. This is certainly not a term generally and immediately understood by everyone to mean the same thing based on the words that comprise it. On the contrary, each person using this term can be expected to understand it differently and to view it positively or negatively depending on his or her conception of the world. At first the term "socialist market economy" seems quite convenient, but significant problems arise when it is employed in connection with scholarly communication or for the clarification of interrelated socioeconomic factors. For these reasons I personally have not used this term in my past work and therefore cannot explain what I think it means. In the following it will only be possible to consider the implications of the "socialist market economy" as I understand it, and in this connection the discussion will be limited to real types of economic systems.

I may be taking a somewhat naive approach by beginning with an analysis of the words that make up the term "socialist market economy." In this connection, I find it less difficult to define "market economy" as a conceptual component, even though ideas about the corresponding economic system vary in accordance with ideological preconceptions—in classical liberalism, the market economy results from

a theory of harmony, while in classical Marxism it is the main element of a theory based on conflict.[13] In my view, the following seems to be a very simplified but acceptable definition of the term "market economy" as a concept of an economic system: In a market economy, "in principle, economic planning, decisions, and actions should be decentralized and coordinated by the institution of the market." [2]

It would be easy to fill a book with a discussion of this seemingly clear and simple approach to defining the "market economy." For the purpose of this brief discussion, it seems of primary importance to clarify what "decentralization" means. In the simplified approach being applied here, decentralization is understood as the autonomous planning competence of all economic units participating in the market on the basis of corresponding rights of disposal. For the most part, the non-Marxist German literature views private ownership of the means of production and freedom of contract as preconditions for the realization of these elements that constitute a market economy, and usually a market economy is considered possible only in the form of a "capitalist market economy."

At this point we are already confronted with the ambiguity of the term "socialism" as the second component of the term "socialist market economy" to be considered. There have always been very different views about the nature of a socialist social system, some of them characterized by great ideological fervor, and in this connection it is above all social democratic and communist positions that have contrasted sharply with each other during the past decades. The official definition of socialism in the socialist countries of Eastern Europe after World War II was clear: According to this view, the socialist economic system is based on social (state and cooperative) ownership of the means of production and on centralized state economic planning. There was no room in this model for the "market economy" as the dominant system of coordination; only market relations were acceptable in a role subsidiary to central planning (usually called commodity-money relations or the operation of the law of value).

However, this dogmatic model of socialism did not completely exclude speculation about combining a "socialist" economic system with market coordination. Even if we disregard discussions on this subject by socialists in the West (in Sweden, in the British Labour Party, and in the 'Godesberg Program' in the Federal Republic of Germany), which assigned the market economy a significant place in the economic system but were rather unclear with regard to the socialist system of ownership, it is interesting to note that such issues were also discussed in the socialist countries of Eastern Europe. As early as 1951, serious attempts were made to introduce market coordination in Yugoslavia by replacing centralized planning with market relations to a large extent, while at the same time the "socialist" nature of the system was to be preserved through a system of worker self-management. [3]

[13] I am forced to present my arguments very briefly in this short contribution. For a much more detailed presentation, see [1].

In any case, the partial or complete substitution of market coordination for centralized planning has been discussed (with differing degrees of intensity) since 1956 in many socialist countries (Poland, Hungary, the GDR, Czechoslovakia, and later in the People's Republic of China), for the most part in connection with efforts to overcome lack of efficiency in planned economies. At first glance this concept of a socialist market economy seems clear: Social ownership of the means of production continues to exist and represents the most important ideological element of socialism, while market coordination provides the economic efficiency needed by the system.

In my opinion, this conception is highly formalistic and unrealistic—what is worse, it combines incompatible elements from different systems. As already stated earlier, autonomous planning competence and independent rights of disposal for all economic units participating in the market, as well as corresponding responsibilities, are indispensable prerequisites for a market economy. If the economic units are granted such authority by society (in the past always represented by the state), social ownership of the means of production is completely undermined—at the most, it remains only as an empty legal formality. In fact, the distribution of economic competence and thereby of economic power means that such socially owned property is controlled by the individual economic units (and, if market coordination is to be effective, it must be—this is precisely the problem).

The present contribution is too brief to permit the discussion of possible objections: One widespread idea is that a formal commitment to social ownership of the means of production will be able to ensure the redistribution of income and thereby contribute to greater social justice (whatever this may be understood to mean) as well as being able to prevent egotistical abuse of economic power. I greatly fear that, exactly as has occurred in modern Western economies, such forms of intervention will very quickly lead to decreased efficiency of the market system, and that the socialist market economy will end up as an unstable system torn between the claims made by centralized state ownership on the one hand and the necessary genuine decentralization of decision-making powers on the other hand.

However, there is still another reason why I believe that the formalistic definition of the socialist market economy as a combination of social ownership of the means of production and market coordination can no longer really apply. During recent years, completely different "new thinking" about the constituent elements of socialism has occurred in some socialist countries of Eastern Europe—in Yugoslavia, Hungary, Poland, and the Soviet Union. This thinking has by no means led to a satisfactory conclusion: There is agreement that the formalistic definitions developed thus far are not suitable as the basis for a new social system that is both humane and also capable of functioning efficiently. During the present, infinitely important phase of discussion the most honest participants seem to be those who admit: "Today we do not yet know what socialism is supposed to be."

During the course of this discussion, which is of extremely great importance for the movement toward greater emancipation not only in the socialist countries but throughout the world, the assumption that social ownership of the means of production is a necessary prerequisite for "socialism", which had been unchallengeable dogma in the past, is now being called into question and relinquished to some extent. Pluralistic concepts of socialism that sometimes leave considerable scope for private ownership of the means of production are now being advocated and discussed. This development has resulted from the realization that the functional weaknesses of socialism in its current form are due not only to central planning, but also result from state ownership of the means of production. As mentioned earlier, such considerations are extremely important for developing a new concept of a socialist system that is socially just and economically efficient. However, due to the present state of discussion, the current definition of "socialism" is extremely vague and open to change. All this is necessary and very positive as far as social development is concerned, but it does mean that the term "socialist market economy" has very little concrete or even generally accepted meaning. It is not inconceivable that, at some time in the future, a clear concept of socialism as an economic system that is also compatible with the market coordination mechanism will be found. However, at present no such concept exists; the term "socialist market economy" lacks any specific contents and is predestined to be defined arbitrarily. It is perhaps even a myth for some thinkers—but of little value for providing a meaningful explanation of reality.

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# THE MARKET MECHANISM IN THE SOCIALIST SYSTEM

F. KOZMA

## I

Whether a given *social* system is socialist, or capitalist, or feudal, etc., is determined by the *vertical* structure of its production relations. A *wholly* socialist society is one in which at all levels the organized communities of workers and consumers collectively dispose—at all levels— of the factors of production and its yields; and where mobility is freed from earlier bonds—that is to say, the optimum trend of organization of the human factor by qualification and talent prevails. The socialist system also has its specific forms determined by time and space, and these may differ widely.

As against this, the market or natural character of an *economy* is determined by the *horizontal* structure of the production relations—namely; by the forces that shape the combinations of production factors, the sectoral (capacity and product) structure, and the production organization pattern of the social division of labour; by the interest relations leading the economic actors to work towards growth, equilibrium, innovation; and finally; and by the criteria determining the size and dynamics of the wealth and current incomes of individuals, producer communities, and nations. If such processes are regulated by a system of *exchanges* (sales and purchases), effectuated with a view of *financial gain*, it is a market economy. If the *"do ut des"* relationship does not mark the flow of products, services, and information in society (i.e. the passing of these from one economic actor to the other is not conditioned by recompensation), or no vital interest is attached to recompensation, it is a natural economy (irrespective of where and to what extent it uses or does not use money as a unit of measure for social labour).

## II

In its "ideal-type", never seen form, the market economy excludes all alien factors, such as:

— natural (physical) relations, guided by factors other than demand and supply;

— monopolies;

— public authorities' interventions.

In reality, such a pure form has never existed; this is a theoretical model which nevertheless reflects reality, with certain changes, as long as:

a) the market field is a *relatively homogeneous* one, i.e. the mere existence of stronger economic units does not prevent the weaker (smaller, beginner) units in

holding their ground in technical development and on the market; namely, as long as the *advantage* of the stronger is not overpowering.

b) the market field is *dispersed*, i.e. the *weight on the market* of an economic unit (its share in demand and supply, employment, R&D, etc.) is slight, having no *macroeconomic* significance.

c) the market is in a *primitive* state; that is to say, the overwhelming majority of the relations between economic units are *simple business transactions*, with practically no complex technological and market relations.

d) the overwhelming part of market transactions are effectuated on the *domestic* market.

With the appearance of the *modern economy*, however, the market has undergone radical "anatomical" and "physiological" changes, which have *essentially altered* its functions and the ways of its functioning as compared with its state in the mid-19th century:

— *Oligopoly* has emerged, and oligopolistic competition with it, as one of the basic tendencies of the modern economy; the market has divided into three spheres: first, the conditions of "free" competition of the earlier market have appeared in the form of competition between the huge oligopolistic firms; second, *uneven conditions of competition* have developed between oligopolies and outsider firms: third, a kind of free competition survives among small and medium firms, as a remnant of the earlier, "classical" period.

— *Integration* has appeared: this is another fundamental tendency of the modern economy, and it increasingly permeates economic relations as a reaction to oligopolistic competition; on the one hand, *big firms* establish long-range relations among each other and with outsider firms by means of contracts, or integration of capital; on the other hand, by expanding the state's role in the economy, they *force* all actors in the national ecoomy to integrate. Small and medium firms partly "give in" to the integration dictated by the big enterprise, and partly they organize their own integrations. (See, for example, the special development of the cooperative movement.) Further, they also seek protection from the state by pressing for protective measures for the small enterprise.

— Oligopolistic competition as well as integration have started *international* expansion on both the regional and global scales.

— As a result, no short-term economic decisions can be made in the micro-, mezo- and macroeconomy without a *clear strategy*, nor can strategic decisions be made without giving regard to the projected *market situations*.

In a market sphere where oligopolies prevail (i.e. in which the economic actors are of widely different powers, the dominant big enterprises each have macroeconomic weight, and an intricate web of integrations has developed baside competition) it is necessary to guide economic processes with a view to their coordination and orientation towards long-term objectives. This is required to counterbalance

the disturbing effects of the oligopolistic competition on equilibrium and development, to provide room for the functioning of integrations, and to assert strategic viewpoints in the macroeconomic changes. It is the essential point of the qualitative change taking place in the market sphere. Namely, in a homogenous, dispersed, and primitive market that need for coordination is still in an embryonic state: the conditions are not yet present and their lack is still bearable, since the tensions caused by the lack of coordination and symmetry are resolved by the automatisms of free competition at the cost of tolerable conflicts (periodical recessions of production).

*Planning* is, therefore, made necessary, and is forced out by the development and existence of the *modern market* (in fact, that is what it is all about: planning is essentially the coordination of economic processes and at the same time their guidance, so that they fit in with the strategic objectives). *Planning is no protagonist of the market but it is a condition of the functioning of the modern market.* The planned economy is not deprived of its market-economy features, but is saved from collapse through planning. Therefore, it is wrong to ask whether an economy is a "planned" *or* a "market" economy, since this does not make sense at the end of the 20th century; (such question only testifies to being mislead ideologically perhaps to professional illiteracy). Today, an unplanned economy is as non-viable and dysfunctional as is a planning system trying to exclude market relations and automatisms.

I would stress that I consider the socialist economies of the 20th century as essentially market economies because I interpret the term "market economy" as signifying a *modern, totally oligopolized structure, functioning in the form of a deeply integrated and strategic market which needs planning and is viable only with planning.*

## III

The small countries of the Central-Eastern European region, and also the large-scale economies of the Soviet Union and China have the following disadvantages as compared with the small- and medium economies of Western Europe and the large-scale economies of the USA and Japan:

— interior technological equipment;
— a 1–1.5 generation's gap in accumulated knowledge;
— outdated sectoral and product pattern of economy;
— low degree of integration into the financial, technological, and business information processes of the world market;
— low standards of organization and management;
— high debts.

All these are, however, not naturally concomitant with socialism, but they are the natural consequence of the region's traditional *backwardness* through the

centuries. This would have been impossible to eliminate in seventy or in forty years even if the double "change of generations" in the technological and economic development had not taken place in the most advanced regions. It is also true that the almost superhuman efforts made at eliminating the lag were conceived under a strategy which was already outdated in the 1950s. The lag is manifest mainly in the following two aspects:

a) relative to a more advanced and more efficiently functioning environment;

b) in comparison with the needs of the population, in their capacities both as producers and consumers.

## IV

At the end of the 20th century, the market is a global phenomenon. By the mid-century, characteristic regional formations had developed, showing that they were on their way towards homogenization. They were connected with one another and with other parts of the world through an increasingly global financial system and the emerging network of international forums for negotiations. In the second half of this century, the financial system has become globalized, in the same way as the technological and business policy information network, and like the transnational giant companies with their producing and servicing activities covering practically all basic fields. As a result, the basic situation seems to be moving in the reverse direction: *the world market is no longer seen as a derivative of the national markets; instead, regional and national markets have begun to function as derivatives, "bays" of a uniform and global market.* A national market can *join* into that system as a *deeply or superficially or tangentially integrated segment*; it may have a place *in the centre, at the borderline of the centre and the periphery, or in the "inner" or the "outer" ring of the periphery.* The place of a given economy in the global market system in a given period does not exclusively depend on its own foreign trade policy intentions. A policy may be important in the launching of processes or in changing their trends, whereas the prospects of launching the desired processes, or the reaction time of the latter, are more dependent on the given circumstances and the intentions of the powerful centres, than on the political will.

The socialist countries' positions in this matrix of the world market vary widely, yet they do display a few common characteristics:

— none are deeply integrated;

— none have a place in the centre.

This is a source of a dilemma, as is the backwardness in the technical, economic and cultural spheres: as long as an economy's place is on the periphery, its deeper integration into the global economic system can only take place under a kind of "neocolonialist" model. On the other hand, as long as it is only superficially

connected to the development centre, it is hardly able to acquire the capital and information wanted for emerging from the peripheral state. Also, opening towards capital and information amounts to renouncing a (quite big) portion of sovereignty over development and balance conditions. Almost all the countries finding themselves in such a situation—primarily the socialist states—have for decades been experimenting with a hybrid solution: they opened *structurally* and remained closed in their *trade policy.*

## V

The character of the market of a given socialist commodity-producing economy is therefore basically determined by its pattern of concentration and centralization, the state of its forces of production, and the degree and manner of its integration in the world market. Accordingly, a market is not "socialist" or "pre-socialist"; instead, it may be, in its form of development, *adequate* to the state of the country's economy, or it may be *anachronistic*, or *utopian*, or *artificially distorted.*

A vertical structure *affects* the market as a matter of course, without, however, determining its existence or non-existence, or even its basic character.

If, in the final analysis, socialism differs from the earlier capitalist system based on market economy in that it essentially seeks *balance*—and in fact finds it to a certain degree—between the *incentive or force* of social conditions to *increase performance*, and the *need for existential security* of the overwhelming majority of the population (by means of collective ownership and decision-making, and mass mobility), it can be achieved best through *a flexibly and complexly planned market economy. An unplanned market fails to guarantee any security, and if market is forcibly excluded from planned development, it stifles the incentive and force for increasing performance.*

A flexible and complex planning of the market demands, first, a deliberately developed and publicly approved *strategy* in which *all* actors of the market take an *active* part; second, a *coordination* mechanism which makes effective and systematic use of all the monetary, fiscal and administrative (legal) instruments (in the majority of cases, the most fortunate seems to be if the *definite* character of a system is determined by the monetary regulation and control system); third, integration into an *international* cooperation network in which the mutual relations of the socialist countries leave enough room for each member economy of the integration so as not to be compelled to resort to exaggerated and rigid protectionism against the capitalist sector of the world market; fourth, in order to make this market operational, the distressing scarcity of resources must be gradually eliminated.

The socialist quality of a market is, therefore, not to be found in the essential characteristics of the market (just as there is no "socialist machine tool" or "socialist conjugation"), but *in the broadly interpreted societal scope and objectives of its functioning.* Therefore, the objective of making the market economy serve, as best it can, the full development of the socialist society, is not to be achieved through desperate experiments (doomed to failure from the outset) to render the market somehow "more socialist"; instead, it is to be reached by taking a *fully realistic* account of all possibilities, constraints and consequences following from the basic structure and development standards of the economy, and from its foreign economic environment.

## WHAT IS THE SOLUTION?

### M. LAKI

If the word "socialist" is the attribute of some movement of the modern age which has set as its aims equality of people (and within it, the equality of opportunities and the support of the handicapped) and which strives to build up a democratic society guaranteeing basic freedoms to its members, then the socialist market economy ought to be searched for somewhere in Scandinavia or at least in the advanced countries of Western and Southern Europe. I am, of course, well aware that the all-round inquiry was aimed not at detecting the advantages and also doubtless disadvantages of "Scandinavian socialism", but at studying the question of whether or not it is possible for a modern market economy to exist in countries governed by communist parties—such countries being characterized by the preponderance of state ownership and qualifying themselves as socialist.

The stress should be put on the word "modern", since (this is an empirical finding) it was not possible to liquidate several forms of the market, i.e. the numerous forms of commodity exchange between the participants of the economy, even in the darkest periods of terror. The black market was active, the raw materials or components stolen from the factory reached the consumer, and people rendered some services to one another as compensations for goods. The function of money was fulfilled by gold, by the meat- or bread-coupons, or occasionally by toilet paper when this was in shortage. Also, although I am not fully informed about the nature of economic transactions in the "hard" planned economies (North Korea, Albania), I venture to say that even today there is no socialist country where—using the words of János *Kornai*—bureaucratic and aggressive coordination has been able to completely supplant market coordination. Hence the answer to the first question (put by Acta Oeconomica): socialist market economy means the totality of market operations transacted in the socialist countries by the participants in the economy (either legal or illegal ventures and/or households).

If the original (Leninist? Stalinist?) idea—that the party-state operates the economy on the basis of the instructions of a central plan—had been successful, and the economies operating on this basis had enjoyed a state of high prosperity, hardly anyone would be worried about socialist market economy or about the nature of the market operations which play a subordinate part in the economy. We know, however, that the socialist economies have, since their birth, struggled with serious troubles. In these economies aggressive and bureaucratic coordination (involving campaign, plan instructions and summation of the plans) has been the fundamental force of integration. This type of economy has been, from the outset, characterized by a shortage of commodities, by irrational and wasteful utilization of the factors of production, by fluctuations in production and in the circulation of products, and by a low innovative capacity. All this (and its concommitants, such as the massive terror inflicted on the people) may have been regarded by some as the cost of industrialization and rapid growth. However, forced growth has lost its wind, but its results, i.e. the catastrophic conditions of infrastructure and environment, continue to afflict the population.

There are many who blame these negative features of the socialist planned economy on planning errors and/or poor implementation, and they think that disciplined work and better planning might improve effectiveness of the system. However, the view that insufficient performance and negative results are immanent characteristics of the system, began to evolve at a very early stage in the life of the system itself. There were some people who, seeing it, considered socialism as a hopeless matter, while others thought that by modification (reform) of the given forms of the management system (in other words, the economic mechanism) most of the above-mentioned negative characteristics could be eliminated. According to the latter, oversupply in the market and, together with that, competition between the sellers could be created, even beside communist party power and preponderance of state ownership. Such developments would eliminate the system's resistance to innovation, wasteful utilization of the productive forces, and the shortage of commodities. Thus, the supporters of this view—the reformers—wish to create a socialist market economy.

Here we find a new definition of market socialism: it is a school of thought or a movement concentrating on developing and testing in practice a model of economy under guidance of the communist party. It is characterized by the preponderance of state- and cooperative ownership and relies on the integrating power of the market. (We must admit that replacement of the party's power by parliamentary democracy, and changing the prevalence of state ownership into the preponderance of private property would mean following the principles of the above-mentioned West European model.)

A very important difference between the two definitions is that the subject of the former one is "existing", while that of the latter is something that "should be". While, with regard to the markets existing in the socialist countries, it makes

no sense to put the second question in relation to the capability of their operation, it still remains a very difficult question as to whether or not the experiments in thought and/or the models of a socialist market economy do work in practice.

With regard to the latter, only very cautious statements can be made. It is known, for instance, that the attempts (of reforms) to extend the sphere of market coordination carried out so far have revealed that significant (economic and political) forces still resist the extension of the market. It is also known that the system's "propensity to restoration" is very strong, and the eventually introduced institutions of the market (for products, labour, money or capital) are often and rapidly able to readjust to the remaining elements of the former economic management.

It would be fine to consider resistance and adjustment simply as factors which reduce the chances of introducing the market economy. Unfortunately, it cannot be excluded that more and different things are at stake. Namely, these obstinately reproduced phenomena demonstrate precisely that basic particularities of the system (party-control, state property) are at the same time the most powerful obstacles to the creation and operation of a socialist market economy.

The poor efficiency of state-owned enterprises which utilize the advantages of the soft (softening) budget constraint, and relationships of subordination are serious problems even in the advanced market economies. Also, it is well known that the conduct of the non-publicly owned, hierarchically organized monopolistic or oligopolistic organizations tend to exclude competition and resist innovation. Thus they shift costs onto the market and combine shortage with price rises. Though these are working in demand-constrained economies, under the conditions of national and world-market competition, they are unable to become dominant in either the national or the world market, despite their considerable weight. The trade unions, as well as the movements of environmental protection also reduce the influence of those big corporations intertwined with the state and/or predominant in the particular commodity markets. All things considered, it seems that in such economies the effects of the state monopoly sectors mentioned in the foregoing are more or less succesfully avoided. This is due to market competition, the small weight of the state-owned sector, to the above-mentioned countervailing powers and to the controlling bodies of popular representation and civil initiatives.

The chances of this situation occurring in "existing" socialism are very small. In the state-owned sector there is an intertwining of the enterprises and the party apparatus, and the state administration is very strong. Also, the domestic and the CMEA market are protected against world-market competition. Taken together, these features do not represent real countervailing power. Neither do the pseudo-trade unions which are organized for mobilizing the workers rather than for the protection of their interests. The trade unions serve the power of the party and the state, or the nationalized environment control. The parliament, which specializes in appreciative nods, does not control or resist the economic activities of the government and initiatives originating from civil movements are rather rare because of

the heavy risks. Thus, the preponderance of bureaucratic coordination, resistance to innovation, the shifting of costs onto buyers, the shortages and the black and grey markets, and the interspersed corrupt elements, continue to exist.

What is the solution? Is there any?

I don't know. The radical reformers regularly (and rightly) speak about: import competition, free trade unions, decentralization, deregulation, privatization, multi-sector economy, and the withdrawal of the party from the economy etc. In my opinion the decisive factor is the extent of such measures. If the recommended changes affect the economy to a small extent only, the traditional Soviet-type socialism will continue to exist, and the market will not be, even later on, an integrating power in the economy. If the system is completely transformed, market economy will develop; but what will then remain for those who wield power at present?

## A NOTE ON MARKET SOCIALISM

M. LAVIGNE

Some minimum requirements are to be met:

A radical economic reform implies:

— an end to central planning with set directives and compulsory tasks;

— competition between state enterprises (with a change in the industrial structure so as to allow for enterprises of different sizes, and a dismantling of the monopolistic pattern of state industry);

— introduction of (and genuine incentives to) cooperatives and private enterprises or activities;

— overall "monetization" of the economy including the creation of capital markets;

— introduction of a "hard budget constraint" for the enterprises, implying legal procedures for bankruptcy, and regulations for unemployment arising from bankruptcies and from an overall change in the industrical structure (i.e. a shift toward modern sectors and the development of services, along with a dismantling of traditional "stalinist" industries).

Of course this is more easy to say (or write) than to put into action. In particular, political (the introduction of a real democracy) and social conditions (to ensure the consensus of the population) are to be met as well.

"Market" socialism requires a definition of the nature of the market and of the property relations which should govern it. A market socialism is not tantamount to a "mixed economy" of the type one may have in countries where there is a strong state sector along with a private sector.

"Market" socialism should both protect the socialist society from undesired income distribution effects linked with the operation of "market capitalism" and

retain some "socialist values" pertaining to socialism. The problem is that socialist values have been so much "devalued" by decades of empty propaganda that it is difficult to make them credible. What strikes me, for instance, in the Soviet case, is the high value attached by the authorities to the notion of *miloserdie*, i.e. charity, which is obviously a religious value. Using it in the context of a lay society is very ambiguous. It may imply that some of the "normal" tasks of a socialist government—for example, ensuring a minimum of welfare—might be performed by individuals if the state cannot carry it on.

There is a need for redifining both "socialism" and the "market". Many Eastern European economists have very "naïve" views as to the advantages of the market. This is not to say (as has been claimed by a French economist) that all economists are addicted to "walrasian" ideas. It is just that, from lack of experience, they believe in the virtues of the market—especially as the first experiments of freely operating economic agents show good results. Such successes demonstrate not only the benefits of a market but also, and probably mainly, the evils of the plan. As for "socialism", I feel that most people in the East no longer believe in it; they take our (i.e. Western "left-oriented" people) committment to socialism as something romantic and *passé*.

As for me I am concerned with the limits of the process. If we have:

| | |
|---|---|
| traditional command economy | market |
| soft budgetary constraint *à la Kornai* | hard budgetary constraint |
| resource-constrained economy | demand-constrained economy |

←————————————————————→

then, when moving from the left to the right, is there a moment where we actually depart from "socialism"? Is the movement irrelevant to the nature of the system as long as we feed in some non-economic considerations? If it is, then what is the economic specificity of socialism?

Our colleagues from Eastern European countries are looking for answers and in return we are asking questions. However, I think it is really a matter of joint exploration.

I think that we also should frankly address some "mythical" views expressed about modern capitalism among intellectuals in socialist societies:

— "one should encourage differentiation of incomes in order to increase efficiency and not be afraid of some people becoming richer and others poorer. After all, there is more poverty in some socialist countries than in developed capitalist countries". This may be true, but only because the socialist economies are underdeveloped; they will not become developed by allowing some people to become rich; they will develop as a result of a policy of modernisation in which social costs will be borne by the collectivity;

— "world prices are rational prices". World prices are manipulated prices just as socialist prices are, but along different principles; rationalising from outside is not the solution; domestic conditions have to be taken into account first, and not all prices have to be set by the rules of the market;

— "unemployment is not such an evil. After all, the unemployed in the West live quite well on welfare benefits, and some are even able to take holidays in our countries". Unemployment is a terrible social evil, which undermines the society. Do not play with that;

— "high prices will clear the market and end shortages". Perhaps this "cliché" is already worn out as the Polish experience has been so illustrative of its irrelevancy. Anyhow: high prices do not clear the market when the gap between demand and supply is enormous. Here again social considerations have to prevail over economic rationality.

February 1989

# MARKET ECONOMY WITHOUT ANY ATTRIBUTES

L. LENGYEL

The question to be answered is: Does anything like a socialist market economy exist, and if it does, can it be operated? In my opinion market economy exists without any attributes: it is neither socialist, nor capitalist. In a certain sense, market is categorically neutral. As there is no socialist price, wage, exchange rate, interest, or even socialist world market with laws which are different from the general laws of the world market—though for a long time it was held to exist—a socialist market economy does not exist. All this does not exclude that in an economy of socialist character, which gives priority to common (public) interests, the market can be influenced by means of social institutions.

Considering a market as socialist would imply the assumption that an internal modification of the laws of the market is possible such that it would mitigate or even completely eliminate internal contradictions of the market economy and would, at the same time, not raise new, more difficult socio-economic problems.

The countries of "existing" socialism, following both the Soviet model and the Yugoslav and Hungarian type of compromise and bargain model (others call them models of direct plan instructions and models of indirect regulation) tried to entirely eliminate or to internally adjust and deflect the market. However, they failed. The crisis in both the Soviet-type and the compromise-bargain-type economies shows that in the case of such solutions, at the beginning, only certain difficulties (owing to the wastage of capital) appear. Then, enterprise and sectoral crises follow; later

on growing inequalities appear between regions within the country; and eventually, serious economic and political problems emerge in some, or even in all countries. Readjustment of the direct command system to a system of discrete corporative bargains and agreements aimed at imitating the market is but gaining time—even if not a negligible time—prior to the crisis. Thus whether we want it or not, there is a single world market where regulation is made by some kinds of uniform norms. Any type of socialism follows, and even must follow this, only afterwards. The question is therefore not whether socialist market economy exists or not but whether the institutionalized impact of socialist movements—furthermore, of socialist ideas, values, the socialist organizations of society and communities—can exercise any influence on the operation of the market.

Let us look at the possibilities one after the other. Obviously, the most important socialist ideas will and must influence the market. Such are: equality, the endeavours to equalize social opportunities, the spirit of community, social solidarity, and an order to grant anyone the right to display his or her abilities; also, we should include the taking of measures against monopoly inherent in ownership—be it state, private or limited group-ownership—and the assertion of a certain foresight, for the sake of protecting and recreating the human environment. Usually the trouble is linked not to the ideas but to the organizational intervention which attempts to press them into the economy and society. These are the occasions when the state and/or huge groups representing various interests suppress human liberty under the pretext of equalization; they identify the property of state administration with that of the members of society and in this way deprive the individuals and the community of their property.

Is it possible that a system of mixed ownership, influencing the market economy, could exist in such a way that the ownership of self-governing communities, of the various public foundations and funds, and of self-managed associations and individuals could live side-by-side? From what respect will these properties and/or ownerships come into conflict with the market? Only if they become interested in nothing but the return of property and capital, and the decisive criterion of obtaining and maintaining property will be adjustment to the market. What can make this system socialist, or more of a social type than the systems that have existed so far? In this system there will not be a lower return of capital but a more equal possibility to obtain property. The difficulties involved can very well be seen from the fact that socialist thinkers thought it possible to solve more equal and monopoly-free access to property sometimes through state ownership, sometimes on the basis of self-government and autonomy, and sometimes by inheritance proceedings or shares to be distributed to the people. For my part, I think that Tibor *Liska* is right when he says that both private and state monopoly are harmful, and the fact that we at present experience the serious troubles of state ownership does not change this truth. Linked to the reform of ownership, without which not even the hope of getting out of the crisis can exist, we have to experiment parallel with

the common funds of self-governments, autonomous units, pension funds and with individual private ventures. If the owners compete in the market and if regulation grants no favour to any kind of property, we may be able to prove whether or not common (public) property is justified, and whether the demand for it exists or not. Then it will be seen whether the various types of common (public) property approach social equality or depart from it, or whether they create equality by destroying human liberty. If we grant some kind of monopolistic favour to any of the properties, if either the common or the private ones feel the supporting hand of the state (authorized by nobody) behind them, or if the bargains and agreements circumventing the market again become possible, the "old rubbish" will be restored.

The second question is connected with social foresight, and the plan and planned system influencing the market. In Hungary and, in general, among those who are dealing with the reforms, this is the most unpopular element. State ownership and planned economy—these are the things we must get rid of. I do know, of course, that the foresight and planning in the "realized socialisms" has been inappropriate, and it is even difficult to look back on them and thus analyze them. In Hungary in the 1980s, it was first the plan that collapsed and became a scapegoat; later on, and up to the present time—with the lack of a plan—the state budget is treated as the scapegoat. This, however, does not seem to bring about a market. On the contrary, economic and financial policy have no relationship whatsoever between one another. No economic political plan and financial and fiscal (budgetary) programmes exist which would be independent but would control one another. It is an indispensable condition for a market economy, and also for a socialist-type regulation, that (especially for matters concerning education, culture, public health, provisions for pensions, environment problems) some kinds of social plans should be drawn up. Improvement of the quality of life is only possible through examination of the forseeable paths of life and by drafting the prospects of the country's economy.

Some of the most important socialist values are those of social solidarity and social cooperation. The norm of "every man is born equal", and the law saying that "no one can have social advantages owing to birth, property, or hierarchic position", mean that society and, within it, the socialist movement have to make efforts to assure the basic rights of human existence. When forming the "social network" we shall come up against market values. In today's Hungarian society the social policy of the government is not suitable for guaranteeing even the basic human rights, or more equal opportunities. True socialism—if it is possible at all to create it—has to replace this social policy by a social system in harmony with the market, the government and society.

To sum up: No socialist market economy can exist but there is a market economy which can be influenced by the institutions and values of common (public) property, of a more democratic access to property, social foresight, economic political and financial planning, and, finally, by those of social solidarity. If some-

one wants to call this socialist market economy, let him do so, but I am afraid that this may lead to misunderstandings and false dogmas similar to the concept of a socialist world economy.

I have not touched upon the chance of a European system of socialist thought and institutions in an Eastern Europe which is growing increasingly Asiatic. There is almost no chance at all. There is much more chance for the survival of a corporative bargaining system and oligarchic government in Hungary and Yugoslavia, and for a development in this direction in the Soviet Union, by ways of "reform". What is more, perhaps after the exhaustion of the "Peter the Great"-types of endeavours we shall together return to a dictatorial regulation which will exclude even the imitation of any kind of a market. But let us believe that there is some hope for developing a market economy which—under the impact of a socialist mixed ownership system and a socialist movement—will not grow inhuman but will become a human one.

## A MIXED ECONOMY

G. LISICHKIN

The conviction that the economy of the present-day socialist countries must not be a market economy, but one totally based on obligatory directive planning, is a great historical confusion which can only be compared with Columbus' discovery of America. Quite a number of authors accuse Marx and Engels of this confusion. To my mind this is not correct. The blame should be wholly shouldered by our contemporaries, who set out to build up socialism from the wrong end. Marx's statement, which is widely known, that a transition from the kingdom of necessity, governed by the market, to the one of freedom, where the entire production is consciously directed through a plan is possible "only where labour which is determined by necessity and mundane considerations cease; thus in the very nature of things it lies beyond the sphere of actual material production."[1]

A situation "beyond" the material production could not exist either in the hungry, poverty ridden Russia of 1917 and cannot exist even today. That is why we should not push the blame away from ourselves. When we get "beyond" the material production then we shall see whether Marx was right in his forecast about commodity–money relations withering away. I am so anxious about Marx's and Engels's reputation because nowadays, in the period of perestroika, theoretical nihilism is in full blossom. And some scientists are ready to throw away Marx and Engels together with Stalin, finding in their theory "the sources of Stalinism". This is by no means correct. There must be continuity in science.

Another erroneous viewpoint is also widely spread. According to it, *Lenin* was against the use of market in the course of socialist construction and only after the crises of "War Communism" did he change his wrong views on the use of value categories in the construction of the new society. But it is known that after the bolsheviks took over the power, Lenin immediately set forward the task of a monetary reform aimed at strengthening the rouble undermined by the war and economic dislocation. At the same time, in the first post-revolution days he planned a transition from the surplus-appropriation system to the tax in kind in the agrarian sphere. He managed to achieve this only after the declaration of NEP (New Economic Policy). That is why Lenin repeatedly stressed, that NEP can be called a new policy only compared with "War Communism", while as compared with the period from October 1917 till autumn 1918 this policy was an old one. [2] Unlike quite a number of the prominent party activists, who came forward with a slogan of immediate introduction of socialism and abolition of the market, Lenin was vindicating an evident truth: "The *economical* basis of *socialism* does not exist yet".[14] And therefore, we should not do away with the market but learn to control it. Lenin's sharp criticism of "left-wing childishness and the petty-bourgeois mentality" (1918) is widely known. "Leftism" was peculiar to such prominent party activists as Bukharin, Bubnov, Larin, Osinski, Uritski and others. After the transition to NEP the struggle against "anti-marketeers" took the shape of a struggle against bureaucracy, which was a personification of economic wilfulness.

Thus the classics of Marxism are not guilty of "anti-commodity" orientation under the present-day circumstances. Such orientation is a product of leftist deviations of the theoretically immature scientists and practical workers, consolidated under Stalin's leadership.

The correct view on the fate of the commodity–money relations cannot be developed without understanding the process of socialization. It is known, that Marx and Engels sharply criticized the confusion of the two types of this phenomenon: the economic one and the administrative-bureaucratic, the forced one. [3]

Economic socialization is based on the constantly deepening division of labour and the growing interdependence of the different kinds of activities. This kind of socialization is a boon. It gives a powerful impetus to labour productivity.

On the other hand we have made sure by now that bringing together a lot of people in order to facilitate the supervision of their activity and appropriation of the products of their labour makes no good. And this truth was also rapidly understood by Lenin. Criticizing the "leftist" communists, who demanded to abolish money, prices, incomes etc, only because after the October revolution almost the whole economy except agriculture was socialized. Lenin wrote (as early as the spring of 1918): "The principal difficulty lies in the economic sphere, namely, the introduction of the strictest and universal accounting and control of the produc-

[14] quoted from the Russian edition, Vol. 38, p. 365.

tion and distribution of goods, raising the productivity of labour and *socializing* production *in practice*." [4] Lenin warned, that "even the greatest possible "determination" in the world is not enough to pass from nationalization and confiscation *to* socialization."[5]

The distinction of different levels of economic maturity, different levels of economic socialization permitted Lenin to see in the allegedly socialized and monolithic economy several (5) sectors, representing actually five separate forms of property. Return to the Marxist understanding of socialization gives us possibility to see even nowadays, in the totally state-controlled economy, the same five levels of maturity although in different proportions. This brings about the necessity to distinguish different sectors and to elaborate for each one the most favorable framework. We should recognize that our economy is a *mixed* one, where the state property (sector) must leave room for the equal-in-rights coexistence of cooperative, shareholder's and private ones.

Therefore, the plan-and-market problem must be set and resolved not for the whole economy, but applied to different sectors. It is clear enough, that for handicraft production the role of the market would be maximal and that of a plan minimal. But for the space-research programs this proportion will be vice-versa. But until now, our rules have neglected the principle of differentiation. Consequently, the "Aeroflot" and the state-owned lace-makers' shop are functioning under the same conditions, which cannot but hamper general economic growth.

Whenever the broad development of market relations is intended, the opponents bring up the argument of humanistic principles, claiming that efficiency and charity are incompatible. I cannot agree with it. It is enough to say that the value of school equipment per pupil in the USSR is 58 roubles, in the GDR 119 and in Sweden 1 thousand dollars. [6] Therefore, to be humane it is necessary to be rich. And one more remark with regard to this problem; the social policy, social maintenance expenditures and economic policy must be based on different logic. It is important that the logic of social policy should set out not from the material equality of people, but from the *equality of opportunities.*

And one more important feature should be different in our market economy from the one that we call capitalist. We must create a market, where the private and social interests are harmonically combined so that following his private interest an individual should inevitably satisfy the social one. We must not "overcome" the egoistic logic of market so as to combine the private personal interest with the social one. This problem was put and theoretically resolved by Lenin in his work "On cooperation". The later practice of Stalinism was based on an entirely opposite concept. Now we must get back to the starting position.

Moscow, February 1989

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## A FIVE-POINT DEFINITION

P. MARER

I define a socialist market economy by the following combination of features: (1) a substantially market-driven economy; (2) where the means of production remain predominantly non-private; (3) the government assumes responsibility for economic policy that substantially directs and circumscribes economic activities; (4) the distribution of income and wealth are relatively egalitarian; and (5) the political party or coalition that governs is not involved in day-to-day economic affairs but is firmly committed to the above four economic principles.

I don't know whether such an economy is workable or not, but the experience so far of such reforming countries as Hungary and Poland suggest that the answer may well be negative, certainly until the ownership issue is resolved in a way that is consistent with market efficiency. I am rather doubtful that this can be done in a reasonably satisfactory way, but I am not absolutely certain.

April 1989

## WHAT MAKES A MARKET ECONOMY SOCIALIST?

T. NAGY

The term "socialist market economy" has been used in Hungary and elsewhere to denote a system which is to be substituted for the "existing socialist systems" undergoing a crisis. It is not bad, as a short and succinct way of denoting the trends evident in the necessary economic changes; nevertheless, I think it is inexact and may give rise to misunderstanding. First, it is quite obvious today that it is not only the economic system that must be substantially changed, but the political system

as well. Second, the term in question is based on the traditionally rigid distinction between capitalism and socialism. Therefore, it suggests that the market economy to be brought about has to be—since it is to be a socialist one—*radically* different from, say, the market economy of Sweden, which is a capitalist one. I do not agree with this. It would be more correct, and more modest, to talk about establishing a market economy of a "socialist character" (displaying features of socialism). I am of the opinion that a democratic society pursuing advanced commodity production and with a monetary economy ought to be created; its socialist nature would be asserted by certain ideas and principles of the socialist movement. Below, I shall substantiate my argument and briefly outline the contents of such a socio-economic system, as well as the conditions of its establishment and functioning.

The idea of a socio-economic system which would be *radically* different from capitalism based on private ownership of the means of production, which would form, as it were, the opposite of the latter, and which would be created by historical necessity, comes from *Marx*. According to Marx, the capitalist system increasingly exploits and pauperizes the working class, worsening the anarchy of commodity production and slowing down the further development of the forces of production. This system would be replaced by socialism in the most advanced countries, and this would be achieved through social revolution, as a historical necessity. In it, the abolition of private property would entail the abolition of commodity production and money, and these would be substituted by the planned cooperation of freely associated producers; in due course, the state would become unnecessary, and would thus die away. *Lenin* talked about parasitic, decaying and dying capitalism, which he saw as the eve of revolution. However, the classical capitalism, which Marx had examined, has grown in the advanced countries into a socio-economic system which further provides, and even more than earlier, for the fast development of the forces of production and for a highly efficient functioning of the economy. High economic performance has not only enriched a small group of society but has improved the standards of living of the masses as well. Modern democracy—this great achievement of humanity— has enabled the masses of working people (to different extents in the different advanced countries) to assert their interests, to exert serious influence on the state, on the increasingly centralized regulation of economic processes and especially on the distribution and spending of the national income. The changes have also affected the sphere of production, delimiting the power of private capital. The socio-economic system that has emerged in a number of advanced countries since the Second World War differs from capitalism as described by Marx in such essential features that it can be hardly qualified as clearly capitalist; yet it is not socialist, either. We are aware today that Marx (and after him, Lenin) were wrong in judging the development perspectives of capitalism and exaggerating the necessarily determined nature of social changes. The image of socialism as derived from the Marxian image of communism has turned out to be a Utopian image in scientific disguise. One cannot seek consolation (as many do) in that, maybe in an-

other one hundred years, it will come true, and that the countries of the "existing socialism" are only at the beginning of the building of socialism.

By "existing socialism" (at this point without questioning the validity of this term) I mean the socio-economic system of the countries, in which political power took steps to institute a system radically different from the commodity production and democracy of capitalism. In some areas existing socialism has made considerable progress. However, the result has been a socio-economic system today qualified as Stalinist, which has by now softened into a neo-Stalinist one in most of the cases.

This system is undergoing a crisis today. It has turned out to be not superior, but inferior to the socio-economic system of the advanced Western countries. We are aware today that the serious troubles are rooted in and demonstrated by, the essential characteristics of the system: namely, by the dictatorial nature of political power, by the fact that the basic proprietory rights over the means of production in the broad sense are exercised by authorities, that economic processes are primarily regulated not by the market but by state and party bureaucracy, that the system bars the national economy from the world economy. It is an economy and a society ruled by an autocratic party-state. In order to answer the question: which way should we go, the roots of the troubles must be recognized, the Marxian Utopia discarded, and the socio-economic system of the advanced Western countries realistically evaluated, without ideological prejudices.

In order to have an efficiently functioning economy, fast development of the forces of production, and an adequate satisfaction of demands, we must create an economic system open towards the world market. It must have an advanced commodity production and monetary policy, with organically linked commodity, money, and labour markets. Such an economic system will be a *market economy* in that economic processes will be coordinated, and production factors allocated, primarily (though not exclusively) by a market mechanism (the "invisible hand"). Also, it will be a *mixed economy* in that the "visible hand" will have an important part in its regulation: i.e. the government's (and partly the different social organizations') activity. On the one hand, the government will lay down the rules constituting the general conditions of the economic activities; on the other hand it will have a part in regulating economic processes: it will provide for public services and infrastructure in those fields in which the satisfaction of demand cannot or is not suited to being left to market forces. In addition, it will exert influence on the market mechanism itself with a view to improving some of its weak points, or undesirable effects. It will be a *mixed* economy also in respect of the forms of ownership. In other words, in addition to the various forms of public ownership of the forces of production (capital) in the broad sense, the individual or joint private property of the citizens, mixed ownership, and foreign ownership will be organic parts of the economy to a much greater extent than today. It can be assumed (in consideration of the initial state) that public property will predominate.

A socialist character may be—and I hope will be—lent to this market economy (I have already expressed my views on the subject elsewhere) by the assertion in it of certain ideas and values historically developed in the socialist movements. Such are the restrictions placed upon power based on private ownership and upon private appropriation of income yielded by capital; in general, this involves keeping the inequalities of income and property within limits, while maintaining motivation for higher performance; it involves improvement of opportunities and life-chances for everybody; it means providing for the vital needs; it means social solidarity and the humanization of labour; and it means allowing employees to have a part in controlling the economy (i.e. management). I would point out that those socialist characteristics are present in the advanced Western countries, albeit to different extents and depending on social and economic development. I think that their assertion does not primarily depend on the proposition between publicly and privately owned capital (in this respect, the significance of the otherwise highly important forms of ownership must not be exaggerated), but on the power relations prevailing within the political and economic democracy. It also depends on these power relations how the government (and the social organizations) regulate economic processes. All the same, the assertion of these ideas and values will be promoted by the existence of the corresponding forms of collective ownership.

The creation and the functioning of the market economy that is to be developed have numerous preconditions, of which I shall mention only the most important ones.

The development of adequate forms of ownership is a key issue. In the present state-owned sector, such new forms of collective ownership must be established and spread, which clearly contribute to the assertion of interest in the long-term profitability and increase of capital, as well as to its free flow and reallocation. For the purpose, it is indispensable to make use of the modern corporative forms—first of all, of joint stock companies. The shares must be handled (possessed) by institutions of public character which are independent of the state apparatus (as well as of the organs representing various interests), and whose interest lies in the high returns of and increase in the value of the share capital. Such institutions may be, for example, a few specialized banks, holding companies specialized in property management, investment companies, pension funds, insurance companies, or trust funds. It is not inconsistent with corporate ownership (in fact, it is desirable) that some of the company shares (with limited companies, part of the stake) be held by private individuals, in the country or abroad. Small and not highly capital-intensive companies with a fairly stable staff may function efficiently in the self-managed form of public ownership. This latter form, however, is not to be made prevalent, because of the risk of short-term interests—such as increasing personal incomes—growing too strong, and of rendering the flow of capital more difficult. Finally, the cooperative form based on the members' association and their joint property, may represent an important version of collective ownership in the future, provided

that the incentive for increasing cooperative property is improved by it. Greater possibilities must be assured for the establishment and development of individual and associated private enterprises. In this domain, there is good reason to let or sell some of today's state property to private persons (more than is the case now). All this amounts to saying that pluralism is needed in the forms of ownership: and they must be granted equal chances in competing with one another.

Efforts made at reaching the highest possible profitability of capital may, eventually, be a reliable guide of decentralized economic decisions only if a proper price system is instituted. In this relative prices would in the long term express the necessary costs of production and in the short term change according to supply and demand. With a few exceptions, this requires free price formation (not restricted by the government), i.e. further essential diminution of the still extensive central price control.

The market economy that is to be established can functioning successfully and efficiently only if it is open towards the world economy. For the purpose, the barriers artificially raised against imports must be lifted, allowing domestic production to compete with import goods; favourable conditions must be created for cooperation with foreign companies, and for the influx of foreign capital for direct investment. Without these conditions, it will not be possible to abolish the monopolistic positions on the domestic market, or to have a smoothly functioning price system. Also, it will not be possible to make use of the advantages of the international division of labour, and make up for the technical and organizational backwardness of the Hungarian enterprises.

Economy-wide planning must fundamentally change. Today, our starting-point should no longer involve planning as the primary coordinator and determinant of the economic processes, and the market should not function in subordination to and within the framework of planning only. In fact, it should be the other way round: the fundamental element is the functioning of the market mechanism, upon which planning must be based and made to help where the market mechanism cannot, or cannot sufficiently, solve problems. Therefore, on the one hand, planning must be an instrument in the hands of the government, enabling it to coordinate macroeconomic processes in the short run; on the other hand, planning should contribute to the development of a long-term development strategy concerned mainly with structural questions.

Finally, an absolutely fundamental condition of the creation and operation of an efficient market economy is that the party-state rule over the economy is eliminated: in plain words, the far-reaching formal and informal intervention by state and party organs into economic processes should stop. The role of the budget in income redistribution should be diminished, primarily through a radical reduction of the various subsidies granted to poorly functioning enterprises, and of the centrally decided and financed large-scale investments. The so far mainly fiscal regulation

of aggregate demand, which paralyzes the activity of efficient enterprises, must be replaced by regulation primarily based on monetary instruments.

Even this brief and roughly-outlined survey makes it clear that it is not possible to create and operate a market economy of socialist character without a thorough transformation of the political system. What is involved is not only a better representation of modern democracy and the assertion of human rights representing in themselves such values which people are less prepared to relinquish at a certain stage of economic and cultural development; and it is not only that the crimes of the dictatorial political system raise indignation. It is the economic restructuring itself that necessitates the elimination of the party and state apparatus' rule over the economy. The way to arrive at this end is to make the political power pluralistic (to create a multi-party system) and thus subject to social control. Such a change, however, would hurt the interests of significant groups and conflict with their ideological prejudices. Their resistance must be overcome. It is not enough if a given number of top executives recognize the inevitability of far-reaching reforms and present reform programme. Grassroot pressure must grow towards developing a democracy.

## MARKET SOCIALISM

A. NOVE

I would define it as a state of affairs in which most of the means of production are in some way "socially" owned (state, municipal, various kinds of cooperatives), and in which the predominant mode in the production and distribution of goods and services is market-related. That is to say, goods and services are provided, and investments made, on the basis of an evaluation of demand and profitability, and not on the basis of instructions issued by state planners.

Any realistically envisageable democratic market socialist economy would contain some private enterprises (this is inevitable unless constantly suppressed by the police!), and also some hierarchically organized centralized sectors, such as a railway network, an electricity grid, telephone and postal system and the like ("natural monopolies"). For reasons I discuss at length in my book on "feasible socialism", connected both with technology (economies of scale, etc.) and producers' preferences, one should envisage a wide range of different forms of organizing production.

If the dominant mode is based on the private ownership of the means of production, then, whatever may or may not be the virtues of such a system, socialism it is not.

The role of the state or local public bodies in "market socialism" would be substantial because of:

a) Ecology, environmental protection, other kinds of external economies and diseconomies, which by definition are not within a sectoral or enterprise profit-and-loss account;

b) Operating and/or regulating natural monopolies, notably important parts of infrastructure;

c) The difficult task of ensuring macro-balance, combating inflation, regulating credit, raising taxes, formulating and enforcing the "rules of the game", including combating "unnatural monopolies";

d) Determining by democratic process the boundaries of the market, ensuring the provision of essential public and social services profit: education, health, street lighting, rubbish collection, public parks, many kinds of culture;

e) Research, the financing of major structurally significant new investments;

f) Devising an incomes policy. (It may be worth considering some interesting ideas about a universal social dividend equal to bare subsistence—unless this acts to discourage too many from working. This could depend on whether unemployment or shortage of labour turns out to be the main problem). There must of course be a labour *market*, the only alternative being labour direction.

I am not too clear in my own mind about a *capital market*, a matter now actively debated in the USSR and the subject of a number of measures in Hungary and China. Of course there should be a flexible and competitive banking system. Enterprises should be able to invest in other enterprises, their employees should be able to buy and sell shares in their own enterprise and in others, too. Bonds should be bought and sold, and if no stock exchange is legal there will be an unofficial one. However, two things do worry me. One is the experience of both Britain and America, in which the so-called sector of "financial services" has vastly expanded and very largely feeds on itself, i.e. it makes its very high income through financial transactions and manipulation (takeover bids, insider dealing, pure speculation), while contributing remarkably little to investment—as a recent study of the London Stock Exchange has shown. The other is primitive state of theory (neoclassical theory) on investment,—and marxist theory is of no help either. To invest one needs investible funds, information (some reasonable grounds for anticipating success, for which one needs to estimate future costs and prices, the future behaviour of customers and competitors...), and finally there is risk. Who takes it, who bears it, who suffers if things go wrong, benefits if they go right?

*Mises, Hayek, Kirzner* have pointed to a real weakness: can there be meaningful socialist entrepreneurship? Is not industrial democracy of its nature rather conservative, thereby reflecting the attitudes of most ordinary people? (If British workers had had the vote in 1800, would there have been an industrial revolution in Britain?) These criticisms have some validity. However, if what really threatens us is ecological disaster, if growth and technological revolutions are not high on the list of desiderata, will these arguments matter very much?

What social and economic conditions are necessary for the functioning of a socialist market economy? One naturally has in mind a pluralist democracy, but this would not necessarily make life any easier: financial discipline and limitations on wage rises do not always win votes. Then one must ask what size of country one has in mind, and think about the role and methods of foreign trade—a matter I will leave aside here, except to point to the need for smaller countries to unite in some kind of common market or *Zollverein* (which creates its own problems, of course). One is also tempted to quote from a recent article by A. *Tsipko*, who referring to the origins of stalinist despotism, wrote: "...The central question (is): can one build a non-barracks (*nekazarmennyi*) democratic socialism on a non-commodity non-market basis" (*Nauka i zhizn*; No.11, 1988, p.19). As for the details of the political system, one must take into account tradition and levels of political culture, and, in countries with nationality problems, the dangers they can pose (look at today's Yugoslavia, and some others too!). In principle, just as one can only suppress the market by continuous and vigilant police action, for which one needs a police state (and a powerful bureaucracy which becomes a privileged caste, class or stratum), so one can only maintain a one-party state by suppressing those who want to found other parties.

There are several problems which arise during a reform process. One is linked with a tendency among quite a number of "eastern" economists to an uncritical worship of the market. Like everything else, it has its built-in inherent imperfections, of which one should be aware. Thus in Britain severe cuts in scientific research are "justified" by the notion that if it is profitable it will be done by private enterprise and if it is not profitable then it should not be done at all. The same reason is given for cutting government-financed training, though here too there can be a substantial difference between private profit and general advantage (in the case of technical training, the point is that a man or woman expensively trained by one firm could go to work for another firm, which obtains an "external economy" without paying for it). The impressive successes of Japan and South Korea have been achieved with the help of joint planning by government and business, and not, as "Chicago" ideologists imply, through laissez faire and a "pure" capital market. It is also sometimes silently assumed the all necessary information for decision-making can be contained in "rational" prices. Meanwhile in western democracies the traditional form of nationalization has lost popularity, both with the customers and the employees, and a lot of rethinking is necessary. To give one example, municipal housing estates were often poorly designed and bureaucratically and heartlessly administered. The "Thatcherite" solution is to privatize, but the result is the disappearance of cheap rented accommodation and a sharp rise in the number of homeless. We know from the experience of many "eastern" countries that housing is a difficult problem there too. All that I am trying to say is that nowhere is there a simple, socially acceptable pure-free-market solution.

In most if not all western countries, the notion of "socialism" does not attract mass support, or at least nothing more "socialist" than Sweden, where an efficient economy and high living standards coexist with generous welfare benefits and a high level of taxation. I see little likelihood of change in the state of public opinion unless there is a severe economic crisis, or people see a link between the untrammelled pursuit of private profit and ecological disaster. Either or both of these is possible. (Yes, I know that the experience of many eastern countries suggests that a state-owned economy can be worse polluters of air and water than any capitalist! But resolute measures could be taken once there is a change in priorities).

February 1989

# AN IRON HOOP MADE OF WOOD

L. SZAMUELY

The notion of socialist market economy is, both historically and logically, *contradictio in adiecto*, a term comprising a contradiction, as Hungarians say: "an iron hoop made of wood". The contradiction is caused, naturally, not by the interpretation of market economy but by that of the concept of socialism.

Even if we disregarded the Marxian concept of socialism which explicitly relies on the negation of commodity production, it holds for all earlier and later theories of socialism that they advocate such economic and/or ethical principles which are opposed to the logic of market economy. This is true even of such socialist doctrines which do not discard either commodity exchange or monetary economy or even private property. I think of such principles as

— solidarity, mutual help *versus* economic competition,

— equality, equity *versus* differentiation of incomes and wealth,

— conscious organization, harmonization ("planning") by society of the social division of labour, of economic activities *versus* the autonomous action of economic units ("spontaneity").

These pairs of contradictions could, of course, be augmented and/or explained in greater detail but the substance of the matter can be reduced to two basic questions in respect of which every kind of concept of socialism is opposed to the principles of market economy.

One of the questions concerns the nature of relations among producers mutually dependent on each other through the social division of labour. Historically, two basic types of such relations are known. The first is the market relations, market coordination, when independent producers establish, by their own decision ("spontaneously") and guided by their own interests, exchange-type relations with each

other, based on some return service. The other is such an organization of the social division of labour where some sacral or secular power—usually arrogating itself the right to represent society or public interest—brings about this relationship directly or indirectly (through rules and prescriptions). Most socialist doctrines vote *ab ovo*, or in the last resort, for the second basic type, that is, non-market coordination.

The second question concerns the nature of ownership, that is, the right of disposal of the means of production (capital goods) and of the products turned out. It follows first of all from the ethical principles of socialism, but also from the assertion of economic rationality through non-market coordination, that every socialist doctrine sets itself the target of eliminating private property, or at least of its strong restriction. As a matter of fact, even those concepts of socialism which leave or would leave the possession of means of production and their disposal—that is, the decisions on allocation—in private hands, deem it necessary to redistribute incomes through the state budget in order to assert the principles of equality and equity in this way, "correcting" thus the consequences of distribution taking place on the basis of the ownership of factors of production. With this they restrict, as a matter of fact, the rights of the owner, first of all *usufruct*.

Is thus the concept of market economy *ab ovo* an absurdity? Does it involve that all those who make efforts at bringing it about, first of all in the present-day socialist countries, chase after wish-dreams in the best case or, in the worst, merely tag the adjective "socialist" to their experiments with market economy merely for the sake of ideological legitimation and/or camouflage, actually meaning abandonment of socialism?

If socialism is interpreted *only* as assertion of the above mentioned economic and ethical principles, the answer is clearly in the affirmative. But the list only comprises those principles which are common to all socialist doctrines—to the various utopian, egalitarian-ethical socialisms, and the Marxian concept of socialism as well. Those principles, however, are missing which characterize one particular line of socialist doctrines—though probably the most important one—reaching from Saint-Simon to Marx. These set as their goal maximum development of the forces of production, creation of abundance of material and intellectual goods, free evolvement of the diversified faculties of man. The only way to reach these goals is to increase the productive power of labour, and not simply by raising labour productivity, but by asserting economic efficiency in a wider sense, that is, economic rationality (see e.g. W. Brus [1]).

Efficiency, economic dynamism, satisfaction of human needs are equally such substantial and indispensable elements of Marxian socialism—which is no doubt the most developed concept of socialism and the one of the greatest social impact—as are the other economic and ethical principles. Without them, every humanistic value and striving of socialism remains a pious wish, a utopia or, what is even worse, turns into its opposite and might become the official ideology of hideous and wretched tyrannic systems.

But this substantial element of Marxian socialism can hardly be asserted under the conditions of non-market coordination. In one of my earlier writings [2] I explained that, in consequence of the complete discarding of commodity production and monetary economy, the Marxian concept of socialism comprises a number of internal contradictions and inconsistencies. It was therefore unavoidable that in the first social experiment aimed at its practical implementation—in Soviet Russia after the 1917 revolution—the goal of operating the economy without commodity and money—as deduced from Marxian socialism—should be abandoned because it was diametrically opposed to the promise of developing the forces of production, equally inherent in Marxian socialism.

Ever since the introduction of the first reform started in Soviet Russia in 1921 (introduction of NEP), the economic reforms initiated in socialist societies have always wanted to assert the intention of Marxian socialism relating to economic rationality. In this sense, it can hardly be alleged that they aim at abandoning socialism, nor is their reference to the Marxian socialism a kind of ideological cape which serves to hide highly doubtful things, but is at least as legitimate as the Stalinist model of plan instructions implementing non-market coordination. True, this model retained, even after NEP, monetary management and accounting in terms of value categories (and thus already the Stalinist model necessarily departed from the Marxian vision of economy without commodity and money), yet in this model all decisions on the allocation of factors of production are taken by the central management bodies—and, in addition, mostly not according to efficiency criteria, but by caring in physical form for the satisfaction of needs which also appear in physical terms (of course, according to priorities determined by themselves).

The content of reforms initiated in the present-day socialist countries is precisely that, in order to assert economic rationality, a shift should take place from non-market coordination operating with monetary forms and value categories to market coordination, that is the activity of central management apparatuses should be replaced by the self-regulation of the market.

It similarly follows from the intent to assert economic rationality and not from abandonment of the socialist ethical principles that the present-day socialist societies seek a different answer also to the problem of ownership, at one time deemed to be solved. The property called social, which is actually one depersonalized in national economic dimensions and is, in addition, centrally managed according to a uniform big-establishment scheme, hinders both economic rationality and the development of the forces of production as well as the assertion of the humanistic values of Marxian socialism in several respects. I will only mention two of these.

— The uniform, undifferentiated public property has no subject in the present-day socialist societies (since such abstract concepts as "the people", "society" *et cetera* do not mean anything in practice). At least a separate institution for its possessing and handling is missing, and thus the function of the owner is not exercised by anybody or anything. The consequence is that there is no functional

guaranty for the efficient use, preservation and augmentation of social capital (i.e. of the wealth accumulated by society). This leads, in the last resort, to wasting and to a low degree of efficiency of the extended social reproduction process, which entails the tendency of economic and technological stagnation.

— According to Marxian theory the basis of social ownership is the socialization of the forces of production. Relying on the experiences of the first industrial revolution, socialists of those times meant by the latter growing sizes of establishments, deepening of the social division of labour, spreading of mass production in big factories, since these provided the biggest source for increasing productivity, the economies of scale. But the unlimited spreading of large-scale production and its superiority proved to be one of the well-intentioned utopies of the 19th century. The advantages (and justification) of the large-scale work organization are very restricted or do not at all exist in the sphere of services, agriculture and—thanks to electronization—even in wide areas of the industry. Development of the present-day socialist economies badly suffers because in the course of economic and social transformations state and cooperative large establishments were made general in the economy—even where bigger sizes do not produce savings but diseconomies of scale. Thus, expansion of public ownership to the non-socialized activities, which, in fact, are not liable to socialization, violates economic rationality, brings about oversized bureaucratic management apparatuses and entails the wasting of social labour and wealth.

Thus, a socialist economy asserting economic rationality can only be a mixed economy, that is, one amalgamating different forms of ownership—in conformity with the state of development of the forces of production and securing the possibility for their development. This would not simply mean a restricted toleration of private property, its survival, but would produce diversified combinations of the most varied forms of both public property (state, communal, group and cooperative etc.) and individual and collective private property.

Thus, the diversified elements of a socialist market economy are just getting outlined but, precisely because of their diversity and dialectical contradictions, they cannot be squeezed into a one-sentence definition—nor would it be wise to do so. One thing is certain: assertion of the basic values of socialism will always mean a constant challange for the socialist society and a task to be solved continuously under the conditions of a dynamically developing, changing, transforming market economy with mixed ownership.

Also the political life of society will revolve around this axis in the interest of restoring the continuously upset social consensus.

There are, of course, many kinds of conditions necessary for the viability of a socialist market economy interpreted in the above manner. If we disregard the general level of development—of civilization, economy and culture—the most important condition seems to be the democratic arrangement of society, the unlimited assertion of a legal state. Political democracy serves not simply the legitimation of

the system, but it is this institutional setup alone which possesses the ability of *self-correction.* Viability of a socialist market economy cannot be secured by any kind of theoretical construction, but only by a self-correcting democratic political system. Otherwise, the economic, political and social techniques, management mechanism necessary for both the assertion of social values and the efficient operation of a market economy based on mixed ownership are well known. They constitute the common heritage of the history of humanity.

That which is not known—and in this respect we are much more uncertain in giving an answer—is the mode and possibility of *transition* from the practice of the monolithic party-state implementing non-market coordination to a socialist market economy. Several open questions emerge. Is a direct transition possible at all or have we run into such blind alley of the history of development where from, in the best case, one can only return to laissez-faire or some kind of corporative capitalism? And would this kind of capitalism be coupled with a democratic political system or rather it would become engaged for new long historical periods with military dictatorships or other authoritarian systems—well-known from the history of Eastern Europe and other regions on the periphery of industrial development?

It is not the social sciences that will give an answer.

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## WE MUST RETURN TO DEMOCRACY

M. TARDOS

I shall sum up in five points the main changes in my economic thinking in respect of planned economy and market.

1. In the years following World War II, before and during my student years, I agreed with the Communist ideal. I thought that the ground upon which the traditional Soviet-type planned economy was built up was in fact created by dissatisfaction with the capitalist market economy, which certainly appeared to rely on human selfishness. The specific features of the latter phenomenon were particularly evident in the 19th century and in the 1929–30 crisis.

The criticism of the system based on private property provided the basis for my conviction: that the "uprooting" of private property, based economic management through nationalizations in industry and collectivization in agriculture, would establish the preconditions of a deliberately planned social administration. Such a process implied the elimination of autonomous economic management by citizens and strictly subordinating national economy to the emerging party-ruled state. This would evolve on the grounds of economic-social solidarity and socialization, and thereby also through the withering away of state and party.

2. As the insufficiencies of the traditional or command economy gradually became clear to me, in the first years of my practical economic planning activity I began to criticize the wasteful growth which neglected human needs and led finally to exhaustion of resources, and crisis. My criticism was levelled against the mandatory plans, and the mandatory system of resource distribution. I thought—as was also expressed in the conceptions of the new economic mechanism—that it would be necessary to leave the road of development of the capitalist market economy and bring into being a society that denied private property. Thus economic management as it had developed in Eastern Europe was to be transformed only through the development of a market limited to commodities, and a uniform incentive (i.e. undisturbed by internal conflicts of interests) for enterprise collectives.

3. The socialist reforms, especially those changes in the Hungarian and the Yugoslav economies, convinced me that socialist property-based economic systems oriented towards the market come up against serious internal conflicts. For example:

— The communist party and the state (ruled by the party) are unable to accept the heterogenous, conflicting forces of the market. Therefore they restrict (not incidentally) the market they have brought into being.

— It is impossible for the so-called socialist market economy to be efficient, since the interests of only one factor of economy, i.e. labour, come to the surface. This leads to the loss of value of the other determining factor of economy—namely, capital.

Even without external anti-reform forces—such as intervention from the Soviet Union or the Warsaw Treaty—these conflicts lead to political decisions that set strict limits to the scope of movement of the socialist economic reforms. The conflict, which cannot be solved because of the logic of the system, drives the reform countries towards crisis. This accounts for the rather strange phenomenon that the countries which hardly deviate from the traditional Stalinist way of socialism only fall into a latent crisis, since they are far behind the development of the market economies. They do not have to face open crisis as long as they can treat social tensions, owing to backwardness, by a policy of seclusion and forcible means (Albania, Czechoslovakia, Romania). The countries that wish to reform the socialist system by abolishing economic management based on mandatory plans, give up the seclusion policy and lessen the use of forcible means; they try to develop their

forces of production and adjust to world market standards. However, since they are still behind, they get into an open crisis (Yugoslavia, Hungary).

4. Following from the above, after 1968 I gradually developed the view that the socialist reform countries must, if they want to overcome their difficulties, return to full democracy and a market economy. This demands that the party-ruled state be replaced by a multi-party democracy, private property be again acknowledged as a form of ownership, and that the domination of state and cooperative property in such economies be eventually repressed.

5. The multi-party system and the evolution of private property require the settling of numerous and by no means easy issues. Such issues involve the development of the state's role in regulation, the treatment of externalities (among other things, environmental damage), the issue of bank notes, the control of money circulation, and income differentiation—to name just a few.

However, the situation of the countries that previously adopted the socialist road is even more difficult: before they can turn their attention to the open issues of the development of democratic market economies, they are compelled to face the difficulties of returning to the main road of social development. One of the hardest problems is denationalization in the market sphere of the economy.

In 1984–5 the Hungarian government sought a solution by detaching enterprises from state administration, and ordering enterprises to be governed by enterprise boards and general meetings. This is at present being completed (in the late 1980s) by a gradual spreading of various forms of association (the share company, the limited company, the investment company, etc.). This way of development is called "socialist" by the government, because of the remaining practical limits to Hungarian forms of ownership.

Others, first of all Tibor *Liska*'s followers, suggest a radically liberal solution. This would not only imply leaving the forced path of nationalization, for it would probably surpass even the capitalist market, constrained as it is by monopolies. The owner's role would be played by the planned market's counting-house, where the members of society would be able to buy temporary proprietary rights through bidding. The weakest point of this model is that, if the economy functions according to the author's logic, it infers that the planned market counting-house is capable of rational functioning and assuring sufficient social concentration for implementing its well grounded decisions. Yet it is only in this way that it would be able to continuously satisfy the rational demands of the artificially created market and the requirements of income distribution—considered as "paying" in the entrepreneurial logic.

Finally, the idea of direct reprivatization is one of the suggested solutions. However, several decades have passed since the nationalizations, so that it is now impossible to return proprietary rights to the original owners and further, society is unwilling to confer such rights on those who want them in order to enjoy the concomitant advantages. Therefore, denationalization could be implemented only

through slow evolution, by means of a natural accumulation of home and foreign private capital.[15]

As I see the reform process, I think that the suggested ways are either not feasible, or would not produce the required result, even though they do contain a great many rational elements that are useful in practice. There is no better alternative than the self-correcting development of the capitalist market economies. Turning back to this road is, however, not easy. The possible development strategies involve innumerable risks and may take longer than we think. This may lead to a situation in which the gap, which has so obviously widened in recent years between Eastern Europe and the advanced Western countries, will grow into a great gulf.

The final solution will most probably involve the slow return of private property, enterprises and banking institutions investing in other enterprises and banking institutions, and beside these, the denationalization of state and large cooperative assets. The new final owners will be:

— insurance companies
— retirement funds
— health insurance funds
— village and city funds
— non-profit oriented enterprise funds.

The new final owners will exercise control over the boards of directors of banks and enterprises directly, as well as through their banks, enterprises, investors and holdings, together with the private owners and the collective bodies of the remaining cooperative and self-regulating enterprises.

In my opinion, where such change takes place in a country that had previously adopted the socialist way, development will turn back to the principal roads of capitalist development; the socialist traits of economic management, determinant for the formation theory, will cease to exist.

## A SKETCHY VIEW ON THE SOCIALIST MARKET ECONOMY

H.-J. WAGENER

First of all, a socialist market economy will be a market economy. This has several implications. The market can be seen as an institution, coordinating and motivating economic behaviour, or as a process of competition among economic agents trying to improve their relative positions. At the heart of both concepts lie

[15] László *Asztalos* thinks this process could take place in about ten years, if the population—influenced by an enlightened government—is willing to renounce luxury consumer articles (tobacco, drinks, etc.) and spend their savings on investments into working capital.

autonomous but interdependent economic subjects. On the basis of their preferences and their limited knowledge they make up their plans and engage in all sorts of contracts which are thought to be advantageous. Every economic subject sees to his own interests and instrumentalizes the interests of the others, these interests being reflected in a general and anonymous way in market prices. (Note the difference between the above and a central plan, where the individual interests are supposed to be harmoniously coordinated ex ante and have very little instrumental value for the implementation of the plan, even if we take the diverse bonus schemes into account.)

From this it follows that the market presupposes a multitude of self-responsible individual decision making units, enjoying freedom of choice, freedom of disposal, and freedom of contract. The autonomy of economic subjects in the market is not compatible with monistic central authority. The market is a pluralistic and, in the last instance, individualistic institution which has to be complemented by a pluralistic political system. Collectivist forms of organization, however, are workable on the basis of voluntary association or the freedom of contract at a decentralized level. The mentioned freedoms may be limited—other than by themselves and by the budget constraint—by law only. Any *ad hoc* interference with individual decision making disturbs the functioning of the market, because its mere possibility creates unnecessary (since it is institutional) uncertainty.

Risk and uncertainty are essential features of the market process, being unavoidable on the one hand and paralyzing on the other. For the greater part individual economic action is routine, but at the margin every activity contains an entrepreneurial element: the search for wealth improvement. No individual will engage in uncertain and risky operations if he cannot be sufficiently sure about its freedom of action and the prospective outcome. The predictable guarantees of a judicial system and an extensive insurance market (which, however, can never insure against the real entrepreneurial risks) create an environment favourable for entrepreneurial behaviour. On the other side, it must be asked whether a systematic elimination of market uncertainty—for instance, by guaranteeing in a planned manner demand for any supply—can restrict or even eliminate the stimulating forces of the market process: freedom of choice and hard budget constraints.

This brings us to the question about the scope of the market, or: what is the role of the state in a market economy? It should be clear that there is no theoretically unambiguous answer to this question. In general, individual decision making and market coordination will be given preference. The role of the state is seen, apart from looking after the internal and external security and the legal framework, in reparing and coping with the shortcomings of the market. Such are the dangers of a concentration of power, instabilities and crises, an unequitable distribution of income, and externalities.

The measures taken against these dangers can be summarized under the headings of the welfare state and the regulated market economy. Although in certain

cases even entire fields of economic activity are exempted totally from competition and market coordination—such as health care, education, defence, supply of money and infrastructural utilities—the scope of the market is, in principle, universal. For instance, it is not possible to use the advantages of the market for the allocation of capital and the distribution of job opportunities to a different mechanism. This would obstruct the informational and motivational properties of the market. Again, we have to stress uncertainty: the daring innovator must have more than one chance to get the needed capital. The resilience of the market economy rests in its all-pervading competitiveness. Competitiveness, however, is not a natural state of the market. On the contrary, every participant is eager to avoid competition and to attain a monopoly position. The best guarantee of competition is free entry and free trade.

From this it would follow that even the investment decisions have to be taken at a decentralized level, on the basis of market information. This need not be the level of the individual. The essential point is that whoever wants to invest is not prohibited by law from doing so but only constrained by expected profitability. Such a conclusion is quite unfavourable to *Keynes'* idea of socializing investment in order to overcome the nasty unemployment equilibrium in which a market economy may get stuck. Yet, Keynes' idea has, up to now, not found any satisfactory institutional solution which would not violate the functioning of the market. So, at least the capitalist state is left with less powerful but more system-conforming instruments if it wants to implement a full employment guarantee, e.g. labour market policies, fiscal and monetary policies and, as ultima ratio, direct state employment. It is not clear whether the socialist state will have more degrees of freedom for enabling Keynesian policies to realize a full employment equilibrium.

All the above-mentioned things are done to a greater or lesser degree and with greater or lesser success by most of the developed capitalist market economies. It could even be argued that where incomes are redistributed in such a way as to get rid of poverty, where the power of concentrated capital is checked by countervailing labour power and state control, and where the labour market opportunities of workers are fairly equal and promising because of education and occupational training, the economic system is governed by socialist values. Sweden, for instance, has already travelled a long distance in this direction.

However, before pointing to practical solutions—which cannot be the task of this short note—it has to be asked, as a matter of principle, what makes a market economy socialist. According to *Marx*, market socialism is a *contradictio in terminis.* To his, and even more so to Engels' rather Prussian military mind, spontaneous processes are tantamount to irrational. Yet even if, for the moment, I disregard together with him the efficiency problem, it is by no means clear why the social character of production should be disguised by the market price mechanism more than by central planning—namely, as if central plans were made less "behind the back" of the individual than market prices. The fact that market prices are

preceived as objective data, whereas central plans are considered as the arbitrary results of subjective discretion, cannot be judged as a major disadvantage.

Together with *Schumpeter* and many others it can be argued that central planning and administration together form the natural system of allocation in a rational world. However, this truly rational Marxian postulate has to be put to question. Since the future remains uncertain and cannot be grasped by rational expectations, the economic mechanism has to be adapted to the requirements of searching for unknown welfare-improving solutions. The process of competition seems to be quite successful in this respect. It also leads to the conclusion that the market, as a process, cannot be simulated by algorithmic devices. Therefore, I stand with Hayek and dismiss the Lange–Lerner solution of market socialism.

Apart from the principal distrust in markets, which I consider unfounded, Marx's and the early socialists' criticism of capitalism concentrates upon the unequal position of capital and labour with respect to decisions concerning the optimal way of production, or the class monopoly of capital. This was seen to be closely connected with private ownership of the means of production. Yet, even if this close connection can be disputed, it is beyond any doubt that the socialist market economy has a property rights problem. On the one hand, the concentration of property rights in the hands of the state is not consistent with the requirements of the market—such as the freedom of contract and the freedom of individual economic subjects. On the other hand, unmitigated private property rights may be inconsistent with the socialist character of the economic system, depending on the situation in which they are exerted. The socialist character of the economy is seen in the existence of equal rights and material possibilities. These are open to all members of society, and they enable them to lead their political and economic lives according to their individual interests—such entities imply that there is no coercion, and that there is freedom of choice, social security, and free access to capital.

The first question to be asked in this context is whether the driving forces of the market process, the stimuli of expected returns and the constraints of financial responsibility, can be separated from private ownership. As fas as large corporate firms are concerned, the answer seems to be in the affirmative. Capitalist experience shows that the ownership rights (shares) are either scattered among thousands of individuals or concentrated in the hands of a few institutional investors who both, very often, do not want to participate in decision making but express their views about managerial performance in appropriate capital market behaviour. The separation of ownership and control does not seem to affect the effectiveness of corporate firms, as long as there is the check of the capital market. The problem, however, is shifted to the question of whether there can be a capital market without particular property rights.

The answer to the former question is less clear with respect to the small and medium sized firms which constitute an indispensable stratum of any market economy. I do not share the rather frequent idea that potential capital-labour conflicts

are less pronounced here because of the smaller scales involved. Paternalism is no substitute for the rights of codetermination if they are wanted by the workers. So, if private property rights are necessary in this segment, which I am inclined to presume because this is also the segment where the entrepreneur is active and because, for the moment, I cannot see any workable alternative, a socialist market economy has to protect the rights and interests of the workers by guaranteeing not only formally but also materially the freedom of contract. The class monopoly of capital is not inherent in capital but is the result of the weak labour market position of the workers. If workers cannot wait because of their wealth position, for instance, they are on the short side.

As a matter of fact, state regulation of economic activities, collective bargaining, and the inventiveness of the market have created so many different property rights constructions in capitalist market economies that it is not very meaningful to speak of unattenuated private property rights any more—nor, for that matter, is it feasible to speak of pure capitalism. For liberal critics, the development of the above features are seen as the cause of crisis and stagnation. Yet, comparative analysis does not confirm their fears. It is evident that a market economy does not exclude cooperative and other forms of decentralized collective ownership rights. The Yugoslav version of market socialism, however, seems to be less successful. Among other reasons, I would conjecture this to be the effect of the lack of capital market. Employment rights rather than personal property rights are a very inflexible form of property rights construction, and they severely restrict the freedom of choice, of disposal and of contract.

Let me summarize this brief sketch. Any rational economic system should be efficient. In addition, a socialist economic system is guided by the ideas of freedom and of equality. Socialism cannot step behind the political attainments of liberalism. These attainments have to be extended to the economic sphere. The market is by no means a perfect, but certainly a workable institution for the achievement of these goals. It has to be controlled and supplemented by the subsidiary and regulatory activities of a democratic state. Since there is no essential difference between the market and the state as forms of human organization, although they may differ in terms of efficiency, the latter has to be guided by the same principles as the former, and vice versa.

All this boils down to the conclusion that market socialism implies:

— decentralized decision making on the basis of freedom of choice and freedom of contract;

— self-responsible individuals who are able to pursue their own interests;

— a distribution of income and wealth which enables every individual to operate on the markets with more or less equal opportunities;

— a politically independent judicial system which creates the necessary certainty for individual decision making and guarantees the existing property rights;

— a state which is subject to constitutional rules and functions as a subsidiary to the market;

— a set of economic policies which are appropriate for stabilizing the economic process.

What remains somewhat unclear is whether market socialism entails or even needs system-specific property rights constructions. Here, institutional innovations may be necessary. They should be sought for through an extension of the democratic rights of workers on the enterprise level.

None of these properties are sufficiently present in any of the really existing socialist countries. The crucial point, now, is the possible path of transition from a system with an incredible agglomeration of power in the hands of a single party which controls the state, the law, and the economy (and with a population accustomed to this state of affairs) to a system which is governed by individual interests and their free coalitions. It is beyond the capacity of a simple economist to evaluate the necessary political and social conditions of such a transition. However, it seems quite plausible to assume that nothing short of a veritable revolution will do the job.

## REFLECTIONS ABOUT AN ALL-ROUND INQUIRY

GY. PETŐCZ

Acta Oeconomica conducted an all-round inquiry on the subject of "market socialism": its interpretation, the conditions under which it is being put into practice, and its chances. The questions are somewhat awkward which is, however, not the editors' fault, but is to be ascribed to the historical circumstances. The way these questions are formulated may even help the profession to extricate itself from the deadlock it is in and find its way out. On reading the answers what we have presumed soon turns out to be case: "market socialism" is neither a scientific term or paradigm based on common consent, nor is it an outcome of an organic development of science; the reason for its existence and current use is by no means its aptitude for analysis or for explanation and summary of empirical data. Rather, it is rooted in factors far from the field of scientific experience. In my opinion, the development of this term belongs to the field of interest of historians of ideology and of psychologists. Wlodzimierz *Brus* described the process—painful and dramatic one for the individual—in which the ideal of a rationally organized economy and the magnificent communist dream of eliminating alienation hit against the realities of Eastern Europe and were gradually forced to retreat. The "socialist market economy" represents, for the time being, a terminal in the process of retreat of the ideal: the last stronghold of a great generation before abandoning the ideals of young age. Without it, the term would most probably have not come into existence.

The invitation to define the "socialist market economy" is impossible to fulfil, because it is neither an empirical fact, nor a logical concept of economics, and economics simply lacks the means for its interpretation. This teleological concept with its special attached values paralyzes both the descriptive economic theory systematizing and interpreting facts, and deductive theory testing the hypothesis of rational behaviour. But the answers provided are valuable, since they are symptomatic: they provide a tableau of the economists dealing with the East European economic systems and their reform.

One large group of the contributors are led in their examinations of reform issues by the traditional socialist values and by the ideal of a "real" (i.e. Marxian) socialism. Socialist values such as equality, community, social interest and rationality on the social level mark out the direction as well as the limits of reform. In their conceptions, therefore, a pre-scientific i.e. ideological justification is given to the majority of issues, such as public ownership, central planning, market intervention on the grounds of welfare policy and the representation of "social interest" in general. Keeping the former, the institutional conditions of a market economy, enterprise independence, plurality of forms of ownership, competition, economic and political democracy should be introduced in order to promote economic efficiency. In the papers of the most prominent representatives of this school the two opposing elements almost necessarily lead to the vision of self-managed socialism. What is really disturbing in these papers of socialist inspiration is the lack of a realistic analysis of the socialist values, of the limits these present in practice, and of the relations and contradictions of market principles and elements. To put it quite simply: how much will the market and the state tolerate one another? My impression is that even our empirical knowledge is now more than what is used in the ideological approach of the above-mentioned papers.

In another, skeptical, approach "market socialism" is identified with the system of the advanced welfare states (model country: Sweden). According to this view, socialism is the outcome of the socio-economic development in efficient market economies. Socialist values are considered untimely and put aside. Reform pragmatism aimed at efficiency is the logical outcome of this way of thinking, the trouble with it being that it is illusion or self-illusion, since valueless reform pragmatism does not exist: practical reform activity represents, namely, a complicated issue of reconciling, balancing, and ranking social priorities.

The third approach to "market socialism" is again strictly value-guided: its values are the respect for the individual, liberty, and democracy. The representatives of this school hold the view that the economic system of democracy and free enterprise (market economy) is also the most efficient way to attain our economic objectives. In this context "market socialism" represents an intellectual and practical reform issue: that of transition to market economy. As against the first school, representatives of this third approach are entirely pragmatic as far as institutional

solutions are concerned. This is, in contrast to the second approach, a problem solving reform pragmatism, aware of values and applied accordingly.

Even somewhat awkwardly put questions can be useful if they throw light on the state of scientific research and encourage further consideration of the questions. The term "market socialism" by all means refers to a reform situation in which most of the East European economists take a stand in one way or another. Which is the way, however, for economics to be efficient, and which role can economists fill in solving reform tasks?

The discussion of the present problems is made more difficult by the overly reform-centered character of East European economic research works and the institutional tradition of analyses. The most important results of Hungarian economics have been achieved in the field of non-normative descriptive analyses of the planned economy. Highly valuable sociological descriptions of institutions have been made of the formal and informal structure of the system before and after 1968, of economy being firmly embedded in the political system, of various pressure groups functioning in the background, bargaining mechanism, cycles, campaigns, regulation by norms, etc. Yet in its investigations of the innumerable facts or reality which can be seen and systematized from many different aspects, this literature has always been guided by the problem area of the reform; it is largely value-oriented as are all the empirical and institutionalists approaches. Its starting point and obvious conclusions are rooted in and are aiming at the same issue: how to supersede the Soviet-type economic mechanism. The base of comparison is provided by the market economies; analyses point out the comparative systemic differences between Soviet-type and market economies on the one hand, and those essential considerations which may play a key role in transforming the economies under examination, on the other. It is in fact a sociological approach researching into the global functional mechanisms of the system that determines the subjects of examination: economic policy, the sectoral system of state administration, the party's role in the economy, the relations between enterprises and administration, the special situation and particular interests of large enterprises, etc., and finally, ownership. No economic analysis i.e. such as is based on a theory starting from rationally behaving subjects has been made of ownership, rules and regulations, enterprises and policies. What we know is certain empirical facts and statistical indicators of economic output, whereas we have no analytical theoretical knowledge of the functioning of economy. Our global picture of economy is basically a black box (with rare exceptions) with its input composed of the results of political relations and affiliations, and an output consisting of indicators revealed by statistical methods.

The lack of a microeconomic analysis to complete the sociological description and the intertwinement of economic theory and reforms present serious difficulties exactly from the point of view of the reforms. To reveal the weak spots of the system does not amount to giving practical orientation: description does not directly lead to prescription. The knowledge that the economy must be transformed into a

market economy with as many of its known attributes as possible does not yet offer any reliable knowledge as to the outcome and effects of certain market-oriented reform measures taken in a given initial situation. Stigler writes: "If they have anything of their own to contribute to the popular discussion of economic policy, it is some special understanding of the relationship between policies and results of policies. The basic role of the scientist in public policy... is that of establishing the costs and benefits of alternative institutional arrangements. Smith had no professional right to advise England on the Navigation Acts unless he had evidence of their effects and the probable effects of their repeal. A modern economist has no professional right to advise the federal government to regulate or deregulate the railroads unless he has evidence of the effects of these policies." [1]

The reform economists relying on an institutionalist background proved to be one-sided and even fetishists exactly in their role of advisors. Thus it is exactly the reform issue of "market socialism" that can make it clear that East European economics has come to a turning-point where it has to switch over to the adaptation and application of micro theory deducting from the hypothesis of rational economic actors, in order to found macroeconomic and economic policy actions. This is the only way for economists to obtain comparative advantages over sociologists in providing answers to economic questions.

Parallel with the transformation of economics, economists must reconsider their place in the reform policy. The reformer is, on account of his proper role, for intervention and against theory,[16] since the latter points out the limits of the former. And indeed, an anti-theorist attitude is often seen. In Eastern Europe scientific development (as well as the development of reform policy) is by all means impeded by the intertwinement of economist and reformer. In order to fulfil their tasks of scientific analysis and political advice, economists must be willing as well as able to withdraw from the direct politicizing. The conditions for this must be provided, of course, by an appropriately differentiated pluralistic political system.

To sum up: in the answers given to the all round inquiry the idea of returning and of a new beginning is recurrent. This can be interpreted in two different senses: as the end of a strictly planned economy and return to a market or mixed economy; and as return to the classic and neoclassic traditions of economics. Such return can create the conditions of progress.

[16] Professor W. Allen *Wallis* of Rochester University demonstrates this correspondence in the light of the antagonistic development of politics and theory with reference to an interesting situation in the history of theory: "we have to notice that what seemed empirically to blow away the institutionalists like dandelion fuzz was Keynes's General Theory. All of a sudden the very same people who opposed all abstract reasoning were seizing upon it because it supported the conclusions for which they had previously thought there was no theoretical basis, and the very same individuals (I suppose Alvin Hansen is the most striking case) jumped from being institutionalists to being theorists." [2]

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# CONTRIBUTORS

Prof. Aleksander *Bajt*, Economic Institute, Ljubljana
Leszek *Balcerowicz*, Central School of Planning and Statistics, Warsaw
Charles *Bettelheim*, Social Sciences University, Montrouge
Henk C. *Bos*, Erasmus University, Rotterdam
Jozef M. van *Brabant*, United Nations, New York
Prof. Wlodzimierz *Brus*, St. Antony's College, Oxford
Ellen *Comisso*, University of California, San Diego
Béla *Csikós-Nagy*, Academician, Hungarian Economic Association
Karel *Dyba*, Institute for Forecasting, Prague
Tamás *Földi*, Economic Information Unit of the Hung. Acad. Sci.
András *Hegedüs*, sociologist, retired politician
Róbert *Hoch*, Institute of Economics of the Hung. Acad. Sci.
Prof. Branko *Horvat*, Economic Faculty, University of Zagreb
Dr. Béla *Kádár*, Institute for Planned Economy of the Hungarian Planning Office
Peter *Knirsch*, East-Europe Institute, Free University Berlin
Prof. Ferenc *Kozma*, Political Institute of the Hungarian Socialist Workers' Party
Mihály *Laki*, Institute of Economics of the Hung. Acad. Sci.
Prof. Marie *Lavigne*, Centre for International Studies of Socialist Countries, Paris
László *Lengyel*, Financial Research Share Co.
Gennadij *Lisichkin*, Institute of the Economics of the World Socialist System, USSR Acad. Sci.
Paul *Marer*, School of Business, Indiana University
Prof. Tamás *Nagy*, Institute of Economics, Hung. Acad. Sci.
Alec *Nove*, University of Glasgow
György *Petőcz*, Institute of Economics, Hung. Acad. Sci.
László *Szamuely*, Institute for Economic and Market Reseach and Informatics
Márton *Tardos*, Institute of Economics, Hung. Acad. Sci.
Hans-Jürgen *Wagener*, Faculty of Economic Sciences, University of Groningen

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# VANISHED MYTHS—WAVERING INTENTIONS (SMALL ENTERPRISES REVISITED)

T. LAKY

Since 1982 several tens of thousand small economic units have been founded in Hungary both in the new forms called "small venture" and in the traditional ones (private artisans, private retailers). In spite of the increase in number their presence can hardly be felt in the operation of economy. Analysing their economic role, the article presents three characteristic types of the small forms: those striving only after selling surplus labour, the small-producers and the entrepreneurs.

When I first wrote a review in the periodical *Valóság* on the domestic small enterprises—which were then regarded as novelties—I thought with good reason that an objective presentation of their manifold forms might dispel some myths then hovering around them [1]. Such myths had been generated by feelings of either enthusiasm or anxiety. Today it is no longer necessary to dissipate these myths because the vague knowledge which fostered them has been replaced by a more realistic understanding (except perhaps those about the incomes achievable in the small enterprises). Hundreds of thousands of people have acquired profound knowledge about the advantages and disadvantages of each form, and about the rules of their establishment, operation and taxation—especially when they themselves have considered trying one of them. 450-500 thousand people were working in some of the new forms by the end of 1987, approximately 10 percent of the active earners. The small enterprises now participate in our everyday activities and one cannot imagine how the economy could subsist without their supply of hundreds of goods and services. Also, for those participating in the small enterprises it is unthinkable that they could do without the extra income earned through the small enterprises. Although such income is the financial basis of existence for only one-fifth of the half a million participants, the other four-fifth also depend on the monthly extra income in order to maintain or occasionally even significantly raise their standard of living. Thus, the small enterprises have become rooted in the economy and society. The myths have vanished—and they have been replaced by the very simple facts of everyday life.

However, nobody is really satisfied with the results. Public opinion is a little disappointed because, so far, the small enterprises have increased the supply of the customary products and services to only an almost imperceptible degree; in the worsening economic situation the decrease of shortages and improvement of services, despite their presence, cannot be felt. Instead of falling, prices are rising and quality does not show any significant improvements in respect of either

products or services. On the other hand, people see the rapidly growing wealth of certain social groups and often suspect that illegal earnings lie behind such wealth. Many are irritated by the saliently high income of those working in VGMK-s[1] or specialized cooperative groups, compared to the wages they earn in their full-time job.

The authorities are also dissatisfied since, even within the sphere of small enterprises, competition has not developed; even the smallest ones do not compete in order to "win" customers. The productive capacity of the economy has not improved. The money accumulated by certain groups of the inhabitants is not tied up in the small enterprises and does not serve to extend production—rather, it appears in the form of consumer demand, continuously endangering the equilibrium between incomes and available commodities. At the same time, the small enterprises are invariably short of, or even lack, capital.[2]

However, the majority of autonomously operating small enterprises are also dissatisfied. The conditions of their operations are not improving and their tax burdens are growing. The difficulty and conditions related to the acquisition of materials and equipment are worse than in the case of the large organizations. The security of their operations does not grow; what is more, they are—with good reason—afraid of the introduction of new restrictions which go beyond the already existing ones.

I shall try to outline only a few of the host of reasons for general dissatisfaction, and I shall point out the trends in the socio-economic situation of small organizations and their members which already seem to have become permanent.[3]

When the small enterprises were established, they carried two important promises in their name, i.e. that they would be *small* and that they would be *enterprises*. It was generally agreed that in every area of the Hungarian economy—in industry, transport, trade, and in all the other sectors—the small-scale units would be able to cooperate with the large organizations and would be able to adjust rapidly to the changing requirements—thus they would be indispensable.

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[1] VGMK (enterprise business work partnership) is a voluntary association of company employees who, after the official working time, manufacture components and assembly units for the company, using the company's equipment. The orders are placed with them by the company, at prices agreed upon, in the form of subcontracting. (Ed. note)

[2] The official of the Ministry of Finance in charge of the small enterprises wrote in 1986 that "according to the available data, the amount of capital invested by the small entrepreneurs themselves is minimal—merely a few thousand forints on average. The amount usually constitutes the starting capital, since the income earned by the operations is converted into personal income" [2]. The situation did not change in 1987.

[3] When writing this paper the data of 1988 were not yet available, therefore I have used the yearbooks of the Central Statistical Office and data processed by the Institute for Labour Research for 1987 for my analysis [3]. However, the phenomena dealt with have not been changed by the further growing number of the various forms.

However, those who have been hoping for a growing number of small organizations can, as a matter of fact, be satisfied: in the national economy—apart from agriculture—about 15 thousand small economic units of some new type, (213 state-owned small enterprises, 2126 small cooperations, 11200 GMK-s)[4] and about 36 thousand traditional ones (artisans, private small retail shops and restaurants) were established between 1982 and 1986. Thus the 82–83 thousand small-scale organizations which had existed before (i.e. rented units, artisans and retail trade) had their number increased by 51 thousand. Almost 500 civil-law associations, a further 500 organizations operating partly in private retail trade, and finally 900 independently specialized cooperative groups were established.[5]

From this brief assessment, and from the relative proportions behind the increase of the new and the old forms (one-third to two thirds respectively), a single conclusions can immediately be drawn: the new forms of organization have been less attractive than the old ones; the conspicuous data showing growth in the number of new ones were in fact pushed up by the VGMK-s and specialized groups (while the old ones often grew primarily by trading activities).

As a whole, in 1988 (apart from agriculture), altogether approximately 144 thousand small organizations were operating: the above-mentioned included 15 thousand new-type units and, within the sphere of the traditional small organizations, 83 thousand artisans, 35 thousand self-employed retail traders, and 11.600 rented shops and catering units.[6]

This means that—hypothetically and according to the statistical average—in the non-agricultural sectors of Hungarian *national economy* the approximately 5000 traditional organizations of the socialist sector are currently surrounded by about 144 thousand small economic units. In other words, on average there are nearly 30 various types of small organizations for every big one.

Although the presence of 144 thousand small units is significant, in the organization structure of the economy it is invariably the large enterprises—what is more, in certain sectors enterprises very large even by international comparison—

[4] GMK (business work partnership) is an independent association comprising a limited number of full-time working individuals partaking in economic activities (production or services). (Ed.note)

[5] As can be seen, the summary does not include the VGMK-s, and those specialized cooperative groups which are similar to the VGMK-s. Today the opinion is already rather widespread that these cannot be considered as "economic units". From the approximately 19 thousand VGMK-s, a maximum of a few dozens and perhaps one-third of the 2300 specialized groups can offer some product or service of their own, in addition to supplementary labour for their companies.

[6] Although it would very likely support my arguments, here I do not include the conventional forms of agricultural small-scale production, i.e. the household plots and auxiliary farms which closely cooperate with the large-scale organizations, nor the sideline production units of the cooperative farms and the small-scale joint ventures of agricultural large enterprises (mainly for food processing); this is because, later on, it would necessitate several digressions.

which are dominant. If we are unaware of their presence, a very important reason for this is that their economic activities and the sphere of their market relations—if only because of their size—are in fact very small.

## Unutilized opportunities

Let us first look at the small enterprise sizes according to the number of employees. Legal provisions have, from the outset, defined the manning level of the new and the old organizations of the various forms, of those working in the state-owned, the cooperative, and the private sectors. However, the limits permitted are much broader than the numbers actually employed.[7] The manpower of the *state-owned small enterprises* is not limited. The average in 1985 was 128 employees. The *small cooperatives* are permitted to employ 15 to 100 persons (though in certain cases the top limit can be exceeded)—on average they have been working with 45 employees. There is, however, no limit to the number of people who can be employed in the civil-law associations and the *specialized groups* which can be established by the cooperatives. The average in the former was 4 and in the latter 37 persons. The GMK is allowed to have 30 members (40 persons together with the employees) and may also employ family members. The actual average number is at present seven persons. From the traditional organizations, in the workshop of an *artisan* 13 persons may work—this figure includes family members, apprentices, employees and the master; the actual average is about 2 persons. In *retail trade* as well as in the *rented public catering units* and those working *on the basis of a contract*, 13 persons are allowed to work. The average in the former is 1.6 and in the latter 3.5 persons, and in the small shops instead of the permissible 5 only 1.8 persons are working.

For some years now the average sizes have almost invariably reached—with the exception of the small enterprises and small cooperatives—a maximum of seven persons. Even a part of this figure is a "sham", registered merely for tax reasons. On the other hand, of course, many are working who need not be registered,—occasional day-workers and helpers. There are also some non-registered employees who are illegally employed.

It is worth complementing the average numbers with a few data. More than half the small cooperatives (54 percent) consist of a maximum of 30 members. More than 90 percent of the artisans and more than 70 percent of the retailers work alone or with only one family member. Merely the average size of the state-owned small enterprises is representative of the small-scale plants. However, the activities pursued by the small enterprises—repairs of radios, TV sets, or domestic appliances

[7] From 1989 the new Act on Economic (Business) Associations has changed the limits, permitting 500 members in the units of the private sector.

in the households, certain operations of car repairs, hairdressing etc.—do not necessarily require plants working with 50–300 persons. *In any of the forms where the number of people who can be employed has been limited by law, the frameworks allowed were actually filled up in only a very few cases.*

We can now draw the second conclusion: the small organizations—especially those belonging to the private sector—are not only very small, but for the moment they not even show any intention to grow and to fill up the permissible limits of employees. Also, apart from VGMK-s and specialized groups, only about half of those working with them have been relying on them as the basis of their subsistance. This is a situation which has remained unchanged for years. The other half of them use these organizations in order to gain extra earnings by exercising their working abilities and professional knowledge in their free time. In 1987 23 percent of the GMK-s' members, 43 percent of the civil law associations' members and 54 percent of the artisans were working full time.

Beyond the manpower, even the capital of the small enterprises—of both the new and the traditional types—is invariably small and the majority of them are not thinking of increasing it,—at least not for the time being.[8] As is well-known, shops with up-to-date equipment are also rather rare among the artisans; the majority of them are satisfied to get by with the minimum tools and equipment needed to pursue their craft.

Capital investment is, of course, not an end in itself. It is the benefit of work pursued with better facilities and more effectively, and the economizing on time, on material and on efforts that justify investment. There are some activities for which capital is not even needed—the capacity to work, and professional knowledge, i.e. expertise, are enough.

A large number of other activities also need minimum capital: the mechanic coming to repair the radio, the TV set, or the washing machine, usually arrives with a bag of tools (and parts) which is enough for almost any of his operations. The house painter, the shoemaker and several other craftsmen can also rest satisfied with a small capital investment—often they do not need to invest into the means of production any more than the sum necessary to buy a car. (Though to set up a self-sufficient workshop for such activities would in fact cost a lot more.) Finally, there are crafts and activities where the job needs a well-equipped workshop, with a large variety of—often expensive—machines and instruments; such are some engineering products and services, and/or certain branches of motor car repairing.

It has been a typical feature that, over the years, new organizations have been established for activities where capital can be neglected: working capacity, special

[8] The finding of *Gálik et al.* [3] is that, at the end of 1987, the capital of small organizations working in some form of association was altogether 34 thousand million Ft; although its amount has been increasing, the per capita volume has decreased. The invested capital in the new forms was only 2 percent of the national value of capital.

knowledge and perhaps a few tools are sufficient. (A quarter of the GMK-s pursue some form of industrial activity, another quarter are involved in construction work, and half of them are engaged in intellectual or material services; it is usual for the civil-law associations to carry out intellectual services. There are also many new small cooperatives which perform intellectual activities, and therefore they do not need to invest capital.)

The fact that the small organizations have, in the majority of cases, an operational staff of 2-7 persons and are not willing to grow, leads to the third conclusion—that, contrary to the promise inherent in their name, they are not particularly enterprising. This conclusion is backed up by their low or even zero-level of capital supply. Most of them are simply family organizations which try to sell their labour and professional capacity in their free time, or attempt to pursue some small-scale production.

## The three pure types of small organizations

The selling of extra working capacity (labour power), small-scale production, and enterprise mean three types of socio-economic objectives and these are essentially different from one another; their participation in the economy is based on different interests and values.

Therefore, I will try to present their typical characteristics and their pure types on the basis of a few criteria—at least as they can be understood under the now prevailing conditions of the Hungarian economy.[9] When describing the three types I shall first give a brief summary of the typical characteristics, using the same system of logic and theory in each case.

For the purpose of comparison[10] I have summed up the characteristics of those (in Hungary very well known) individuals who, in addition to their full-time job, pursue extra work to earn extra income. Selling working capacity (labour power), physical strength, professional knowledge, special skills, in legal or illegal (non-taxed) form at the expense of leisure time is a worldwide phenomenon.

[9] The "pure" or ideal type—as interpreted by Max *Weber*—is a description given for the sake of making things comparable. It strives to emphasize purely the essential particularities and neglects the multiple phenomena of reality which may often shade the essential characteristics or which may even be contradictory to one another. "The more clear-cut and unambiguous the ideal types, i.e. the more abstracted they are from the real world, the better they can be used from the aspects of terminology and classification, and the more appropriate they are from the point of view of heuristic methods."[4].

[10] Selling extra labour is the chief form of what is called in everyday language the "second economy"—this differs from the more accurate definition by R.I. *Gábor* [5].

*The typical characteristics of selling extra working capacity*

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|---|---|
| 1. | *Objective:* to obtain additional income; to follow the consumption level of the guiding social stratum. |
| 2. | *Economic function:* to meet the demand in the area of the given activities based on the working capacity (labour power) of the members. The organization is able to respond to changes in the demand (market) only in a narrow scope of movements, within a sphere and by ways determined by the working capacity of the members. Offers made by the organization can also only be extended up to the limits of the members' working capacity. |
| 3. | No *capital investments* are made. They are not even required by the activities and they would also be contrary to the interests of the members—these interests being linked to short-term extra earnings. |
| 4. | *Profit* is the result of selling personal working capacity (labour power). |
| 5. | *Income* is consumed by the members; it appears in the market as a consumer demand. |

In Hungary it was the lasting shortage of labour and the shortage of commodities and services—along with the regulation of enterprise incomes—that long ago contributed to the creation of legal frameworks for many kinds of auxiliary jobs. These frameworks have been widely extended by the various forms of small organizations.

All the new forms of organization are suitable for earning extra income (except for the state-owned small enterprise which only employs full-time workers). The members may belong to any of the several strata of society. One can find among them the unskilled worker who sells his physical strength, the office clerk who sells his or her (persumed or real) ability to organize (e.g. rented accommodation agencies), the university reader or lecturer who sells his knowledge, or the top company leader who utilizes his special knowledge or perhaps his business relationships.[11]

The organization is based on skills which have already been obtained and/or the knowledge of the members—while the connections they have with their state-owned or cooperative place of employment also play a significant part. Those who establish such an organization do not intend it to be a long-term viable business, but merely an instrument for the moment which gives them a new framework for their old objective—namely, to complement their personal income. Their activity is a combination of what they have pursued earlier—either legally or illegally; in other words, they carry out repair work or assembly, teach languages, make programmes

[11] According to an assessment, 3 percent of top company leaders and 11 percent of the chief executives participate in some form of small-scale enterprise [6].

(software) or design. The disadvantage of the organized form is that a part of the profit is collected in the form of taxes, whereas its advantage lies in its legality; in other words, by making an acknowledgement of lawful work and earning, they become more respectable for some of the customers. In addition, the fellow-workers also bring some work, and this makes it easier to assure more or less continuous activity for all the members.

The *objective* of this organization is *exclusively* to provide a modest rather than large, but *stable extra income* for the members. When there are many orders, they undertake the job with a later deadline, and/or involve occasional helpers. If there is not so much work, they relax and look for new orders. The *capacity* of the organization is, however, *always limited by the members' own working capacity*; they do not wish to grow, they just want to utilize and maintain the already given capacity. Capital investment is either not necessary or an alternative the members do not prefer. Indeed, a significant part of the activities requires no investment—shop, office, or equipment—since the workplace is the site of construction, or the plant of the company which gave the order, or the flat of the customer; in the case of intellectual work it can be the member's own desk—but even the kitchen table at home might do at night!

However, even where it would be necessary and possible, no *investment* is made, since it *would be in opposition to the primary purpose*, i.e. supplementary earnings. As there are no business, or business-developing ambitions, and the objective is not to make the *organization* viable, competitive and able to grow, *the income earned by extra work is destined for personal consumption.* It can be used for basic needs or for lavish, luxury consumption, according to the position of the person concerned. The occasional modest investments are free of risks (tape recorder for teaching languages, new tools for the assembly work, personal computer or a car), since they can be used as investments for the household (being in the sphere of personal belongings) even after the small organization has ceased to exist.

For the majority of people this is satisfactory and they do not want anything more or anything different from it. Their economic attitude is typical, owing to the multitude of socio-economic conditions, i.e. to the obvious fact that it is worth basing one's personal subsistence primarily on a full-time workplace in the socialist sector. This has so far been judged as the most favourable option, for it provides a secure—if modest—livelihood, and at the same time it can act as the organizer or market for the extra work. *It is therefore a natural endeavour for the individual to maintain his or her full-time workplace.*

Any intention to become genuinely independent has not been really encouraged—e.g. by economic policy-makers; while true pressure (as e.g. the danger of losing the full-time job) was also missing.

Nevertheless, there are a few people engaged in small enterprises who—though they started with the intent of obtaining extra income—have also found

some other attractive incentives such as independence, the opportunity to implement their own ideas, or the chance to compete on the market.[12]

The majority of people, however—anywhere in the world where it is possible to live on two incomes, but especially in Hungary—need strong incentives or even coercion to change their life strategies. This is particularly true if such strategies have been formed by socio-economic environmental effects which have been operating for several decades.

Today in Hungary a significant number of the members of the new small organizations sell their labour in this way. (In 1987 51.000 of the 68.000 members of the GMK-s, 2000 out of the 4000 members of the civil-law associations, all those working part-time in small cooperatives, and about 300 thousand members of the VGMK-s and specialized groups—which are not independent economic units, but merely replace labour missing in the company—were involved in this practice.) Calculated in this way, 87 percent of the approximately 412 thousand people working in the new forms of organization sell their extra working capacity (they join those who *individually* and legally sell their working capacity in a broad sphere) in several possible forms. Included among the latter are those who, beside being employed, are entitled to pursue some industrial trade—this accounts for nearly half of the number of artisans.[13]

The selling of extra working capacity (labour power) means a lot of small personal markets, and the relations of demand and supply are in accordance with the extent of personal capacities. The existence of these small markets is obviously useful not only for the individuals but also for the whole of society, since in most cases they meet actually existing needs. They will always have their own place in the economy, because there will always be some needs which can only be satisfied by mobilizing extra working capacities.

Potentially, however, important opportunities will remain unutilized if the activities required get stuck in the sphere of extra work, if the organizations do not accept the challenge of the market, and if they do not undertake growth and

[12] "I have founded a civil-law association with one of my colleagues. We have been working together for about fifteen years... Our aim was simply to increase our salary by a certain little amount of money, by doing some part-time extra work... we thought it would be a good thing if the association enabled us to earn two or three thousand forints each per month. This would make it worth doing, and this would make us happy." After the first and the following series of professional successes they decided to become independent—by then they had been joined by several others. They were not sure of success, "...but we wanted to try it. It was delightful to see that our products were in demand...", and that it was possible to produce rapidly, within a few months, something that had been made in four or five years at their earlier workplace. This story comes from an interview with the president of the small cooperative "Műszertechnika" (Instrument engineering) [7].

[13] According to data of the Central Statistical Office, between 1982 and 1985, compared to the number of self-employed artisans, the proportion of employees licensed to carry on a trade increased from 48.5 to 66 percent.

the necessary investment. That is to say, if they do not grow beyond the sphere of those who increase but, at the same time consume their income.

*The typical characteristics of the small-scale producers*

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|---|---|
| 1. | *Objective*: assuring a livelihood (for the family), on the consumption level of the guiding social reference group. |
| 2. | *Economic function*: meeting demand in a definite sphere of activities, with the capital investment and work performance needed for the activities. They respond to the changes in the demand only in the sphere of these activities and within the scope of the existing conditions (capital investment and the form of work organization). The range of the offered products is increased rather carefully, so as not to risk their basis of livelihood. The aim of the organization is not growth but rather stability, and the creation and retention of a clientele which is necessary for subsistance and the continuation of business. |
| 3. | *Capital investment* is made to the minimum extent deemed necessary (equipment, machines, workshop needed for reaching and keeping a stable market position). New investment projects, such as the modernization of equipment, needed to bring about conditions of stability—can only be enforced by competition. |
| 4. | *Income* is the combined result of invested capital and labour. The decisive factor is labour performance—the degree of capital utilization depends on the labour input. |
| 5. | The main portion of the *income* serves the livelihood of the members (families)—hence, it appears in the market as consumer demand. A smaller part of it—to the extent deemed absolutely necessary—returns into the productive sphere, in the form of capital investment. |

This seems to be the general pattern for such types all over the world. It represents millions of owners of small businesses—the "men in the street" who are the basis of the capitalist economy and who appear with their little supplies in a world where there is vast demand. According to Schumpeter's classical example: the butcher tries to sell his product to the tailor, the tailor to the bootmaker, the bootmaker to the farmer who produces the meet for the butcher. Even if the example sounds a little bit naive, because the forging ahead of mass production in fact changed this simple structure, the essence has not changed. Today too, the small producers and servicing organizations fit into the circulation of the economy as a whole by working according to the demand and supply of their little markets. What is more, their role is growing again, as the demand for products which meet special requirements. Parallel with big industry, the network of small, separately-based and specialized workshops is also growing.[14]

[14] I.T. *Berend* has written about this phenomenon: In contrast to the mid-19th-century or

In Hungary the (non agricultural) small-scale producers represent a relatively very narrow sector of the economy.

Although it is not a homogenous social circle, its body mainly consists of artisans working in industry and services. On the basis of their typical economic attitude and independent of their organizational form, many of the new small economic units are small-scale producers too.

With regard to its internal stratification, this group is essentially as heterogenous as that of the agrarian small producers, or of those cultivating household plots and auxiliary farms—all of whom have been recruited from very different strata of the society. A basic difference, however, between the agricultural and the non-agricultural small producers is that while for the former ones small-scale production means a complementary income, for the latter it is the basis and main source of living. (About 70 percent of the artisans have a household-plot farm and supplement their income by small-scale agricultural production.)[15]

Undertaking autonomous living is the distinctive feature of the small-scale producers. This is, of course, not a decision for life. However, the data related to the initiation of independence, the termination of independence, and the fluctuation in the number of artisans, indicate that under Hungarian circumstances it is not so much the economic opportunities or the widening or narrowing of demand which leads to temporary or permanent withdrawal. It is influenced rather by the changing attitudes related to the ideological function of ownership relations and, together with it, the loosening or stiffening of taxation and other legal provisions.[16]

The activities involving small-scale production do not always require professional knowledge, but special skills or trades which can be obtained after some years of training. In the majority of the trades which require professional knowledge (skills) the activity postulates the existence of an independent workshop, special machines or equipment or, occasionally, significant capital investment.

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even early 20th-century forecasts, modern economic development has presented a great surprise: namely, while the expected concentration process has in fact evolved with considerable impetus... at the same time a *contrary* trend has also unfolded... in significant areas, primarily in the branch of services—which has forged ahead astonishingly and which is gaining ground—the function of small private activities has been reproduced... Thus, the "rotation of concentration" has established small-scale private activity as a substantial branch in the modern 20th-century economy. [9]

[15] Based on the 1983 mobility and income surveys of the Central Statistical Office, the analysis carried out by Á. *Vajda* gives a lot of new and rich information about the artisans [10]. In the following I have frequently relied on her findings. Although as yet is cannot be verified by statistical data, experience shows that the characteristics concerning the artisans which are discussed here, also apply to those who become independent in the form of some association.

[16] More than half (!) of the artisans who were active in 1983 had become independent within the previous four years, i.e. "during the late seventies and early eighties when more liberal economic political attitudes were shown towards small-scale industry".[10]

It is a very important distinctive characteristic that those who undertake small-scale production or services, *invest some capital* in order to be able to work. This may be a large sum or a small one; its source may be a donation from abroad (such were the first key-copying machines), it may be the result of consistent saving in the preceding years, it may be the accumulation of income from legal or illegal extra work, or it may involve the shop or working equipment of some traditional family trade inherited from the parents. (In rare cases it may be some credit. In practice the small organizations cannot borrow from banks, though they themselves do not prefer loan repayments which involve some risks.)

*Invested capital is paid off in line with the actual work performed.* In the income gained by the combination of labour and capital, *performed labour is decisive.* In this case "labour" also means the time spent on "standing by", i.e. keeping the shop open, or offering permanent availability to the potential customers. After all, the clientele represent the true basis of existence. Gaining and maintaining a reliable clientele provides the security necessary for survival. The capital needed for carrying on trade is not considered as an "investment" which yields some return, but is regarded as a means of work and a condition for serving customers properly.

Some (smaller or greater) part of the work—since it is the basis of living—is also undertaken by the family members. The shop or workshop of the small producer is often a family work organization.

Employees are kept to the minimum. This is because, on the one hand, to employ any extra labour is very expensive. On the other hand, the small producers are careful not to extend the family work organization. In Hungary it is quite unfavourable to be a private entrepreneur—let alone having to think about being considered as an "exploiter".[17] Their economic operations can be characterized by sound moderation and, even more, by caution. They are especially circumspect in issues of growth and/or investment. They strive to preserve and keep in good repair what already exists, rather than begin new activities perhaps at the cost of larger sacrifices and new investment.[18]

[17] Only about 10 percent of the artisans employed some personnel—on average 1.6 persons. In 1985 there were altogether 43 active artisans in the whole country who worked with more than 6 employees in their workshop. (Source: Report to the 1986 general assembly of KIOSZ, the national federation of artisans.) The latter are presumably no longer artisans, but very likely entrepreneurs who belong to the next type of small organization. In the 11 thousand GMK-s, there are 5400 full-timer employees. The employees are usually people who did not wish to become members of the organization. [11], [12]

[18] "I must say that in certain respects we were born lucky. It was not necessary to create demand for our products, for it was already there. This is why we have become lazy. We have no plans to broaden our product structure because the whole of our capacity is covered by orders... It is our principle that at the end of the year we distribute our profit. We clear out the cash; when we start again in January we pay again as necessary." (Interview with the leader of an engineering GMK. Manuscript, in the Institute for Labour Research.)

Even is cases where demand is good they pay great attention to the balance between family livelihood and investment, since the leading objective of the activity (i.e. family living) must not be put at risk. To make investments, such as purchasing new machines and new instruments, or acquiring new workshops is only permissible—even when it is in the hope of increasing future income—if it reduces the production costs an/or if the prevailing way of taxation by the government does not endanger the subsistence of the family.[19]

It is mostly competition that urges the purchasing of more efficient equipment in order to modernize the shop or workshop. (This is another reason why it is a problem that in Hungary the competitors do not represent a power pushing for modernization and innovation. Yet all over the world innumerable new means of technology and new production processes are adopted through masses of small workshops—thereby permanently increasing the potential of the economy.)

Under the Hungarian circumstances the restraints discouraging investment strengthen specifically the propensity for consumption (occasionally luxury consumption). For the small producers the whole point of their economic activity is often the possibility of achieving a social position expressed by the way of life and the circumstances of their living.

In their way of life they do not follow business standpoints but social patterns. In their mode of living they strive to join strata having higher incomes than their own, consequently, organization for small-scale production is subordinated to this goal. The aim may be a personally owned house, a more comfortable flat, a holiday home, the children's education, or simply the consumption of the income. In other words, as far as possible, they behave in a way which does not raise the attention and suspicion of the authorities and the social environment.

According to the current order or social values, this can include several forms of luxury consumption, e.g. expensive sports, travelling abroad, clothing according to the latest fashion etc. (While in the interwar period the majority of the stratum of artisans and small shopkeepers—who represented a significant mass of people—"...took their place at the bottom of the social ladder" and "passed over from the hopeless lot of being workers into a no less hopeless independence", the artificially

[19] The product of a GMK leader—who had earlier been an artisan and now manufactures a special plant—protection agent on the basis of his own invention—is in much demand. Thus he could sell much more than the quantity produced currently by two families. He gave a definite answer to our question, "Do you not think about running up your output in the course of the next few years?" He said:—"I do not intend to grow beyond the present framework." He wishes to buy a station waggon because carrying the raw materials and finished products by hired trucks is too expensive. "I hope", he says, "nobody will find fault with this plan of mine, since the respective decree says that as long as it does not affect the family income level, tax-free accumulation is permitted. (Interview—a manuscript in the Institute of Labour Research.)

reduced number of their present-day successors have achieved a much higher ranking on the considerably rearranged income scale.[20]

Under Hungarian conditions the achievements of an income judged fair in a narrower or wider social environment is rarely threatened by competition or decreasing demand; it is mostly influenced by deteriorating conditions of operation—primarily by taxes.

Complete withdrawal involving the winding up of the activity and, with it, losing part of one's existence, also means losing the clientele and leaving the invested capital unutilized. Yet this is a last step only taken under the pressure of necessity. Certainly, the small enterprises try to avoid this course of action. For a time they try to maintain the workshop and the sphere of business, even at the cost of self-sacrifice; thus they increase their complementary incomes: they change the main job into a secondary one and the marriage partner also undertakes some employment (this happened in mass numbers in 1984–1985). However, they do not abandon the equipment while there is some hope of starting anew. Also, if there is some possibility of doing so, instead of withdrawal, they attempt to counterbalance the growth of taxes; they do this by raising prices, by increasing the share of work performed without invoicing, by keeping back investments or by suspending the activity.

With very few exceptions, all the small organizations not included in the preceding type, belong to this one. It includes the full-time working artisans, the GMK-s and civil-law associations that pursue either industrial or construction work, or servicing activities, which do not merely sell extra time and labour. (Also, the retail traders working in a family work organization, and those who operate state-owned or cooperative shops and public catering units on the basis of renting it or any other kind of contract, can be classified as belonging to this group.)

Any, otherwise modest, individual supply of each member of the masses of small producers is—today more than ever—a natural and indispensable part in the operation of a modern economy.[21] This group of society has to strive for stability; for the sake of its livelihood, it is forced to meet the demand in its sphere of activities and it has to permanently modernize its means of production. However, the factors which urge such behaviour have been missing from the Hungarian economy for decades.

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[20] From the analysis of Á. Vajda [10]: in relation to other groups of earners the artisans represent the highest proportion of those living in flats with three or more rooms (artisans 27%, intellectual (brain-)workers 23%, agrarian manual workers 17%, and non-agricultural manual workers 16%); in flats with all the usual facilities, behind the brain-workers (representing 88 percent) they were in second place (74 percent).

[21] The economic successes of Italy have been achieved during a recession in the world economy—a recession has lasted a decade and a half. This is usually explained by two factors: modernization of large-scale industry, accompanied by reduction of scale *and* strengthening of the multicoloured world of the small economic units. See, for example, the analysis of Á. Simonyi [13].

Most of the small producers are satisfied if they can simply maintain their business, and if their business sustains them and their family. Under favourable economic conditions, however, this is the sphere where the organizations are ready to grow and change, i.e. where genuine enterprises are produced.

*The typical characteristics of enterprise*

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|---|---|
| 1. | *Objective*: profit, i.e. a surplus over the value of the assests (capital) invested and utilized. |
| 2. | *Economic function*: meeting the demand in the sphere/s/ of activity which promise profit, within the scope of manoeuvring limited by the invested capital. By responding sensitively to changes of demand, they terminate or reorganize their activities. Endeavours are aimed not at stability but at the permanent utilization of existing opportunities. |
| 3. | *Capital investment* is carried out to the largest possible extent, depending on the expected profitand risk. In order to pursue activities promising higher profit and requiring rapid and dynamic extension of their supply, enterprises are ready to mobilize foreign sources too, in addition to their own capital. When profit is declining, investments in this activity are reduced and/or capital may be completely withdrawn in order to invest it in some other profitable branch of business. |
| 4. | Within the *income* resulting from the combination of capital and labour, capital is the decisive factor. Intellectual,manual or organisational work serves the utilization of capital and it helps to maintain its profit-yielding capacity. |
| 5. | The main part of the *profit* is re-invested in economic activities, in order to boost the profitable ones, and to organize new ones. Personal consumption remains on the level of the guiding social reference-group; it is not significantly extended, even if the profit grows rapidly. |

"The entrepreneur", as A. *Madarász* quotes from Schumpeter [14], "... is a *sui generis* phenomenon who, like the poet, is born, not developed. His characteristics are foresight, imaginative power, and, above all, a determination which is able to turn against the pressure of routine. Furthermore, he has the ability to seize and realize opportunities inherent in anything that is new. In his behaviour he is in perfect opposition to static economic subjects, because his relationship to the economic process and his actions are not determined and called forth by the process—it is rather the case that he determines the development. He is not passively subordinated to events, because he actively initiates them."

Nowadays this reverence is somewhat ridiculous, especially the praise of personal properties and faculties. Today even one who is not too well versed in psychology, knows—if only from the plenty of experience gained through our history—that a personality may grow strong or waste away, depending on the forces at work in

the environment. Thus the numerous characteristics of the social order of values, as well as the economic circumstances, play a decisive role. In fact, the entrepreneur is not born, he is developed—if the circumstances allow this. Still, it has to be acknowledged that the entrepreneur who, instead of the routine-like combinations of production, brings about new ones, opposes the trends to which most people are socially accustomed, and is prepared to risk failure, is more daring than the average man. Therefore all economies consider the entrepreneur to be a "changer"; he is the most important figure of the economy because he dares to stand up against traditions, and he creates the enterprise—namely, the economic organization which is sensitive to the relations of demand and supply. The main criteria and the currently most accepted definition of the enterprise have also been formulated by Schumpeter [15]—although he relies heavily on, and quotes, Max *Weber*.

My primary endeavour is to sum up here the characteristics distinguishing this form from the previous two types of organization as they can be interpreted under the circumstances of socialist economy and society.

The enterprise is, according to the classical definition, profit-oriented. If a given undertaking does not yield the surplus expected above the investment, capital will be withdrawn and invested elsewhere. Hence, the enterprise will participate in the process of economy because and until it can promise opportunities of gaining profit. In the hope for profit the enterprise runs several risks: it risks the investments made by the founders (realization of the capital which was needed for the foundation and operation), occassionally it risks all personal property, and it risks the income of the participants in the enterprise.

Thus, the active participation of capital—i.e. investment which can be expressed in terms of money—in the economic activities is an indispensable condition for carrying on the enterprise. Investment in the enterprise—which in the previous types could be neglected, or played only a complementary role alongside human labour—is fundamental, and utilization of the invested capital becomes the primary objective and/or an inevitable condition. The determining factor in the profit—i.e. in the benefit stemming from the combination of capital and labour—is no longer the input of human labour but some other circumstances: for example, quick adjustment to demand, ability to create new demands or resoluteness in eliminating non-profitable activities. In other words, the function of labour can also be fulfilled by some "new idea".

The enterprise strives to preserve its flexibility, not its activities. It is ready to change products, services, or organization sizes—thereby adjusting to demand. In cases where there is excess demand for some product, the enterprise is prepared to boost its supply and/or to supplement its own resources by involving external capital. The taking on of a loan—with acceptable interest rates—is often regarded as a reasonable risk.

The interest of those participants linked to successful enterprises is stronger than those whose success is linked to the prestige they have achieved in their di-

rect social environment: the former wish to be acknowledged on a national or international level. Personal consumption becomes subordinated to success. If an undertaking needs some investment, the requirements of the family or household are pushed into the background. (It is another thing that in the case of success the level of household or personal consumption may exceed the level characteristic of the social stratum of the entrepreneurs.)

A decisive part of the profit is, however, year by year reinvested in the enterprise; it will be embodied in continuous developments in new and increasingly efficient equipment and opportunities. If the enterprise does not succeed it is liquidated and the members attempt to invest the remaining capital in a new, more promising undertaking.

The evolution of a stratum of entrepreneurs oriented to growth—and valuable for any society—were, for a long time, punished rather than stimulated by the circumstances of the Hungarian economy. Perhaps the social and political tolerance which now at least takes notice of and accepts the utilization of extra labour power and small-scale production will, to some extent also let enterprise come to life (even if this process is still not liked). It is a miracle that, under the conditions of a political, ideological and social public opinion which has deliberately restricted enterprise and has grown sometimes rather severe, such undertakings could, in various forms, come into existence. Such are the few dozen of artisans, GMK-s, civil-law associations and small cooperatives operating in the form of an enterprise. For example, J.*Pintér*, an artisan living in the village of Kecel, became widely known in Hungary through articles written about him in the press. He has invested tens of millions in workshops and machines needed for production in order to meet the ever increasing number of orders. He now manufactures products for export and these meet even the most sophisticated requirements. His net income in 1985 was more than a million—but he himself and his family live in a modest way: "his home is neither poor, nor luxurious, but one of those of which two hundred thousands can surely be found in the country."[16]

In another context I have already quoted the interview with the president of the *"Műszertechnika Kisszövetkezet"* (Small cooperative for instrument engineering), who is an engineer engaged in technological development. The article about him was published in the periodical "Mozgó Világ" (Moving world). Starting from a civil-law association, where he began working part-time, he and his partner moved into full-time work with a GMK of 30 members, and eventually they arrived at a small cooperative, which now may employ 100 members (according to the prevailing regulation). In parallel, they have moved from the first order of 120 thousand forints to the 600 million turnover in 1986. Between 10 to 15 percent of the profit was usually spent on wages and the majority was always accumulated for the development of the undertaking, buying materials, or financing investment projects. [7]

One more example from our own data collection: a metalworking GMK has seven members, four of whom are full-time, and three part-time workers. In the GMK, which today produces an annual income of several millions, the principle is that the full-time workers may earn one hundred thousand and the part-time workers fifty thousand forints per annum. ("These are, of course, not rigid figures—the amount may be 10-15 thousand more or less.") All the money remaining after tax is invested: they have built up a new workshop, purchased machines and a lorry. In addition: "The idea came to me when heating was installed in my house. I heat with oil. The oil tank is buried in the garden. I found out that it was unnecessary to buy a new one, because the old one could be fabricated out of my iron materials with minimum work. But if it is as simple as that, why not make another one in addition to it? And if I have these, what would it take to obtain the right of selling household heating oil? We acquired it, and ÁFOR (the state company for oil trade) is a good partner. This is all very well, but people buy oil only in winter, or perhaps late in summer. So, if someone has to sit there all the time anyway, we might be engaged in something else, too. Then came the thought of trading in building materials. Now we also undertake purchasing and transport. The customer tells us what he or she needs and we search for it and deliver it within a fortnight. We ask for a down-payment of 50 percent of the estimated price. This is good for us, because it is capital which is easy to circulate... An amount of hundred thousand forints is invested in trading activities. The investment returns the sum of the capital five times a year. We work with an average profit margin of 10 percent, we do not want more... Now I am very interested in the idea of operating a "csárda", a Hungarian-type roadside inn. I have already chosen a house on the outskirts of the town. Some people think it ridiculous, since there is a restaurant opposite of it. But I know what I want. And also many other people know I do. One of the town leaders said, "If this GMK issued shares, I would immediately buy some for a hundred thousand forints." (Interview: manuscript in the Institute of Labour Research.)

Though most of my examples are about enterprises, they are still rare among the small organizations. The majority feel neither forced, nor encouraged to follow the way of "Műszertechnika" or of any other successful undertaking.[22]

It is a hopeful sign that some entrepreneurial organizations already exist and that owing to this, more and more of the most successful GMK-s and civil-law associations are becoming small cooperatives offering broader frameworks and possibilities for growth. However, the tilting of the balance is still hardly perceptible.

[22] The president of "Műszertechnika" was not born an "entrepreneur", and he says he does not feel like one. "It was astonishing even for myself that, having been engaged for thirteen years in research and development, I am now a business manager—not one who sits in libraries, rummaging in literature. Earlier, I had spent most of my time sitting in the library of the Institute of Geophysics and in the Technological Library, learning and learning..."

To demonstrate it in terms of magnitude, it can be said that hundreds of thousands of people sell their extra labour power; there are about one hundred thousand small-scale producers and, perhaps, 100 or 200 genuine small enterprises: a few dozen artisans, and several dozen GMK-s, civil-law associations, small cooperatives and specialized cooperative groups. One can even say that in the sphere of both the new and the old organizations there are relatively rather few small producers, but even fewer enterprises. I think it is no longer necessary to enumerate the consequences of the unutilized opportunities because of the repressed activities of the great mass of small organizations. This is the reason why, despite so many good results coming from their activities, we are still dissatisfied.

## Persistent hesitation

The changes in the proportions of the three organization types (and along with them, the creation of new relations of demand and supply, and the strengthening and broadening of markets around the large numbers of small organizations) are invariably hampered by great powers. Without claiming to be able to give a thorough explanation, I can hint at a few well-known aspects which show that the situation now is hardly any different from that of five or six years earlier, despite the intentions of economic policy.[23]

The most important one seems to be the political judgement on the private sector, which affects the vast majority of the small organizations. Although today, in everyday political practice, it is permanently stressed that this sector is indispensable. The latest rules—thus e.g. the tax system and the system of obligatory social security contributions, equally working as a tax—have created new conditions for 1989, based on the indisputably correct principle of "equal conditions of competition". Yet, as a matter of fact, they have brought the small units and those in private ownership into the most disadvantageous situation. They have, namely, disregarded some basic differences characteristic of the small state-owned, cooperative and private organizations. Thus, e.g. the fact, that the state-owned small enterprise is established by the investment (transfer) of state capital. The managers get a guaranteed salary. It is that part of their income *beyond* the basic salary which depends on the success of their economic operations, i.e. income in the form of bonuses, rewards and profit shares, to be paid out at the end of the year. The social security contribution of employees is paid by the firm.

The capital of the small cooperatives comes from the contributions of the members (if one can speak about capital at all). The leaders also earn a guaranteed salary which—depending on the economic results—together with the dividends may

[23] Several important reasons are listed e.g. by G. *Révész* [17].

grow to be a multiple of the basic amount. The social security contribution of members and employees is paid by the cooperative.

The organizations of the private sector have to (ought to) raise the capital needed for their operation themselves. The obligatory social insurance rate also acts as a tax. The income of both leaders and members depends exclusively on work performed.

The regulations ignored the fact that the services the different economic actors are able to resort to are not equal and that in the course of redistribution the big companies and cooperatives have received several kinds of support in carrying their burdens.

With raising the rate of the social insurance, which acts as a form of additional tax a very effective measure has been taken in order to delimit the creation of self-realiant existences. As long as people work in the small organizations of the private sector on a part-time basis only, i.e. as in a secondary job, they are free from most of the burdens weighing on the private sector and they maintain their right to resort to any kind of services (benefits) related to social insurance. Once they become fully independent, all burdens fall upon them, and they are unable to enjoy the same services which are available to the employees of the socialist sector [18].

All this is happening in an economic environment where most of the large organizations are oriented not toward enterprise but the fulfilment of some targets. With the large organizations the basic conditions of enterprise are missing: the possibility of choosing between activities on the basis of profitability; the capability of bearing the consequences of unsuccessful economic actions; and the absence of somebody or some organ who is "responsible" for the risk and who can define the boundaries of "responsibility".

In such a situation the autonomous actions of the small organizations are inevitably watched with suspicion and the lightest charge against them is that they are "getting round the law". In the case of especially successful operations, the first to take notice of it are the supervisory bodies, often the Economic Police. All these are, in addition, accompanied by the petrified and stereotype judgements of the society, which are not particularly sympathetic towards the "tricky fellows in private business". Furthermore, the anticipation of social resistance and the fear arising from condemnatory public sentiment owing to the differentiation of incomes, seem to be, for the time being, stronger than the government's intent to dynamize their economic activities.

Under the given repressive conditions it is understandable that only the most ambitious people undertake the operation of a small organization as an enterprise. In fact, they should get more stimulation, more unambiguous encouragement and motivation in order to build up and supplement the market of the large organizations. This market should be built downward from the top, but it should also be supplemented by lots of small markets made up of individuals and groups. However, as long as the judgement on their function is hesitant and uncertain, their intention

to change and make headway will also waver. In the modern economies the small-scale private activities are given new roles and are more important than they were earlier. In Hungary, the current transformation of the economy has opened up new areas for the small units. The latter, in turn, should be given the chance to open up new resources for the economy. Today we are already aware of what the small organizations are able to do and we also know that there are far too many unutilized opportunities. However, a political will claiming higher performance from the economy, may eventually achieve that many small organizations should not only exist, but an increasing number of them should grow into enterprising units.

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## РАЗВЕНЧАННЫЕ МИФЫ—РОБКИЕ ПОПЫТКИ (ЕЩЕ РАЗ О МЕЛКИХ ПРЕДПРИНИМАТЕЛЬСТВАХ)

Т. ЛАКИ

Начиная с 1982 г. в Венгрии возникло десятков тысяч мелких хозяйственных организаций как в новых формах, называемых мелкими предпринимательствами, так и традиционных (мелкие частные предприятия, мелкая частная торговля). Несмотря на значительный количественный рост наличие этих организаций едва заметно в функционировании экономики.

Анализируя экономическую роль этих организаций, автор показывает три характерных типа мелких форм: те, кто желает лишь реализовать дополнительные возможности труда, мелкие производители и предприниматели.

Большинство стремится только к реализации дополнительной возможности труда и получению благодаря этому дополнительного заработка и не желает расстаться со своим местом работы в социалистическом секторе. Поэтому их предложение ограничивается той деятельностью, которая может выполняться только в свободное время. Мелкие производители— в первую очередь те, кто занят в традиционной мелкой промышленности— также прежде всего используют свой труд и труд членов своей семьи. Свои доходы они главным образом используют не для капиталовложений и модернизации, расширения своего предложения, а на нужды своей семьи. Стремящиеся к реализации капитала предприниматели составляют еще очень узкий слой. В статье анализируются причины этого.

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# CAN THE PROMISES OF THE HUNGARIAN "WAGE REFORM" COME TRUE? (SOCIAL MECHANISM OF WAGE DETERMINATION AND THE COMPETENCY OF WAGE THEORIES)

R.I. GÁBOR—GY. KŐVÁRI

Based on recent findings of research into the Hungarian labour market, the authors point out that current ideas about the feasibility and desirability of "wage liberalization" do not stand the test of scientific proof. Under the given structural conditions, and especially with the absence of spontaneous mechanisms acting to control inter-firm wage differentiation, "wage liberalization", contrary to the expectations of its advocates, would not promote either a general improvement of job performances, or a nationally efficient re-allocation of labour, while it would release a wage inflation spiral.

Policy-wise, one of the main implications of the results presented in the paper is that instead of pursuing the intended policy of "wage liberalization", efforts should be made to suppress the proliferation of informal and selective wage bargains, and encourage the emergence of some system of collective wage negotiations.

Conditions for an effectively operating labour market have not yet been developed in Hungary: more often than not, the assertion of economic rationality invites government interventions. At the same time, the experience of the last two decades illustrates that government interventions could at best produce partial and temporary results—combined with side-effects which call for further interventions.

Liberalization of the labour market is obviously conditional upon a general liberalization of the economy, which, in turn, preconditions the existence of a relatively advanced capital market. On the other hand, an indispensable condition for laying the allocation of capital on market foundations would be a proprietary interest of the people in economic management positions, i.e., their strong and immediate interest in making profit in the long run as against short-term wage maximization or expansion under any circumstances (made by using new capital investment and/or involving additional labour). For the time being, however, it is not clear even in theory whether on the ground of state ownership such a proprietary interest can be generated. Therefore we cannot share the optimism of those who think that, in the socialist sector of the economy, the market mechanisms of capital allocation—based on decentralized decisions—can gain priority over the bureaucratic mechanisms of coordination within a foreseeable time.



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Under such conditions, unless the growth and balance disturbances of the Hungarian economy become dramatically more serious, the labour market will continue to be characterized by a high level of employment and by a global overdemand. (It is interesting and significant that not even the lasting economic stagnation of the 1980s has led to such a degree of decline in the labour demand which—if only transitorily—could have turned around the direction of global imbalance in the labour market.) At the same time there is a danger that the fever-high expectations of public opinion—in connection with wage reform—will force the government to take ill-considered "deregulatory" wage policy measures.

## From chronic labour shortage to chronic disfunctions of wages: general features of the Hungarian labour market

In order to answer the question in the title of this paper ("Can the promises of the wage reform come true?") we must take full account of the structural particularities of the Hungarian labour market.

We have to set out from the fact that in any labour market, the flow of workers between places of employment and their efforts at work are formed partly by "pushing powers", i.e., the liquidation and creation of jobs and the selection of employees, partly by "pulling powers", i.e., advantages arising from the deliberate changing of places of employment, or from greater on-the-job efforts. The influential potential of these pushing and pulling powers is nevertheless dependent on the equilibrium conditions in the market.

In Hungary, amidst the global shortage of labour the effects of the pushing powers in the labour market are hardly experienced at all. The employees migrate from one work-place to another largely on their own initiative; they do this in order to increase their wages, or to improve the ratio between wages and performance. In their jobs they make efforts to ensure that their performance in the normal process of production should be appreciated to the greatest possible extent as surplus effort, thus warranting the payment of special bonuses. The uncertainty of recruiting labour and of acquiring various inputs in general has excluded, from the outset, the condition that wages and the selection of the labour force should be based on strict and uniform requirements towards performance.

Under the given circumstances the withholding of performance by the workers, as a weapon in the fight for higher wages and/or better ratios between wages and performance, has led to excessive differentiations in those ratios even among employees of similar status at a particular workplace. This has resulted in the unequal distribution of chances of performance, and the acknowledgement of actual performance has also become differentiated. In the factories the bargain about wages and performance is mostly "selective", rather than "collective". Instead of

open wage negotiations involving the vast majority of the employees, which are well-known in the market economies, in Hungary bargaining is carried out in fragments. It is limited to the most influential employees of the plant, it excludes both wider and local publicity, and it takes place through informal negotiations. Consequently, neither inter-enterprise labour migration, nor the bargains between employees and employers about wages and performance, can function as mechanisms which are able to bring about the parity between wages and performance in an efficienty way.

The withholding of performance by employees, the competition between rival employers in the labour market (who offer different wages and/or concessions of performance standards), and the different parities between wages and performance even on factory level, unequivocally demonstrate that the pulling powers based on wage differences cannot fulfil their function satisfactorily. This is so, even though—as we pointed out earlier—the general overdemand (which normally characterizes the situation in the Hungarian labour market) in principle assures them of an outstanding predominance over the pushing powers. These circumstances create what we call "the syndrome of a wage scale which is narrower than economically justified, but too wide from social aspects".

In order to explain this syndrome we have to refer to two further premises, and to an interpretation of the "relative sustaining capacity" of the wages. According to this, in a particular country, at a given time, the sustaining capacity of wages can generally be characterized by a quotient derived from a division of the average wage of employees by the per capita income of persons in households which live, partly or entirely, on wages. It stands to reason that the sustaining capacity, understood in this way, may change even while the real wage level remains constant (by changes in the non-wage types of income earned by the population, or by a changing level of employment); on the other hand, the sustaining capacity of the wages may remain at the same level even beside highly changing wage levels.

Let us set out from the obvious presumption that wage differences influence the employees' behaviour (their efforts at the workplaces, their decisions on changing and selecting their jobs or occupation) insofar as they affect the consumption possibilities of their family and themselves. We presume, on the other hand, that the consumption level which provides a moderate but still acceptable way of living, and which has to be covered by the minimum wage, is the higher the higher the average consumption level.

Thus, based on the above interpretation of the concept, it follows logically from these premises that the higher the level of employment and the proportion of income over wages of the inhabitants (including, in addition to the surplus income from the socialist sector, the incomes stemming from the second economy of the households living on wages and salaries), the narrower is the possible range of the wage scale and, together with that, the scope for maneuvring in the differentation of wages. In addition—assuming that the average wage level is given—the average consumption, which eventually defines the minimum wage, is also higher. On the

other hand, in those cases where the employment level (the proportion of earners to dependants) and/or the ratio of incomes over wages grow higher, the effect the same wage differences exert on the level of household consumption (and consequently, on their incentive power) will become weaker.

Therefore, the higher the employment level and the ratio of income over wages of the earners (and, as a results, the weaker the sustaining capacity of the wages), the larger are the wage differences necessary for driving the flow of the labour force, while the smaller are the wage differences which are socially possible. Also, the symptoms, which we called earlier "the syndrome of the wage scale", appear more markedly.

This syndrome manifests itself most conspicuously in the inner conflict of public opinion. On the one hand it complains because of the excessive salaries of those at the top level of the hierarchy of earnings, and qualifies the minimum wages as unfairly low. On the other hand, it grumbles over the small wage increments which can be achieved (within the framework of the given wage scale) by more and better work, greater knowledge or skills or by getting a higher position etc.

## From systemic features of the Hungarian labour market to the responsibility and scope of government wage policies: mis-(placed)-trust in wage liberalization

The Hungarian enterprises' competition for labour either by paying higher wages or granting concessions in respect of performance, their low (wage-) cost-sensitivity and the lack of wage flexibility to labour demand, the massive but circulatory flow of the workforce due to the variance of incomes (by circulatory we mean that it does not modify the distribution of labour between economic branches, occupations or enterprises) create a strong and permanent tendency towards wage inflation. This tendency is further increased by the fact that the company managers not only consider the wage position of their enterprise as an attractive factor in the labour market, or as a means for maintaining the appropriate and loyal staff for avoiding incidental hindrances to production; they also look at it as one of the most important indicators of successful economic management. It is largely due to this that their technocratic ambitions of making new investments are not a sufficient guaranty against the spiral of wage inflation.

With regard to the weakness of the pulling powers in the labour market we have already pointed out the significance of the high level of employment and of personal incomes over wages. As we have seen, this significance results from the fact that while, on the one side, they obviously increase, on the other, they also reduce the total amount of working capacity utilized in the economy. This reduction is caused by the diminishing sustaining capacity of the wages, which, in turn,

simultaneously narrows the socially acceptable range and widens the economically desirable one of the wage scale.

Given what has been said so far, it is not surprising that both the documents on wage policy issued by the government, and various working materials elaborated by experts, suggest that the range of the wage scale should be widened—i.e. the distance between the minimum and maximum wages should be increased. The suggestions have been made on the basis of economic considerations, and they refer to the weak pulling capacity of the wage differences. At the same time, based on social considerations, they urge a significant increase of the minimum legal wages. Also, it is not by chance that wage policy in the preceding two decades sometimes expected performance-increasing effects to come from the scope of enterprise movements, and sometimes from the improvement of the—necessarily restrictive—wage regulation techniques.

The wage liberalization attempts made in the meantime (for example, the measures taken in 1985 in order to abolish the separate regulation of wages) justified the misgivings of those who claimed that the general easing of wage regulation would result, under the given conditions, in an outflow of surplus wages. Since such outflows would not be covered by increased performance, it was obvious that they would increase inflationary pressure. The selective loosening of the constraints in question (e.g. experimental wage regulation in 1983–1984, preferential rules for "wages club" member-firms since 1988) has brought about practically the same effects except that they have differed in the timing of their appearance. After a short time it became apparent that such inter-enterprise wage-tensions were also developing in the local or partial labour markets and that central economic management would sooner or later be forced to assure the companies facing a worsening wage position that they would "catch up" eventually. Yet such assurances could only add to inflationary effects, along with those resulting from the free wage differentiation among the enterprises. Also, the companies lagging behind in the wage-competition may cause in their role as suppliers serious production problems and hindrances to their partners owing to their difficulties of recruitment and incentives.

Thus, however true it is that individual enterprises will be able to overcome the withholding of performance, the lexity of labour discipline of their workforce and the troubles of recruiting and selecting labour such that wages can be increased, this interrelation is by no means valid for the ensemble of all enterprises. Therefore, to anticipate a general performance-increasing influence due to spontaneous inter-company wage differentiation is a mere illusion.

Let us, however, immediately add that practically the same circumstances are reflexted in the wage and stimulation systems of the enterprises, which have, in the main, always been free to make their own decisions on the internal distribution of the wages. The same can be seen in the informal bargains, which are a chief determinant of wage differentials on the shop floor, and the loose connections between wages and performance. This is the way in which it may come to pass

that while the relative differences between the minimum and maximum wages in Hungary are—contrary to public belief—not lower than they are in many of the West European countries (this is true not only with regard to the totality of jobs but also in a more detailed breakdown), wage differences found between employees of the same qualification and in the same jobs within a given factory considerably exceed those deemed reasonable and customary in Western companies.

Clearly enough, the realistically expected level of endeavour, motivation (stimulation) and workforce selection at any firm depend not on the higher or lower rate of the wage increase in itself, but on the firm's favourable or unfavourable wage position. The companies which lag behind in the competition for wages are—in order to avoid losing their attractiveness in the labour market—forced to grant concessions related to performance requirements.

Thus, under the given structural conditions and with a lack of spontaneous mechanisms acting against inter-enterprise wage differentiation, neither the global, nor the selective versions of "wage liberalization" can promote a general improvement of performances. At the same time, the cumulated enterprise wage differences become sources of wage inflation. This would be so even if one could presume that, with selective liberalization, better economic management results would be found behind the wage increases realized in a privileged sphere of enterprises.

In contrast with one of the cardinal points in today's wage liberalization concepts, it is certainly not some kind of egalitarianism which is the bar to increased performances at the workplace. The main factor causing the problem is the lack of an economic constraint which would encourage Hungarian companies to realize a distribution of wages and a selection of labour which would combine with uniform performance requirements, and also to aim at uniform parities between wages and performance. Similarly, in the lack of such a constraint, "wage liberalization" could not have the effect of making companies exploit the skills and professional knowledge of their employees as far as possible—rather than simply paying them more.

All this, of course, does not mean that referring to the structural conditions of the Hungarian economy, we may turn a blind eye to the indisputable signs of the much talked-of undervaluing of professional skills. It is very probable that in a situation in which some find themselves in a permanently disfavoured wage position (e.g. those working in education and in the health services), which certainly contributed to devaluation of the diplomas themselves, wage policy also has to be blamed. The government, instead of developing those wages and salaries falling in the sphere of the state budget and public services and adjusting them continuously in line with rising enterprise wages, has followed the practice of allowing them to catch up belatedly and only partially.

Neither theoretical arguments, nor experience support the fundamental assumption of the wage liberalization concept. According to these premisses, in a country with a closed national labour market, the efforts of the employees at a

given workplace develop—either in time or in comparison with other countries—in conformity with the existing real wage level or with the growth of it. Also it is not the case that in Hungary the wage level is kept "artificially low". These premisses make it seen as if in the given circumstances in Hungary a significant increase of the real wages (i.e., their adjustment to the "costs of the reproduction of labour power", or to the higher income level of some activities in the second economy) could release some "hidden" powers in the performance capacity of the workers.

In our opinion, given the existing performance capacity of the economy, some reserves can only be found in curbing the decline of real wages (e.g. by reducing the staff in certain overmanned public offices and by cutting public expenditure). Yet the exploitation of these reserves could only indirectly improve the possibilities of settling the current economic problems, namely through its impact on the public atmosphere. Even so, the real wage level in Hungary would continue to be far below the level desired by the majority of the population (which is obviously based on the amount of income needed to cover the costs of standard consumption).

Moreover, however powerful the arguments are in favour of mitigating the disparity between the incomes of the first and the second economy as a means of "restoring the prestige of the main job's worktime", higher real wages in the first economy could only produce higher overhead hourly labour costs in both economies, thus restituting the original income disparity—except at a higher price level.

## Professional debates—bureaucratic decisions—conflicting social interests: from bargains about wage regulation towards regulation of wage bargaining

According to the advocates of radical wage reform the increase of real wages and the liberalization of wages are dictated by the need for political stability and are a pledge of improving economic performance. Understandably, they look with suspicion at such economic counter-arguments which may seem conservative. Also, they are widely supported by large masses of the wage- and salary-earning population. It is their conviction that the failures of wage policy in the last two decades—i.e. distorted wage differentials, performance-withholding wages, unacceptably low real wage levels—are the results of stubborn insistence on the bureaucratic control of the outflow of nominal wages in enterprises.

Their suspicion may be understood but not excused by the fact that, as a result of the halt of the reform process of economic management—which started in 1968—and along with the programme for transforming the institutional system as a whole, the changing of the institutional system of the labour market also had to be taken off the agenda. Thus a system of public negotiations aiming at agreement between employees and employers, and carried out in a regulated manner with government participation, could not be developed either. Therefore, it is not

surprising that the gap has been filled seemingly in the form of a distorted image of such a negotiation system—by clashes that promise no compromise between self-appointed programme-giving groups. Such groups are usually organized by experts, or at least by people appearing in the guise of experts. They are accountable to nobody and nothing but their own professional or civic conscience.

It follows from this state of affairs—and some agreement has begun to develop in relation to this question—that the most obvious task is to build up the missing system of negotiations as soon as possible. At the moment, the only thing which needs to be agreed upon is "merely" that, in Hungary, owing to the lack of wage-flexibility of labour demand (or to wage-cost insensitivity) in the enterprises, the wage bargains on the factory or enterprise level cannot replace the external control over wage-increasing opportunities as a means of preventing wage-inflation. The significance of institutionalizing wage bargains within enterprises lies not in this, but in the lasting and essential differences between the endeavours of employees and employers. Perhaps the most important difference is that, although both share the goal of raising wages, the trade unions, quite naturally, should fight for higher wages for those who have less chance of achieving these in the informal bargains, while the company managers, by contrast, naturally urge the improvement of the possibilities of paying higher wages by keeping in mind those employees who have the greatest power in informal bargaining. Their motives are basically technocratic ones; for example they might wish to develop a staff of loyal and selected employees so that smooth production and expansion can be guaranteed.

For the time being little hope can be seen for solving two vitally important sets of questions. One of them concerns the right proportion between incomes according to work and social benefits (transfer payments) according to needs.

There are some who, on the basis of social considerations, would like to shift the emphasis towards the latter kind of incomes. On the other hand, others pay more attention to motivation (stimulation) and stand for the opinion that the existing ratio of social benefits (transfer) is too high. On this point the decision makers feel, with good reason, that their scope of maneuvring in forming the ratio in question is very strongly limited. This follows from the strongly fixed rules of the game in each sphere of distribution; also, and to a greater extent, the limitation arises from the fact that neither of the spheres faces an abundance of resources. The parties in the dispute are inclined to forget about this when trying to justify truthfulness of their respective standpoints.

This type of discussion is endless and hopeless, but not lacking in certain lessons. Again, the point is that in the lack of an institutional setting in which conflicting interests could be reconciled through open negotiations, professional arguments move in a vacuum.

It can only be understood by taking into account the existence of a confusion of roles how the mutual interactions between the distribution of labour incomes and that of social transfers could be left out from the debates about the correct relative

proportion between labour incomes and social transfers. Conspicuous manifestations of these interactions are, on the one hand, the wages differentials developed at the place of employment according to social viewpoints and, on the other hand, the distribution of social benefits according to merit and performance.

Such interrelations of the two distribution spheres clearly demonstrate the confusion between the two functions. Thus, at the moment, it can by no means be guaranteed that increasing the proportion of incomes according to work would not eventually be harmful to both the social and the motivating (stimulating) activities. The outcome if the emphasis fell on the side of social incomes might be a shortage of resources, causing a more "social" distribution of wages. As a matter of fact, we should not forget that in this case the fulfilment of the social function would be shifted increasingly onto mechanisms alien to it.

In saying all this, we again wish to make it clear—beyond the lessons so far—that fights of interests between the actual participants of society can by no means be replaced by professional discussions in an issue in which it is impossible to take a responsible stand on the basis of professional knowledge alone.

The other set of questions concerns the judgement regarding the connection between inter-enterprise wage differentiation and the liberalization of wage regulations.

Without wanting to repeat our arguments on why it is theoretically groundless and practically impossible to carry out wage liberalization which aims towards a functional role for inter-enterprise wage differentiation, we wish to stress the one question which is most directly linked to the importance of interest-representation.

There are very few issues today which enjoy the broad agreement of public opinion. However, one in which there is such agreement concerns the termination, as soon as possible, of bureaucratic control over the development of wages paid by enterprises. This agreement, which includes both employees and employers, clearly means that if a decision were made on the basis of an understanding between the organizations representing the two directly interested parties, it would predictably and unequivocally go in the direction of wage liberalization. This is the same direction as that of the "inclusion of interests", which at present characterizes political decisions, i.e. the direction we deem to be impracticable. If this is the case, why do we insist so energetically on extending the role of the negotiations between the representatives of interests, and so earnestly on recognising the agreements based on these negotiations?

There seems to be a contradiction in this. However, it would be a mistake to draw conclusions on the long-term outcomes of decisions based on the bargains struck between interest representation organizations by merely relying on the reactions expected from the present bodies of interest representation. The present reactions of the latter are comprehensible in the given situation, but are only excusable because of the lack of previous experience.

It gives food for thought that in the practice of the market economies, where the open negotiations between the representatives of interests have constituted an organic part of the labour market for a long time, an unlimited inter-enterprise wage competition is far from being an issue raised by the organs representing the interests of the employees. In Hungary, in the given circumstances, it is particularly disturbing that the trade unions themselves stand up for the liberalization of wages. On the contrary, the obvious task would be to take the field against the economic government which now acts on behalf of the state as the owner, and against the chamber of commerce which represents primarily the interests of company management. It would be necessary to do this in order to ensure a minimum wage which keeps in step with the changing cost of living, and social benefits which keep in step with the development of wages.

We have demonstrated that, in the present circumstances, central economic management has no choice but to use wage regulation as a tool of anti-inflationary policy. The maintenance of the real value of social incomes (above all, that of the pensions), currently a prime task of social solidarity, also speaks in favour of this. For this purpose—in contrast to the practice followed so far—a uniform ceiling should determine the wage-increasing possibilities of the enterprises. Such a control of wage increases in the enterprises—although some of them would (understandably) find it deleterious—could only become a really effective braking power on the keen endeavour of enterprises and employees to increase wages, if its introduction were to take place on the basis of public agreement with and common responsibility of the bodies of interest-representation.

The assumption may be ventured that the introduction of such practice might even exert a beneficial effect on the relationship between firms and the economic administration. It would, namely, put an end to the uncertainty and mistrust caused by the frequent modifications of and individual (firm-by-firm) interferences with wage regulation. If the firms knew the possibilities of wage rises beforehand, they could place their internal mechanisms of wage payment and incentives as well as their decisions on wage distribution on more solid foundations.

This is, at the same time, undoubtedly a solution which might with good reason arouse the animosity of the enterprise managers. This is because they have been fed with enticing hopes of new wage liberalizing measures, and with a more radical wage reform than has so far been made. We still think that such a solution is only seemingly contradictory to the reform ideas which urge enterprise autonomy. It would indeed accelerate the creation of conditions which are indispensable for the operating capacity or a basically market-coordinated modern economy and, within it, of a labour market. In other words, such conditions are—among other things—vital for building up the institutionalized interest-representation of the participants in the labour market and the mechanisms of their negotiations. Later on, when market coordination becomes dominant, these may serve as bases for developing

and asserting restrictions and norms of behaviour in the market which are essential when dealing with labour, wages and social issues.

For all that it should, of course, be self-critically confessed that wage differentiation depending on the economic performance of enterprises has proved to be untenable as a guiding principle of wage regulation. Its earlier application has led to inevitable and frequent changes of the regulation structure and to interventions aimed at wage adjustment; these often transgressed the declared rules of the game. In addition to this, by declaring that it has a role in stimulating performance, wage regulation has undertaken a task which is impossible. What is more, even central economic management itself cherished the illusion that it would be possible to find a solution for regulation; it was anticipated that this would be in conformity with the operation of the labour market, that it would help maintain equilibrium on the macro level and, parallel with these, that it would foster economic growth and efficiency. At the same time, it would be supported by both employees and company managers.

If regulation could create such a harmony of interests, or the market in itself could simultaneously assert the requirements of economic rationality and social equity, neither institutions representing partial interests, nor social mechanisms for reconciling those interests, would be necessary—either today or in the future. We have to recognize that neither of these expectations is realistic. In other words, the development and reinforcement of these institutions and mechanisms are practical measures of pressing necessity, and they may, at the same time, lead to the realization of some more long-term objectives of the reform.

The question as to when the changes in the structural conditions will render it possible to implement the much wanted liberation of the enterprises from bureaucratic wage control goes far beyond the regulation of wages, and at present it is hard to give a precise answer. What we can do today is to prevent, as soon as possible, the mushrooming of informal bargains about regulations. These must be replaced by institutionalized and public wage negotiations between the national organizations of interest representation and the government. Developing the system of wage negotiations on the macro level (this being the most urgent practical measure) may cause bargaining which at present goes on mainly informally at the places of employment to be replaced by institutional bargains between those concerned. These will then openly and clearly play their own roles.

# ВЫПОЛНИМЫ ЛИ ОБЕЩАНИЯ "РЕФОРМЫ ЗАРАБОТНОЙ ПЛАТЫ"? (ОБЩЕСТВЕННЫЕ МЕХАНИЗМЫ И ТЕОРЕТИЧЕСКИЕ АСПЕКТЫ ФОРМИРОВАНИЯ ЗАРАБОТНОЙ ПЛАТЫ)

Р.И. ГАБОР—Д. КЕВАРИ

Авторы исходят из того, что до сих пор в венгерской экономике не сложились условия функционирования либерализированного рынка рабочей силы. Они считают, что либерализация рынка рабочей силы невозможна без общей либерализации экономики, в частности относительно хорошо функционирующего рынка действующего капитала. Но обязательным условием для того, чтобы поставить аллокацию капиталов на рыночную основу, является заинтересованность хозяйственных субъектов в собственности, теоретические возможности чего еще недостаточно уяснены. Опираясь на свою точку зрения и последние результаты теоретических исследований в области рынка рабочей силы, авторы показывают, что столь популярные в настоящее время концепции "либерализации заработной платы" научно несостоятельны. В данных структурных условиях, при отсутствии спонтанных механизмов контрдифференциации заработков между предприятиями, "либерализация заработной платы" не будет способствовать ни общему улучшению хозяйственных результатов, ни эффективному перераспределению—в аспекте национальной экономики—рабочей силы. В то же время рост различий в заработках между предприятиями приведет к возникновению спирали инфляции заработков. Что можно достичь сегодня—это как можно быстрее покончить с неформальными торгами в связи с экономическими регуляторами и переход к организованным и открытым переговорам о заработной плате между общегосударственными органами представительства интересов и правительством.

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# MARKET RELATIONS IN INTRA-ENTERPRISE WAGE BARGAINING?

L. NEUMANN

In David *Stark*'s model the internal labour market of the socialist enterprise is a flexible institution of genuine market nature. According to the author the examination of enterprise business work partnerships (VGMKs by the Hungarian abbreviation) which are made to compete, shows, in contrast to Stark's model, that several kind of coordination mechanisms may prevail in the wage bargain. Although the latter takes a market form, the notion of market merely means that the participants in the wage bargain possess a relative autonomy and wages change depending on power relations. Instead of open tenders, the income attainable by the VGMKs continues to develop in the mechanism of bargaining on allocation. The income of members is formed, behind the open market negotiations and bureaucratic rules, by a social regulating mechanism, as a result of hidden conciliations between the lower level management and the workteams.

The confrontation of the ideal types of market and bureaucracy is frequently encountered in the form of an explanatory principle in the Hungarian and international economics literature. In Hungary, beyond the theoretical interest institutionalist economists take in this pair of notions, the latter also occupy practical experts and the general public. According to János *Kornai*'s summary study, the reform of the Hungarian economic mechanism essentially consists of the strengthening of market coordination at the expense of bureaucratic coordination [1]. The strengthening of market relations is reflected also by the way in which intra-enterprise wage bargaining is interpreted as market bargaining.

In Hungarian empirical and theoretical literature analysing wage structures within the enterprise, market categories have been present for some time.[1] In Hungarian labour sociology, the identification of differences of interest, and their recognition in political ideology, were developments of the 1960s. The revelation of conflicts of interests between enterprise managers and workers was accompanied by a description of the behavioural strategies of the actors. These could be traced back to economic motives by means of market (labour market) categories. These

[1] The note was struck, perhaps, by the astonishing title of an article published about ten years ago: "Minesweepers at the front of production, or small entrepreneurs on the enterprise market."[2] The title of the then scandalous article gives an idea of the change in approach to industrial relations. In contrast to the earlier ideology, it recognised the actual conflicts of interests. In the ideology of the 1950s, a unity of interests was assumed to exist among the actors of the work process, on account of the public ownership of the means of production, where work was a "heroic act"; as for the interpretation of workers' attitudes, only moralizing and disciplining had their place. See [3].

ideas, first held to be heretical, have slowly infiltrated into the official economic and sociological literature, e.g. into a textbook of political economy published in 1985.[2]

This interpretation, in market terms, of wage bargaining within the enterprise continued to emerge in analyses dealing with the functioning of the enterprise business work partnerships (workteams).[3] The establishment of the VGMKs makes it indeed appear that workers' groups are market actors who can form alliances through market bargaining, make out contracts with the customer as a rule, mainly with their own enterprise. Earlier, diligent workers who did their best in the rush that always followed the jerks in the work process, were compensated for their efforts mainly by being assured of relatively high earnings, even during slack times. Alternatively, lower levels of work performance were accepted. In contrast to this, the VGMK opened a parallel channel of wage-payment: the enterprise can immediately remunerate the workteam directly with a money payment equivalent to the countervalue of their additional efforts. Thus the wage bargain assumes a monetary form, fulfilling a most important criterion of market coordination.

According to David Stark, the changes in work organization that followed the establishment of the VGMKs mean that the workers' groups which are in a favourable bargaining position within the enterprise have obtained, as subcontractors, a chance to have a share in the market. [5] Stark recognized the identity of a most important feature of the intra-enterprise labour markets in the capitalist and the socialist economies: enterprises make efforts at reducing and warding off the effect of elements of uncertainty in their environment. On account of differences in external circumstances, however, the enterprises' adjustment mechanisms are also different. In Stark's heuristic "mirrored opposition" model, the labour market which functions within the capitalist enterprise with a market environment is a basically bureaucratic formation: promotions, pay rises, and dismissals take place in adjustment to impersonal and formal prescriptions. At variance with this, the socialist enterprise tries to mitigate the uncertainties arising from its bureaucratic environment by leaving labour allocation and incentive to internal mechanisms based on the market principle.[4]

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[2] "The manifestations of labour demand and supply within the enterprise may be considered as the special microlevel subsystem of the market that is functioning on the macrolevel." The author of this textbook adds in a footnote: "The intra-enterprise market can, of course, be discussed only in an approach other than the usual. In fact, the ensuing sales contract between the enterprise and its workers (following the labour contract—L.N.) approaches, quite well, and in many cases even fulfils, the criteria of a market bargain."[4].

[3] Henceforth workteam or VGMK according to the Hungarian abbreviation and the practice of *Acta Oeconomica*. Ed's note.

[4] It seems to me that in his article Stark seeks a solution to the acute problem of American large enterprises, i.e. the bureaucratised, rigid internal labour market. Thus he views the advantages of the flexibility of the Hungarian VGMKs in this light. On a closer examination of the elements of his model concerning the socialist economy, reservations ought to be made about his interpretation

In the present article, I shall examine in some detail one of the components of Stark's model. The specially Hungarian characteristics of the internal labour market will be analysed, and two specific questions will be addressed: what kind of coordination mechanisms assert themselves in wage bargaining within the Hungarian enterprise, and how is the intra-enterprise wage bargain to be interpreted?

Like Stark, I shall base my argumentation on the results of research which has dealt with the VGMKs. More exactly, I shall centre my attention on the special cases in which workteams are in fact made to compete within the enterprise.[5] In such cases the enterprise management is the initiator of the functioning of the mechanism based on the market principle, since the enterprise will always make the remuneration of the workteams directly dependent on the enterprise's demand for and the supply of extra work. It is interesting to look at the way in which the actors involved in wage bargaining react to having the chance to take part in open competition. If indeed the conditions of a price-regulating market are asserted in the wage bargaining, then the enterprise that makes its workteams compete has in fact established the adequate institutional system of a wage bargaining, since it considers the wage-determining role of labour demand and supply as legal and even desirable. If, however, the experiment fails, one must take into account the fact that other coordination mechanisms prevail, suppressing the ideal type of the price-regulating market.

## Subcontractors or workers being paid a task wage?

The work organization of the VGMKs resembles, in fact, the subcontractor system widespread in American industry in the 19th century. Thus, for instance, the purchase and sale of capital equipment and raw materials are tasks for the owner. In the United States, subcontracting foremen were free to hire and fire workers, could decide on wages, and controlled work processes.[6] However, the workteams cannot be considered "internal enterprises" in the same way as they are in István

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of the bureaucratic environment of the enterprise. It is exactly the inter-enterprise labour market, which strongly affects the conditions of wage bargaining, that can be considered as the most characteristically market section of the Hungarian economy. This is certainly true in that, as a function of demand and supply, even extreme wage differences may develop. This is especially striking if compared to the labour market of a modern capitalist economy, in which collective bargaining constrains the market mechanism.

[5] The empirical research was carried out in 1984–5. The case study summarizing the results can be found in [6].

[6] There is the essential difference, of course, that the work organization of the VGMKs is confined to the overtime, only a fragment of the working hours. The analogy is also deficient, however, in other aspects: for example, the privileges of the workmasters of the steel industry were protected by their militant trade union, whereas the interests of the members of VGMKs are not represented by any trade union. (See: [7].)

*Siklaky*'s model. Nor, as certain authors of organizational theory recommend, can the practice of "intrapreneurship" be compared with the modern large enterprises of the Western countries. [8] The differences between the VGMK of the enterprise which is made to compete, and "advanced intrapreneurship" can be summed up as follows:

1. The entrepreneur of Siklaky's model is assessed in the terms of an actually functioning commodity market. VGMKs have in fact been separated from the external market. Price formation is independent of the prices of the cooperation partners who perform similar work.

2. Intrapreneurs dispose of every production factor, capital included. The members of the VGMKs have only their own working capacity to dispose of. The only legal way of increasing their income is to rationalize their working method.

3. It is a principle of Siklaky's model that "the bid is to be the bidder's", i.e. the entrepreneur who can better operate the enterprise is entitled to keep the benefit of his inventiveness. In contrast with this, the VGMKs, who are made to compete, have to be against themselves. The cause that lies behind this superficial differencee is to be looked for in the different functions of competition: the bidding in the model takes place in the market of the potential entrepreneurs, whereas the competition between the VGMKs is a simulation of the market for goods and services. As a matter of fact, the workteams are doing wage-work. The price contains the wage (and its tax burdens). The competition among the VGMKs is in fact a wage bargaining taking place on the market of jobs.

4. In the model the centre commissioning the work fulfils functions involving the handling of capital: it is an organization independent of the entrepreneurs. Neither the entrepreneurs, nor the bank-like centre can influence the rules of the game.[7] As for the workteams, the enterprise plays a dual role: it is maker of the rules as well as organizer of the competition. It creates a playfield which conforms with its own interests: this is a closed "market" in fact, in which it is the only customer of the workteams separated from external business relations. Thus the power relations within the organization can be manifest in the form of economic dependence. The competition is, therefore, an instrument in the hands of the enterprise management, that can be used in bargaining with the VGMKs on matters concerning wages and performance. Thus the enterprise shifts the solution of the wage conflicts between employer and the employed onto impersonal mechanisms and can, through the "up-to-date" market legitimation, sanction the wages thus coming about.

Although there is no question of subcontracting, there are indeed changes of work organization in the case of the VGMKs. The most striking change in the

[7] *Liska*'s original model leaves this an open issue; one need not know the circumstances of the origin of the rules of the game in order to understand the mental construction of the model. However, the relation between the bank and the entrepreneurs cannot be left out of a consistent examination of the co-equal relations.

relation between enterprise and employee is the spreading of payments according to results, and these have no ceiling. They are similar to the lump-sum wage remittances applied in the building industry, with the reservation, of course, that the workteams represent a form of surplus labour (overtime). The real novelty consists in the collective nature of the settlement in a number of trades. This is because, in Hungarian industry, payment by results (performance) based on individual competition has been the most widely used wage system. Piece-rate payment is not necessarily the form best suited to the actual work organization. For example, the VGMKs I have examined are composed of repairmen whose work cannot be planned beforehand, and thus it can hardly be "piece-rated", the work organization being based on their constant readiness and immediate intervention. The elimination of functional disturbances demands special skill and long years' experience. What is more, the repairmen's willingness to cooperate is especially important for the enterprise management.

In conformity with the conditions of the work organization, repairmen are paid time-wages in their main job, since the payment of task-wages would be unreasonable. Yet this is what has been adopted in the organization of the VGMKs; thus it has been the duty of local factory managers and foremen to establish the norms required from the VGMKs in the field of repair works.

The advantage of payment by results is that it encourages the improvement of work performance. If some relatively complex task can be picked from the repair work process, the applied form of wage-payment may be appropriate for a kind of autonomy for the work organization, and also for the introduction of innovations.[8]

In an enterprise where earlier neither the managers' system of incentives, nor the workers' wages had led to improvement of efficiency, the introduction of payment by results has helped to suddenly reveal reserves and to achieve unusually high incomes. In fact, seeing the high hourly wages earned in one or another job, the enterprises introduced measures to diminish the VGMKs' incomes. Furthermore, the idea of making VGMKs compete also arose from the conception of checking high incomes, parallel with stricter control in the form of administrative restraints. The primary objective was not to reduce costs of production—which is a natural effort when creating competition between subcontractors—but to knock down extremely high earnings. The central management of the enterprise found that the managers of the production units, when engaged in direct talks with representatives of the VGMKs in the course of the wage bargaining, were not really interested in reducing prices. This was because the amount that could thus be saved was slight in comparison with the expenses of the production unit and, anyway, it would not have made any difference to the personal incomes of the managers involved. The competition was expected to "muddle" the personal relationships that had been

[8] The new features of the inner work organizations of the VGMKs are discussed in more detail in another one of my articles [9].

established among managers of the production units and the representatives of the VGMKs. Therefore, the open and compulsory invitation of tenders was an attempt on the part of the central management of the enterprise to tighten control over medium-level management.

### The competitors' reaction to forced competition

In the six months following the "institutionalization" of competition, there actually developed real competition in a few factory units. However, price-lowering bids were rather rare, and the saving was slight even in comparison with the unit's yearly payment to the VGMKs. Hourly wages which appeared to be unusually high could, however, be knocked down: for instance, in the majority of even those workteams that enjoyed relatively good bargaining positions, the members had an average monthly income Ft 1–2000 less than before; moreover, VGMKs became subject to selection and this led to the abolishment of some. This can only partly be attributed to the fact that the managers of the production units charged with effectuating the competition agreed with the enterprise's intention since they were, from the outset, not in a position to control the wage and performance conditions of the VGMKs. The thing which in practice formed the basis of the competition was the measure according to which the enterprise put a limit on the individual production units' yearly payments to the VGMKs. At the same time, new workteams were being established, so that the contracted amount paid to each member was naturally reduced. The lower managers spent the amount saved through the competition on new commissions for workteams. In this way they also enlarged a normally limited labour capacity. That is to say, although the enterprise simulated the demand-constrained market by an administrative instrument, it was effective.

However, the limits of competition among workteams were already evident when local managers were still encouraging competition. One of the reasons was that some of the workteams found themselves in a monopolistic position in their own special field due to the specialization existing within their particular work organization. This situation was also bolstered by the principle of "one brigade—one VGMK" (thus copying the official workshop organization). In the sphere of competition, advantages were enjoyed by those who had the necessary special skills, local knowledge, and by those who were the exclusive users of certain equipment, or had much longer experience in the given kind of work than the competitors. Competition was also illusory in those cases in which only one of the teams had the internal cooperation relationships required for organizing the job. In such cases, the managers who introduced the competition could not give the job to any other team without risking the job's fulfilment. The assertion of monopolistic positions within a factory is disadvantageous, of course, only in respect of the competition;

that is to say, it cannot in fact be considered a disadvantage that the work is done by experienced specialists.

Another obstacle in the way of competition—which cannot be prevented by the management—is the "cartelization" of workteams. This may occur if the jobs announced for tender are distributed during the course of a parallel negotiation, or even during the course of an official tender. Representatives are able to distribute potential work among themselves openly, exchanging just a few words; on the other hand rivals might simply withdraw. Even in real competition, VGMKs easily find the way to cooperation, since competitors are, otherwise, in an everyday working relationship with one another. Thus it is contrary to their shared system of values and norms to contravene the collective interest, i.e. to "knock down" prices.

The initial successes of the competitive situation were followed by a strengthening and perfection of the mechanisms of distribution. This practice was involuntarily encouraged by the enterprise management, as it put a limit on the amount which could be contracted for by the VGMKs of each production unit. As a matter of fact, "quotas" were established for the production units when drawing up plans at the beginning of the year. Bargaining would then begin between the central management of the enterprise and the production units, after which the units enjoying advantageous bargaining positions could pay out the multiple of what had been planned to their workteams. (In the year under discussion, the enterprise's number one objective was to increase Western exports and this effort was supported by preferred wages. Therefore, the units that produced exportable final products were in the best bargaining position.) The production units then further distributed their "quotas" among their sections, some of them trying to ensure that extra hours should diminish by adopting an even distribution of the diminishing sums of money available to the VGMKs. Thus was the performance of the VGMK members expected to improve. In the end, "quotas" were exceeded to such extent that the central management of the enterprise drew back and the following year they set no administrative limit at all. [9]

[9] The limitation of expenses paid to VGMKs by the enterprise itself is by no means a typical phenomenon, since the enterprise's interests are attached to loosening the constraints of wage regulation. As we can see, the enterprise under examination did not insist on its own plans. Thus the expenses paid out to VGMKs increased despite their own intentions. However, the conception of establishing quotas based on the former year's figures arose again in 1986—on the state economic management side. It is at this point that the reader should be reminded of the well-known phenomenon—found also in this case—which is that wherever money quotas to be spent on some special purpose are established, wastage will also occur. The established quota is, as a rule, not exceeded, yet other, substitutional expenses (in our case, those of external cooperation contracts) invariably tend to increase. The quota that forms the basis of the following year's calculations must be spent, at whatever low efficiency, otherwise the money is drawn away by the central management. The wages thus "scooped up" at the end of the year, i.e. the sums of money paid to the VGMKs do not function as an incentive.

The distribution mechanism, ranging from the top management of the enterprise to the medium-level managers who announced the competition, was in conformity with the enterprise's intention. In fact it followed the practice of resource allocation customary in a hierarchical organization. The chain of distribution was, however, also established on the levels of management below the executive announcing the competition, i.e. exactly where the market of the "entrepreneurs" was expected to function. Invitations for tenders were compiled on the basis of the lower level managers' proposals. Each manager wished to announce as many jobs for their own field as possible, since it would be easier to carry out their tasks with the additional resources of the VGMKs, and at the same time additonal income could be offered to their workers. Discussions between the higher executive announcing the competition, and the works managers usually led to a distribution of the "quota" in proportion to staff numbers. Almost in every workshop, VGMK members knew exactly the per capita "workteam money". What is more, distribution went further within each workshop, and this reached each workteam. The representatives of the VGMKs are, as a rule, members of the lower-level management; typically they are foremen, workmasters, or technicians employed at the workshops. In compiling the proposals, workshop managers asked for the opinion of those foremen-representatives who had good local knowledge, or even cooperated with them in delineating the tasks for the VGMKs. Of course, the representatives tried to take such tasks in which the monopolistic position of the workteam could be strongly asserted, relatively high hourly wages could be attained, and members could be regularly occupied, i.e. earn regular additional income. In fact, the announcements regarding the competition for contracts came out as a result of cooperation between executives and representatives of the workteams, who exploited their monopolistic positions. In other words, the chance of a real competition fell to a minimum. At the official biddings, the VGMKs just approved the preliminary agreements concerning the distribution of jobs. Paradoxically, it was the actual bidding that counted as anti-manager behaviour; some of the workteams which were in a strong bargaining position made serious attempts to bid if they were discontent with the preliminary distribution of jobs.

There are two reasons for the failure of the enterprise's attempt to regulate the wage bargaining on the market principle: first, it can be explained by the economic environment of the enterprise; second, it can be explained by the enterprise's internal work organization. It is general knowledge that the soft budget constraint which confronts Hungarian enterprises does not encourage any reduction of costs. The local enterprise managers who enter into negotiations with the workteams are not directly interested in reducing the sums involved in the contracts. In fact, economic reasons would, at most, account only for the managers' indifference. However, in the case under examination the local managers were actively against competition, and in this they were in coalition with economic workteam members. Their behaviour was motivated by the circumstance that the members play key

roles in the work organization. Thus the managers could not dispense with their loyalty and accumulated special skills. Earlier, too, there were those the managers could count on: they did extra hours, and undertook additional burdens, if circumstances made it necessary. The remunerations paid to the VGMKs succeeded in winning the loyalty of this group. Such loyalty would have been risked, if the managers had allowed a sharpening of the conflicts inevitably concomitant with competition.

## A price regulating internal market?

After outlining the case, an attempt will be made to provide an answer to the original question: which forms of coordination assert themselves in the wage bargaining of the VGMKs? The market faced by the workteams is obviously far from the ideal type of the self-regulating market, for strong monopolies hinder the development of efficient competition mechanisms. What is more, the cartel agreement among the bidders also seemed to be inevitable. The coalition between sellers and buyers is not at all a satisfactory feature for the functioning of a commodity market. Though this intra-enterprise market does possess the formal characteristics of a market (seller and buyer sign a contract following an open bargain; transactions take place on a monetary basis; prices may fluctuate), in this process it is exactly the regulatory and coordinating function of the market that cannot prevail, i.e. the features that qualify a market as a market in the neoclassical economic approach. In lowering the prices a more important role is played by the norms arbitrarily "settled" by the announcers of the competition, rather than by the biddings. Demand is also easy to manipulate on the enterprise side: it can have the job done, perhaps at a higher price, by an external contractor; furthermore, it sometimes happens that the job that could not be sold at the competition comes up as a task within the framework of the main job. Even supply can be practically shaped by the intentions of the enterprise management: in our case, the majority of the VGMK leaders were encouraged and persuaded to undertake this role; and in fact, it could be fatal for a VGMK if it could not receive enough profitable commissions. This would not necessarily be due to a general decrease of the enterprise's production (and labour demand), but simply because of a decision made by the top executives.

The lack of the classical price regulating function is explained by the circumstance that on this particular market, it is not atomized sellers and buyers (without any decisive influence on prices) that meet, but a procurement monopoly (more exactly, a monopsony): that is to say, the enterprise, and the workteams are in a more or less advantageous bargaining position, perhaps even enjoying monopolistic advantages on their own partial markets. Instead of the horizontal relations between sellers and buyers, the sub- and superordinate relations of the organizational

hierarchy prevail as economic dependence, at least according to the enterprise's intentions. This asymmetrical "market" formation notwithstanding, the real power relations are clearly reflexted by the efforts at cartelization: if necessary, the workteams that offer their labour power form a common front. If such a cartel is in fact formed, the bargaining in question can hardly be considered a market coordination in the neoclassical interpretation.

In the course of the wage bargaining within the enterprise, it is not indifferent and independent partners that meet, but employers and the employed. Therefore, the price which forms during the bargaining involving the VGMKs is not shaped solely by the economic advantages of the given exchange transaction. Demand and price mainly reflect the power relations prevailing between the partners, in which the wage payment capacity of the main job and the influence of the local labour market play a role in the same way as do the changes in the social and political environment. However, a decisive role is played by the external market, which is not the market of the subcontractors, but that of inter-enterprise labour. If the enterprise succeeds in reducing the hourly wages paid out to the workteams, it risks losing workers. This is because they can find other employment with higher wages—perhaps with VGMKs paying more—or they can sell their labour power at a higher price in the second economy. This would, however, run contrary to the intentions of the enterprise, since the primary enterprise interest attached to the VGMKs consists in keeping and stimulating labour.

The external labour market does not correspond, either, to the criteria of the neoclassical equilibrium market.[10] The nature of the market mechanism has also changed in the capitalist economy, yet the notion of the market has remained a synonym of efficiency: thus, in the long run, the profit motive i.e. the criterion of efficiency prevails through competition and the mechanisms of selection.[11] As a result of the selection mechanism, employment grows in those fields of the labour market that can be profitably enlarged and new jobs are created. Unprofitable fields are reduced, and places of employment are abolished.[12] A similar assertion of the efficiency criteria is not found in connection with the growing number of VGMKs, even though the self-justifying arguments of the enterprises are full of references to considerations regarding profitability.

[10] Yet the imperfections in the functioning of the internal market are not to be exclusively ascribed to the special features of the inter-enterprise labour market. The effect of the institutional separation of the external from the internal market must also be taken into consideration; therefore, our question remains, following Stark: in which way is the external market reflected within the enterprise?

[11] For the market mechanism prevailing under today's capitalist conditions see [10].

[12] Not even the inter-enterprise labour market of today's Hungarian economy fulfils this criterion. In fact it can only be fulfilled under the circumstances of a market economy, in which the market is the predominant integrating institution of the economy as a whole. (See [11].)

What accounts for the use of market categories in the enterprise wage bargain, if the original criteria are not fulfilled? In relation to the VGMKs, the market signifies that a kind of autonomy of the actors involved in the bargain is recognized. It also indicates that prices are formed prior to the exchange (i.e. carrying out the job)—in the course of direct negotiations between the parties concerned, as in a real market bargain—and that the prices (i.e. the wages) may vary greatly, depending on the power relations. This horizontally organized bargaining mechanism, legalized in the form of the VGMKs, may be called a market. What the notion of the market first of all implies is that the bargain exists and has a right to exist, as opposed to the earlier interpretation of enterprise relations. In this, wages were dictated from higher quarters, and when workers attempted to force out rises by asserting good bargaining positions such attempts were regarded as blackmail.

We have seen that exchange transactions can be made between workers and managers, or between different groups of workers and the various levels of management. The description of these transactions may help towards an understanding of the bargains between the enterprise and groups of employees.[13] As Stark says, these are not *quid pro quo* deals made once and for all, but they are simultaneously pro- and retrospective in time. They are seemingly independent of the bargains concerned with the organizational conditions of the main job. This is because, judging from my own research, the compensations were only accounted between the well or badly paid VGMK jobs. In their calculations the members' considerations were not concerned with anything more than whether the extra work as a whole would be profitable for them. We could not find any such clauses in the VGMK contracts which made provisions for the remuneration of some additional performance in the main job, or which laid down any punishment for failure. The workteams' contract is meant to be independent of the wage bargain of the main job, but this is just illusory and implies no more than that the contract is not directly connected with one or another event of the main job. As a rule, those workers whose performance

[13]The co-authors *Héthy* and *Makó* also tried to describe the relations between the groups with different interests within the enterprise by means of the existence, or the lack of, transactions. [12] In their description, however, the transactions between the different groups are not elements of a market integration. They are, instead, of a reciprocal nature, such that may also have an important part to play in the integration of the microunit of a modern society. As a matter of fact, the transactions are nearer the conception of modern reciprocity than the market, even in Stark's interpretation. When he talks, namely, about the various transactions between management and the workteams, Stark means, by the word market, a system of relations taken in a wider sociological sense. In this approach, not only money, material goods and services can be exchanged on the market, but pieces of information, advantages related to position, organizational influence, and values that cannot be directly exchanged for economic advantages. (In the Hungarian literature, the category of "administrative market" was for some time used as a concept of a similar nature in that it described the bargain between enterprises and the central/state economic management. It appears that the use of the concept in this sense was not a happy choice, since it makes it more difficult to distinguish exactly the two institutions from each other that can integrate economy: market and bureaucracy.)

is not so important for the management never have a chance to form VGMKs. The management regarded the members of the prospering workteams as useful labour and key personalities of the enterprise and, consequently, they were supported in the competition. (An economic workteam can be formed without the support of the management; in such cases, however, it will not get good jobs, and will be compelled to dissolve sooner or later.) The transactions between the management and the VGMKs thus cover the whole of the relation between the enterprise and the employee. The payment made to the workteam (having become a *de facto* element of the wage system) along with the wages paid out for regular hours and for overtime, and with other elements of earnings, compensate the workers' services. Such services can only artificially and imperfectly be divided into the units which together form the subject of the exchange within a repair work organization. As mentioned before, this organization demands permanent readiness.

## A bureaucratic internal market?

The bureaucratic traits observed in the VGMKs' wage bargaining are inadequate for the ideal type of bureaucracy, in the same way as the price regulating market was not found to be an adequate model, either. (As we have seen, the primary meaning of the market terminology is precisely the negation of bureaucratic forms of coordination.) It is true, though, that the intentions of the central economic control and management, as well as the enterprises' attempts to curb the increasing incomes of the workteams, emerged basically as bureaucratic prescriptions. However, they did not attain their end. (As a matter of fact, the organizing involved in the competition actually strengthened the power of bureaucracy. Paradoxically, if the rules had been followed exactly, this would have amounted to the acceptance of the laws of the market. We have seen that it was the intention of the top-level management to restore the hierarchy of authorities, and to tighten control over those sections of mid-level management which had ignored the norms prescribed by the enterprise.[14]) It is another question that the vertical coordination basically characteristic of bureaucracy could not, in the end, be completely restored.

It is easy to discover bureaucratic traits in the way enterprises handle workteams, i.e. in their efforts to regulate deals by strict rules. For example, enterprises have developed a mass of internal rules, regulations, and manager's orders with

[14] A lasting problem of bureaucracy focusses on how control can be exerted over mid-level management. This is also illustrated by the socialist brigades' movement. The mobilization by political means of the lower level of the hierarchy is intended to compel mid-level managers to follow the central line. (On the Bulgarian brigades' movement, and the purposes of "counterplanning" see [12].)

the intention of settling questions concerning the signing of contracts and the case of incompatibility within the management itself. [14] It is a familiar characteristic that the enterprise's objectives determine the field of activity of the economic workteams, and that the vertical relations and the traditional functions of the wage system partly remain. Even after ordering the competition, the bargains that determine the expected earnings of the workteams still find their place on the steps of the hierarchical organizations; the income that workers can earn through VGMKs depends on the bargaining ability and shrewdness of the managers of various levels. The role of those executives who have a distributive function is upgraded. Therefore, since they organize the workteams' affairs, the managers' prestige within the organization also grows, along with their power over some of their staff. Therefore, in this way, the economic workteam also contributes to the maintenance of the stability of the organization.[15]

The survival of the bureaucratic traits could be explained by the organizational traditions and by the managers' clinging to their control functions. On the other hand, it could be ascribed to the effects of the external circumstances. There is, however, one more reason for the lasting strength of the bureaucracy. *Crozier* says that observance of bureaucratic prescriptions and adoption of the "unwritten rules of the game" provide stability not only for the organization itself, but for its members as well. [15] The VGMK members and lower-level managers who shy away from the risk involved in market regulation find natural support in the traditions of the hierarchical organization.

## The control mechanism on the enterprise market

The lack of regulatory functions in the market process, and the practice involving the repeated transgression of bureaucratic rules, could lead one to the conclusion that a kind of disorder is characteristic of the relation between the enterprise and the workteams, and that prices, i.e. the members' incomes also appear to be unregulated by the state economic management: the payments made to the economic workteams open up a channel such that the outflow of purchasing power circumvents the valid regulation of wages.

However, the case of the VGMKs shows that the managers's "manipulations" and the workteams' reactions constitute a more or less effective form of regulation. Although no wage control according to the market principle has come about in

[15] I believe that even a partial survival of the distributive functions represents a bureaucratic trait, even if this does not fulfil certain formal (Weberian) criteria of bureaucracy. Where competition by decree is the officially recognized attitude, the distribution may not assume an official form and may not be manifest in written documents. (If it were not paradoxical, this phenomenon could be called an anti-rule and informal bureaucracy.)

its pure form, the experiences of the competition—which was sharpened because of the delimited "quotas" point to some of the likely effects of the market. In an open competition, free from the managers' "intervention" the differences in the various bargaining positions can be directly asserted. Economic workteams that are in a monopolistic position only compete on a formal basis. Also, where there is real competition, those workteams which possess greater expertise will defend their positions, while those with less skill or experience may even lose the jobs offered in their own usual field. Those workteams which are unable to prepare overtime work in their main job also suffer disadvantages.

The direct assertion of the bargaining positions which arise from the key posts would make incomes so widely differentiated that it would be impossible for the local management to simply turn a blind eye. Relying on its own value judgement, it interferes: it tries, right from the time when the competition is announced, to evenly distribute jobs, possibly among the workteams engaged in its own field and considered as worthy of such commission. The management is led, in its judgement, more by economic rationality and the interest of the organization than by any social considerations. This is because the "factory peace" maintained through an even distribution of earnings is at the same time a useful instrument for attaining the production objectives. The managers who manipulate the competition try to provide permanent additional income mainly for those groups of workers that are important for them. On the other hand, the "redundant" or "unreliable" workteam loses their goodwill.

Differences of income would be much higher, if the management did not knock down high earnings by repeatedly adjusting the norms. The differences would also be higher if there were no informal negotiations between enterprise managers and workteam representatives. Such workteams, which are otherwise important for the management would also suffer disadvantages. The thing that forms the basis of the control is the consensus on the workshop level with regard to who "must" or "can" earn, and how much. This is indeed a "democracy of envy"—as Márton *Szabó* cleverly puts it in the title of one of his articles—which may well prevent differentiation by performance. [16] Yet the levelling within the circle of the elected may attain a veritable regulatory role, given the lack of other control mechanisms, in situations where "one can earn as much as one is not ashamed of". The managers that maintain relations with the workteams do their best, on the one hand, to keep hourly wages in the Ft 60–80 bracket. They admit that below Ft 60/hour, it is unprofitable for the workers to engage in VGMK work. It is the recognition of this fact that determines the managers' behaviour. They will help, in the course of the next competition, the workteam that has less work; or, the managers will allow the workteam job to be done in the regular (legal) working hours, if the bidding, or the confinement of the calculation, is so "successful" that the members of some of the VGMKs turn out to be losers. The workteams themselves adjust incomes by

relying on the adopted order of values; the distribution of jobs and earnings among workers of different skills and ages within the workteam also relies on this.

The consensus sanctioned by the majority of the managers and workteams may eventually be thwarted by one or another workteam's particularly strong bargaining position, or by the influence of a representative within the organization. The occurrence of outstanding incomes cannot be totally excluded. As a rule, however, the parties interested bargain on the "price" of clear-cut tasks and the hourly wages the parties consider reasonable are rather near one another.[16]

In his article Kornai mentions the ethical and the aggressive coordination that runs beside bureaucratic and market coordination. The social regulatory mechanism discussed in this article certainly contains ethical principles, yet its main motive is not a moral one. It is based on the rational decisions of the members of the organization: on the one hand, it is to maintain the ability of the organization to function properly; on the other, it is to maintain the loyalty of the workers who actually participate in the transaction, on the basis of the mutually acceptable wage/performance parity. On the grounds of the compromise of interests, there may in fact be no question of aggressive coordination. This control mechanism of the horizontal organization does not fit into Kornai's typology. In seeking answers to the question concerning the forms of coordination which prevail in the wage bargaining within the enterprise, and which kinds of mechanism control attainable incomes, one must point, in my opinion, to the above-outlined compensatory social mechanism as the dominant regulator. This goes alongside the limited role played by market relations and bureaucratic traits, even though, with its informal rules of the game, the said mechanism may appear rather as a breaker of the rules under the given institutional conditions.[17]

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[16] Using the term taken from Crozier's book, this regulatory mechanism can be called a form of "social control". [17] In his description of the functioning of bureaucracy, this is what the author calls the unwritten system of rules which prevents, in the course of the games going on within the organization, the player in the stronger position from scooping up the total possible profits. In the struggle for power within the organization, the competing groups are compelled to use cooperation, albeit in subordination to the objectives of the organization. It is in the common interest of the groups that the organization survive, thus solidarity may exist even between antagonistic groups. However, I do not want to borrow Crozier's term, since it can be misunderstood in the Hungarian usage: first, it is identical with the term covering the control functions of so-called "social organizations" (party, trade union, etc.); second, it produces the image of some kind of justice.

[17] As a matter of fact, it is not really surprising that the control mechanism of the enterprise's wage bargain can hardly be explained by confronting the theoretical categories of market and bureaucracy with one another. Our conclusions are very similar to those investigations which have examined the role of state and market in shaping Hungarian housing conditions. There, too, the effects of bureaucracy and market are dampened by an autonomous social mechanism: that of voluntary cooperative work of the population. (See: [18], [19].)

## Institutionalized wage bargaining and the internal labour market

The suppression of legal forms is also indicative of the fact that the institutionalization of the wage bargaining has remained imperfect despite the presence of the VGMKs. If the workteams' wage bargain fulfils the criteria of a market bargain, it points to the fact that there is market selection, uncertainty, and precariousness in the agreements. Prices may fluctuate extremely, since the locally attained, momentary bargaining positions of the workers' groups manifest themselves directly, i.e. without any institutional mediation in the outcome of the wage bargaining and, consequently, in the wages.[18] That is why the contractual relations of the VGMKs cannot be interpreted unequivocally as participation in the market and institutionalized wage bargain of the same time.

The agreements concerning a fair wage/performance parity are not considered as final by the workteams, either. That is why the actions of the representatives of the workteams are not so much directed at attaining exteremly high incomes, but more at acquiring moderate and stable complementary incomes. The demand for a permanent monthly complementary income is probably rooted in the "employee attitude" of the economic workteam members: as opposed to the entrepreneur's attitude, they refuse to take risks. Even the transitory loss of complementary incomes is hardly tolerated by households. Because of the diminishing purchasing power of the earnings from the main job, the income earned in the VGMK has grown to be an important instrument for maintaining the consumption level. This, too, accounts for the nature of the transactions between the workteams and the enterprise: it is easy to see, why market transactions are softened into wage bargaining.

The appearance of the workteams also provides the conditions for the creation and formalization of the internal labour market. The VGMK is an important instrument in the hands of the management for bringing about income differentiation. The legitimately unequal chances created through the managers' initiative may be considered as a confirmation of the dual intra-enterprise labour market, or of the separation of central and peripheral workers.[19] Due to the fact that the membership of one or another group depends on reliability and accumulated work experience, the borderline between the two groups can, in principle, be shifted.

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[18] In one of his earlier studies, János *Kõllõ* also calls attention to the probable consequences of letting the power relations prevailing within an enterprise to freely assert themselves. [20] Also, in connection with the workteams, Stark recognizes that market bargaining is possible only for some of the employees; thus he contrasts the socialist enterprise's *selective* wage bargain with the capitalist countries' institutional system of *collective* wage bargaining. On those traits of the workteams' wage bargain that point towards institutionalization, and for a detailed account of the constraints affecting the process see: [21].

[19] Groups which are able to dispose of different bargaining abilities were identified at an earlier date, although before the workteams the management used different strategies with them. With the emergence of the VGMKs, the privileged groups could grow, and thus discrimination has increased. (See: [3], [22].)

Those outsiders who can prove their abilities—mainly young people—have a chance to become members. Therefore, the formal direction of a worker's career may be set within the enterprise.

In reality, however, the VGMKs' membership is, apart from a few exceptions, rather exclusive, in spite of the above-mentioned possibility existing in principle. This is further strengthened by the factors which jeopardize the attained income level. The members themselves consider the economic workteams as uncertain and transitory sources of additional income. They regard the raising of taxes, and the restrictions applied by the enterprise as signs of their suppression. (The question that was most often asked in the course of the interviews was this: "Will there be workteams next year?")[20] The institutions of the internal labour market can fulfil their functions only if the prospects of promotion are calculable in the long perspective. The existence of the VGMKs gives the enterprise the opportunity to offer momentary advantages to its best workers. However, it is not adequate for shaping a long-term strategy to be used with all employees. (This is reflected by the fact that incomes earned in the VGMKs are not taken into account in the calculation of pensions.) It is true that, within large enterprises, a process has started which leads to the stabilization of internal labour markets to be structured through legal instruments. Yet, given uncertain conditions of their functioning, VGMKs cannot provide the strong framework that is really necessary for lasting stabilization.

As Stark says, the function of the internal labour market is to mitigate the factors of uncertainty rooted in the environment, and to provide protection for the management as well as for the preferred workers' group. The workteam is a means of adjustment in the hands of the enterprise management. Primarily, it enables the management to use extra working hours in a flexible way. For workers, however, it implies an uncertain supply of jobs, and unstable incomes. An extreme version is the free market wage bargaining. Were it to become reality, it would indeed help to absorb intra-enterprise labour reserves. However, the price of this—to be paid by the workteam members—would be fluctuating incomes. The VGMK members, who constitute the preferred group of the dual intra-enterprise labour market, can legally assert their favourable bargaining positions. For them, the internal labour market functions as a channel for asserting their interests. At the same time, there are no institutions which could provide protection against the changes, uncertainties and extremes of the market. It is not a federation representing workers' interests that dampens the uncertainties of the market, but the social character of the bargaining parties' informal system of rules.

[20] For the state's handling of the small entrepreneurs' sector, see: [23].

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## РЫНОЧНЫЕ ОТНОШЕНИЯ В ТОРГАХ В СВЯЗИ С ЗАРАБОТНОЙ ПЛАТОЙ

Л. НАЙМАНН

В модели американского социолога Дэвида Штарка внутренний рынок рабочей силы социалистического предприятия—в отличие от жестких, бюрократически организованных институтов капиталистических крупных предприятий—гибкий институт рыночного характера. По мнению автора статьи, анализ конкурирующих хозяйственных товариществ на предприятиях в противоположность модели Штарка показывает, что в торгах в связи с заработной платой действует целый ряд координационных механизмов. Хотя эти торги принимают рыночную форму, однако понятие рынка означает лишь то, что участники торгов располагают относительной автономией, цены изменяются в зависимости от соотношения сил. По сути дела неизменные бюрократические черты организации. Вместо открытых конкурсных переговоров достижимые товариществами доходы складываются благодаря механизмам торгов в связи с распределением. За открытыми рыночными переговорами и бюрократическими правилами доходы членов формирует неформальный регулирующий механизм общественного характера, складывающийся в результате скрытых соглашений между руководителями низшего уровня и трудовыми товариществами.

Хотя товарищества являются средствам легального выбора руководителей, между рабочими группами с различной способностью к торгам, на социалистическом предприятии не могут сложиться такие же формы продвижения, как и на внутренних рынках рабочей силы крупных западных предприятий, так как трудовое товарищество является нестабильным институтом и не может дать длительной перспективы профессионального

**продвижения. Непосредственное использование позиции в торгах рыночного типа означает, что договоры хозяйственных товариществ на предприятиях лишь в ограниченной степени можно считать институциональным воплошением проведения интересов наемных работников.**

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# QUESTIONS POSED BY HUNGARIAN TELECOMMUNICATIONS IN THE AGE OF MICROELECTRONICS

GY. PÁRTOS

Due to the revolution in microelectronics the once stable world of telecommunications can be characterized by radical restructuring processes, new strategic alliences among the manufacturing companies and fierce competition for the markets closed earlier. Is there any answer to this challenge in the Hungarian telecommunications industry?

The paper examines the most critical factors of the development pattern and the structure of interests of the Hungarian telecommunications enterprises. According to the author, manufacturing on competitive costs supposes the organic and much deeper integration into the international relations of manufacturing. Consequently, the Hungarian telecommunications industry faces the dilemma whether to maintain the monopolistic positions (and to lose competitiveness) or to reshape the pattern of development undertaking—gradual but definite—domestic and foreign competition.

Telecommunications enterprises have, for many years, had the best economic parameters in the Hungarian enterprise sphere. However, in an international comparison their performance does not look so good: the per capita output value of $10,000 amounts to only about a tenth of that of the world's leading American and Japanese monopolies, and to a fifth or a sixth of the leading European performances.

In the following, an attempt will be made to point out those specific features of Hungarian development which have led to these differences in performance, and also to the growing deviation of the Hungarian performance (and, indeed, of the entire East European development) from the world tendencies.

In our opinion, the risk involved in this deviation is considerable in the age of microelectronics. As a consequence of the introduction of microelectronics in the field of telecommunications, the whole international telecommunications structure is undergoing a radical reorganization and is treading along a new path. This new path is radically different from the old one, yet the Hungarian telecommunications enterprises continue their progress on the old path, relying on the premisses of the foregoing 20–30 years' development strategy, which has proved successful under the specific Hungarian conditions. This delay is closely connected with the fact that the Hungarian economic regulation is hardly sensitive to, and transmits any new development trends to the enterprise sphere at a very slow rate. This economic environment creates, sometimes artificially, development (market sales) perspectives which gradually lead to deteriorating market positions.

**Preliminaries of the development strategy resulting from CMEA specialization**

The telecommunications industry in Hungary and other East European countries displays two important organizational and structural features; these have their origins in the past.

1. First, the historical heritage, the one-time *organizational integration into the international and multinational organization and market structure* of telecommunications is still in evidence.

Before World War II, the Hungarian telecommunications industry had very close connections with the big international monopolies of industry. The Hungarian manufacture of telecommunications equipment and radio transmitters and receivers grew to be a large-scale industry due to the European network of ITT of America, and through the affiliates of Siemens, Ericsson, and Philips. This ensured for it a strong market and highly advanced technical-technological position in the Eastern European region. The early history of the telecommunications industry of the East European countries can be described, on the whole, as a struggle among the above-mentioned as well as other (AEG, Telefunken, Marconi, etc.) multinational companies for the market. Hungary, and especially the Tungsram Company, played an important role in this process because it represented an advanced technological industrial culture. Also, at that time, Hungary had telecommunications of the rotary system type in the East European region. Thus the struggle of the multinational companies for the East European markets entailed *by definition* that their subsidiaries—which had been founded with direct foreign investment—should possess the most up-to-date technology, an offensive market strategy, and a highly-developed market organization.

This organic relationship with the multinational companies was to have lasting consequences even after its cessation. This could be seen in technical and technological aspects (the technical parameters of the telephone network: rotary or strowger system, or the ensuing crossbar technique), in the trade sources, in the technological relations, and partly in the qualification of the older technical staff.

2. The second characteristic feature has its roots in the breaking away from the early development process. By the early 1950s, telecommunications companies had all been nationalized. After the nationalizations, the progress of development was no longer determined by the efforts of the big multinational companies. Independence meant that the factor which had represented the strength of the enterprises in question (including possession of the techniques, technological procedures, and the market organization of the leading monopolies) was no longer an advantage, but a constraint on patents. Thus began the gradual emergence of an East European development path: an "East European market" separated from world development by an ever widening gap.

According to the original conceptions, it was hoped that this model would build up a new and autonomous East European market capable of closing the tech-

nological gap. In this way cooperation and specialization experiments started in the CMEA. In this isolated East European development, Hungarian telecommunications technique ought to have played a prominent role, as its historical traditions placed it above the other countries of the bloc.

As a matter of course, the new enterprise strategies after the nationalizations centred on autarkic production; their aim was to satisfy the domestic market based on the technical standards as they were at the moment of nationalization. This was true not only for Hungary, but for each East European country. The first intention of the autarkic way of development was to substitute imports from the capitalist countries of the West. Having stabilized their production level and found a smooth way of development, the national telecommunications industries were able, from the 1960s, to make increasingly important deliveries within the Eastern bloc. In fact, it can be stated that the dynamism of the telecommunications industry has been clearly based on these countries' mutual exports.

The new strategic model was supposed to satisfy two essential conditions:

1. It had to support an independent (East European) technical-technological development, i.e. an independent development which would correspond to world trends in its parameters.

2. It had to attain market dimensions which would allow the return of development costs and economies of scale in production.

The two factors specified above were, under the given circumstances, closely connected. The need for an independent technical–technological development was in fact the direct consequence of breaking away from the international telecommunications structure. Namely, it had always been the few big multinational companies integrating the productive activity of the industry that had also provided for technical development. Therefore, breaking off production and market relations with these companies implied, as a matter of course, breaking off technological relations. In the 1950s, the key issue of development for the new telecommunications industries of the socialist countries was to acquire, within the shortest possible time, the crossbar and analogue technologies. These had already been developed and introduced at a fast rate in the Western European and advanced overseas countries. Thus the initial steps of the cooperation were concerned with the development of such a technology within the socialist bloc.

These experiments, however, have remained fruitless in efforts to assert compatibility with West European systems. This was caused mainly by the highly different standards of technical development between the individual countries, the different national systems, and—a problem to this day—the deficiencies related to parts supply. For the Hungarian economic management—as with other socialist countries—the CMEA specialization did not represent any real perspectives in the field of development and the import of technologies. Therefore, the CMEA has been important only because its market has absorbed large volumes of telecommunications products; even though it has made numerous attempts to form a technological

development cooperation, it has never had much success. In Eastern Europe, the Soviet Union was the first to develop the crossbar technology; however, this model is different from the West European standards. The small Eastern European countries' telecommunications industries, if they wished to make use of the development potential offered by the CMEA market, were compelled to join this trend of technological development. As a matter of fact, it is along this trend that the so-called ATSZK-switches of Hungary, as well as the Czechoslovak and GDR developments, have been made.

As has been mentioned, the independent and isolated Eastern European market was in fact formed in this field during the 1960s, and it has grown to be a determinant factor in the rate of development.

There is, however, another specific feature of this development model: the *division of the market* into two parts. This is indicated by the fact that none of the national PTTs wish to adopt the technology developed in the Soviet Union. Such technology satisfies specific Soviet needs, but deviates from the standards applied in the West. Thus the telecommunications industries are compelled to supply some other type for their own domestic markets. This implies that the radial-type specialization of the small countries does not, or only partly, takes advantage of the economies of scale potentially possible on the Soviet market. The fact is that the small countries' markets are unfit for large-scale production, but this problem cannot be solved within the framework of the CMEA. At the same time, the Soviet market potential, which could provide the most dynamic element of development, does not even solve the problem of acquiring techniques. This is because the Soviet financing of development, which is in the form of credit-granting, cannot be used for the purpose. What is worse, since the Soviet market—the only meaningful reason for the East European model—has become technically isolated, the potential for each small countries' individual development (independent technical-technological development) has also come to nothing. As a matter of fact, the small domestic markets do not enable the initiation of developments because, based on such scales, they are fraught with high risks. In addition, exports to the Western and to the developing countries do not seem very promising because of the barriers created by international patents, and also because of the lack of necessary references.

At that time, importing technologies from the West did not seem feasible, either, for several reasons. On the one hand, the Hungarian as well as the other small countries' economic policies were based on total import substitution. On the other hand, it was believed that importing new technologies might involve the risk of cutting down on the ambitious national industries; this was not to happen because the industries represented a sector of great strategic importance.

However, in the end no other way of acquiring the new technologies remained open but to turn to those multinational companies which were expelled at the time the socialist countries were trying to establish their own independent industries. The purchases were realized in the form of licences: Hungary bought the crossbar

technology from Ericsson in such a form—albeit after prolonged negotiations. This way of acquiring technology entails, however, a considerable time lag and a loss of efficiency in trying to keep up with technical progress.

The main advantage of technology introduced by means of licences was that, despite long delays and the realization of a lower level than originally intended, the vital change was still effectuated. In such a way the technical-technological standards of enterprises could be raised to a higher level. In Hungary, however, two important targets were not achieved, even though they had originally been considered of key importance. One of these was concerned with the expectation that the transfer of technology effectuated in the form of licences would lead to a "big leap" in Hungarian telecommunications techniques. Introduction took much longer than had originally been conceived and, on the whole, it is now considered to have been a failure rather than a success of the Hungarian telecommunications industry.

The hopes that had been attached to the export anticipated as a result of the licences also came to nothing. That is to say, the licence agreements allowed only limited Western exports, since they stipulated that the product in question could not be delivered to the licence-giver's own potential markets. Therefore, licence-based development tends to have its main use in the domestic markets. Its advantages are in proportion with the dimensions of the domestic market; it is not very promising in the international market. The main advantage consists in the avoidance of certain risks, as well as in the saving of some of the development costs.

Along the line of development described above, the telecommunications industries of the small Eastern European countries have to some extent been able, during the last forty years, to satisfy the telecommunications needs of the domestic markets. They have also been able to follow, even though with considerable delay, the international trends of technological development. At the same time, their production has been highly profitable. This is partly due to domestic sales, and partly due to the Soviet market, which constitutes between a half and two-thirds of the market. Coupled with these facts has been the lack of competition from imports.

The telecommunications industries of the Eastern European countries have deviated widely from international trends in their inner pattern, size of enterprise, scales and lines of production, and trade activities.

Those telecommunications enterprises of the CMEA—including those of Hungary—that can be compared with the Western medium-size companies on account of their scales and capacities, have sales patterns similar to those of the transnational monopolies—i.e. they export more than half of their output.

— As against the diversified production patterns and exports of these monopolies, however, the CMEA enterprises have narrow lines of production and only one export market. The last two factors mentioned have resulted in dependence on the buyer, and this has led to cyclical fluctuations in the enterprises' development (sales).

In spite of the departures from international trends, it can be said that the enterprises have been involved in successful activities, and these have not only been related to their national economies. This has partly been due to the fact that, in the period we examine, the entire international telecommunications structure displayed development characteristics significantly different from the general organizational pattern and functional mechanisms of the West European market economies. Although the Hungarian and, in general, the CMEA telecommunications industries eventually developed different paths from the Western model, those paths were similar in certain respects at that time. Nearly every country's telecommunications industry worked in a national market that was well defended through a mass of protectionist measures, and in which domestic manufacturers enjoyed monopolistic positions. The monopolistic positions were secured by government regulation and government orders. Alongside these, to varying degrees the budget provided the financial resources for technical development. Thus, on account of the protected market positions, the national enterprises had stable cost and price conditions in comparison with other sectors. Therefore, it can be said that the then prevailing worldwide conditions of enterprise development, due to the fact that national markets could be monopolized, not only suppressed the deviating development features of the CMEA, but in a way also strengthened them.

## Changing conditions under the impact of microelectronics

The transformation of telecommunications techniques through the emergence of microelectronics is clearly considered in the international literature as a radical, even revolutionary, change. As a consequence of this change, computer technology and telecommunications techniques, which at one time were developing along separate lines, have begun to coalesce: the electronic telephone exchange is in fact a highly sophisticated computer with a specific task. The emergence of the new informatics industry has bound together the two separate lines, and has produced effects that have fundamentally changed the traditional structure of telecommunications. Costs and prices have ceased to be stable, and the growth of the material costs has been accompanied by a drastic fall in the prices of parts; such changes have taken place in the course of hectic processes in all fields of microelectronics. The introduction of microelectronics has led to changes in order of magnitude of development inputs, and in the economies of scale in production. The development of the new electronic main exchanges requires development costs of such magnitude ($500–1000 million) that it is possible only for the giant companies of the industry. The return on such huge development inputs can only be guaranteed if there is success on the export markets—this is particularly true with reference to those European countries which dispose of small and fragmentary markets.

Therefore the crucial point of the changes is that the protected, autarkic development paths based on the earlier conditions of production have gradually become impossible. Also, the institutional restructuring of telecommunications (deregulation and reprivatization) has led to the development of competition on the national markets of the telecommunications industry. In the course of this process, the relationship between enterprises and governments has changed: at one time the telecommunications industry was protected and subsidized by the budget; it is now organized, like most other sectors, according to business principles.

Of course, the challenge of microelectronics has not left intact the development path of the CMEA countries' telecommunications industries, either. However, while in the world market earlier development strategies were revised, within the CMEA countries microelectronics continued to develop along the earlier autarkic paths. Although the mechanisms prevailing in the CMEA did not make it possible to establish a form of cooperation capable of improving international competitiveness, the Soviet Union, as well as the GDR, Czechoslovakia and Bulgaria launched large-scale microelectronic projects. These development projects were, however, still aimed at autarky, or at providing for Soviet exports, or for the necessary parts supply—whether making use of Western licences or not.

The Hungarian telecommunications enterprises have developed peculiarly "one-way" foreign economic relations as a result of the development strategy described above. Their connection with the world market has two aspects:

— On the one hand, they import up-to-date parts; on the other, they import technology. The connection consists, therefore, primarily in imports. This also implies that the Hungarian enterprises' activities mainly involve assemblage. Therefore this dual import connection puts the Hungarian enterprises in a dependent position, since the general conditions of their production, as well as their competitiveness, are determined by factors which are beyond their influence.

Parts supply is the most difficult and uncertain element of the Hungarian telecommunications industry:

— The almost impossible task of procuring parts from the socialist countries, coupled with the extremely high prices (between 3 and 5 times higher than the world market prices), make CMEA specialization totally worthless for the enterprises. As for the conditions of production, what is predictable in this relation is the potential dependence, and competition between manufacturers of final products. It has been like this in the past, yet the phenomena in question may increase even further in the age of microelectronics. Since the small CMEA countries all sell their products on practically the same markets, they have no interest in supplying the competing business partner with parts.

— In Hungary, the high prices of parts, quality problems, and the small volumes of output are all factors acting against competitiveness. They also help to push the manufacture of end products towards autarky. It is possible to envisage that this autarky will be enlarged such that it reaches the regional level—at most.

— In the early 1980s worsening problems related to the balance of trade represented another significant factor of uncertainty in the import of parts.

At the same time, export positions on the Western markets are rather weak. The purpose of exports is simply to ensure the zero balance of imports of parts from the West, or to comply with administrative orders. They represent the least profitable segment of the enterprises' activity. The majority of the articles exported consist of items which the Western companies had already stopped making during the 1970s; most of these items are very far from modern technology. Their production can be considered in fact as "jobwork": they do not contribute to the modernization of the product pattern, they rather help to conserve it. Constructions embodying modern technology are sold (if they are sold at all) on the Western markets only in slight quantities. This is because only essentially lower prices can be achieved on those markets than on the domestic markets.

The lack of an organic integration into the world market is best illustrated by such cases in which real high-tech products are a failure on the market. This demonstrates further that in today's world of electronics the challenge is not, or is *not only, technical but also economic*: the decisive factor is not the ability to manufacture (assemble)—which most countries can do—but quality, competitiveness, in other words the costs of the manufacturing process.

The link with the world market through the import of parts becomes a model if it is viewed together with export specialization toward the CMEA sphere—mainly for the Soviet Union—and the autarkic production for the home market. Practically all the Hungarian telecommunications enterprises have specialized on the Soviet market: a decisive, i.e. 50 percent, proportion of their output goes to the CMEA market. It was in fact these two markets—the socialist and the domestic—that at one time paid for the end products (made from parts imported relatively cheaply from the West) with rather high prices—especially when the introduction of up-to-date technology was involved.

As has been mentioned, this import substituting development provided, and still does provide, relative prosperity for the enterprises. An essential element of the profitability of import substitution is the *monopolistic position* enjoyed on the domestic market.

This model was based on a form of technology transfer which provided for following the phases of technical development as well as for maintaining the model. However, it is the form of the *licence* that further strengthens both import substitution, and the technical *monopolistic position*. Thus the model applied in the past, and considered as highly successful with regard to profitability, has brought about interest relations (due to the regulation based upon it) which it is in the vital interest of enterprises to conserve.

With the emergence of microelectronics, this development model is challenged from two sides, and the situation involves factors of daily increasing uncertainty:

— Due to the globally increasing importance of considerations associated with the balance of trade accounted in convertible currencies, the role of the "parts factor" has grown in importance. Embargoes exert a similar effect. With the given development model and the connected interest relations, this circumstance has encouraged an extension of import substitution into the field of parts manufacture.

— Due to the one-sided connection with the world market, the challenge posed by electronics is experienced today by the Hungarian enterprises mainly in the increasing difficulties that they are having in selling the traditional technologies—even on the CMEA markets. This is the consequence of several factors. First, the Hungarian "parts problem" puts the development model based on the CMEA in a difficult position in itself, on account of the challenge posed by electronics. The deterioration of the CMEA market positions also seems to be inevitable because the neighbouring small CMEA countries will, owing to their large-scale development of electronic parts, raise strong competition for the Hungarian enterprises on the market of the end products. With the present—essentially similar—model the Hungarian enterprises will, from the outset, suffer a disadvantage because of the higher level of the neighbouring countries' autarkic parts supply. This will be coupled with their lower price and cost sensitivity—consequences of their domestic economic mechanisms. Second, the CMEA market will become less important for Hungarian foreign economic policy, because of the balance of trade problems. Namely, the one-sided foreign economic connection involves a conversion of dollars into roubles; it can be even said that the competitiveness of Hungarian telecommunications manufacturing has largely come from that conversion. Due to the growing importance of macroeconomic equilibrium considerations, CMEA quotas have been constrained, and this damages the enterprises' income positions.

As a reaction to this many-sided challenge, an industrial strategy is taking shape among the Hungarian telecommunications enterprises and in the development proposals submitted to the central economic management organs. This suggests that the only feasible way forward is to carry on with the previous development model. Any industrial strategy which questions that model is seen as groundless.

One of the essential elements of this industrial strategy which follows logically from the autarkic import substitution model is the extension of *autarky and import substitution to the manufacture of parts.* Since this path is practically the same as those adopted by the other small CMEA countries, the adoption of an identical way of development (production, sales, technical standards, foreign economic relations) by Hungary will encourage the trend acting in this direction to grow constantly.

*The other essential element of the industrial strategy deals with the form of purchasing electronic technology.* The enterprises' interest in maintaining the given model makes the purchase and introduction of licences the only feasible way of technology transfer. This is because it is the only way to ensure a monopolistic position in technology, and thus ensure an automatic development of a monopolistic position on the market. Therefore, the licence-based model represents the only adequate

form of technology transfer in the given import substitution model; however, this only holds if the non-competitive conditions of the domestic market are conserved by the external environment of regulators (albeit in an administrative way). In this situation *the weakness of the organic foreign economic connection becomes a factor strengthening the model.* In addition, the undoubtedly existing considerations related to strategy and Western embargo exert a protectionist effect; this effect also acts towards import substitution.

However, a continuation of the earlier path as the only possible industrial strategy (through increased autarkic parts supply and licence-based technical transfer) entails consequences much different from, and even diametrically contrary to, the earlier ones. Namely, the sharp turns that have been and are taking place in the telecommunications structures of the advanced industrial countries have basically changed the economic parameters of the international development path. As has already been mentioned, the new path *places costs (which had up until now been neglected) in the centre*; this is due to the elimination of national monopolistic markets and the development of new cooperation strategies.

The continuation of the Hungarian and the CMEA development model based on the present interest relations, within the framework of the above-mentioned strategy, means that the Hungarian telecommunications industry will increasingly deviate from international trends. What will be the signs?

Licence-based autarkic development, or development which concentrates on the CMEA, is further possible if the industrial strategy set forth above is adopted. This strategy will not be apt, nor is it intended, to change the existing form of the world market connection. On the other hand, it will clearly help to ensure that the importation from the West of parts needed in electronics is continued with a balance near zero. This should be so even if the Western import ratio rises somewhat in comparison with the present ratio.

The CMEA market positions will not probably deteriorate; however, it will be possible to counterbalance this situation with sales on the domestic market. It is highly likely that this will even be encouraged by the central management organs, since the Hungarian balance of trade with the socialist countries in electronics and telecommunications clearly shows a surplus and, above a certain level, this is not desirable.

Thus, within the framework of that strategy, and following the given development path, the enterprises can continue with profitable production, as well as attain higher technological standards. Thus everything seems to be in perfect order.

The departure from the international development trends will be signalled by the *cost relations* of the electronics industry; this will be the veritable new feature of the Hungarian telecommunications industry. The analogue-crossbar exchanges (and, by and large, all the related technology) have been sold at prices not widely different from those of the world market. This means that by basing the Hungarian manufacture of telecommunications equipment and telecommunications networks

on the licence-based crossbar manufacture there *has been no losses in the national economy*—apart from the slowness and deficiencies of the introduction of licences. Namely, *there have been no additional costs* in comparison with possible imports, even though, for certain reasons, it has not enabled exports to be made to the West. This is the main substance of our opinion, which is that Hungarian enterprises—deviation notwithstanding—have so far adjusted themselves to the international trends.

With the coming era of electronics, however, the present strategy requires *considerably higher costs of manufacture* than the international trends—even in those cases in which the most careful consideration is given to the introduction of licences. The cost and price relations prevailing in the international market of parts cannot be ensured—namely, they cannot be anticipated through a strategy that lacks an organic connection with the world market. Along with this, the Hungarian and, possibly, the CMEA parts supply will involve significant additional costs.

*Only the domestic market and, to an ever lesser extent, the CMEA market are willing to pay the additional costs associated with Hungarian electronics products.* This end is to be served by ensuring monopolistic positions through the issue of licences, maintaining the given form of connection with the world market, and treating the embargo as a protective customs duty.

This will lead, however, to an increasing discrepancy of enterprise interests and national economic considerations, since enterprises will only be able to prosper on the basis of the domestic—and possibly the CMEA—customer "overpaying" for products (as compared with the world market price). Thus the price the national economy has to pay for deviation from the international trend consists of the additional costs which the Hungarian manufacturers add to their prices on the domestic market in comparison with world market prices. There are today numerous examples to illustrate the case.

Today's industrial policy considerations are concerned with the ways and conditions of continuing the earlier development path. Therefore, it is difficult to estimate the size of the additional costs on the national economic level (paid by the consumer—i.e. the entire economy and society). For the same reason, the advantages and disadvantages of this industrial policy are not rationally weighed up, in the manner of cost-benefit analyses. However, by the time the consequences become clear, the continuation of the earlier path will have been decided and institutionalized through the purchase of licences. If that happens, the genuine industrial policy alternative (which, even if latent, is still present) will be eliminated.

The alternative can be formulated in the following way, with due regard being given to the international development trends:

— How can the conditions of international competition be asserted in the Hungarian telecommunications industry such that production and consumption will at least be competitive in respect of prices? (That is to say, although the

Hungarian products would not be exportable, at least they should not cost more than if they were imported.)

The simulation methods of the Hungarian price system, used at present and to be used in the future, are obviously not suited for the purpose. Only the stark reality of world market conditions is satisfactory. This reality can hardly be conveyed through direct import competition, since the necessary amount of foreign exchange is not available—either in the short or in the long run—amid the present troubles associated with indebtedness.

Import competition can be created, however, by means other than the import of products; for example, by making use of direct foreign investment (equity capital) in joint enterprises. Without making light of any reservations and counter-arguments that may be brought up, one must say that this way of development remains hidden because it would entail a disturbance of the *status quo* created by the Hungarian regulators and interest relations, as well as the loss of monopolistic positions. Therefore, it would run contrary to enterprises interests. The possibility of a joint venture has been proposed by a foreign firm to one of the Hungarian telecommunications enterprises. In the field of production, however, the enterprise's interests were opposed to the joint venture. This is because it would have jeopardized the enterprises' monopolistic positions in the field of technique. Such a solution, therefore, does not seem to be feasible, because of the lack of interest on the part of the enterprises.

However, it would be possible for the macro-level management of the telecommunications industry to bring into existence a sector within the industry—with foreign participation—consisting of enterprises willing to take part in the process. It would also be possible to involve new enterprises without monopolistic positions.

The aim of this new sector would be to establish a new kind of connection with the world market. If such a connection could be successfully created by means of production cooperation, it would represent a new element alongside the isolated, autarkic development model based on the CMEA market and the interest relations underlying it. The existence of such a sector could result in enterprise prosperity and national economic benefit achieving coordination through the necessity of reducing production costs. If such a segment came into existence within the Hungarian telecommunications industry (which is the case, for instance, in Turkey and Spain, to name but two), the enterprises outside this sector would also be compelled to take measures bringing them nearer to world market conditions.

# ВЕНГЕРСКАЯ ТЕХНИКА СВЯЗИ В ЭПОХУ МИКРОЭЛЕКТРОНИКИ: КАК ДАЛЬШЕ?

Д. ПАРТОШ

Вторжение микроэлектроники в область телекоммуникационного оборудования вызвало значительные—и еще далеко не завершившиеся—структурные процессы в стратегии развития предприятий, связях между предприятиями, отношениях рынков к услугам в области связи и т.д. В статье делается попытка уяснить, как венгерская промышленность связи ответила и отвечает на эти кардинальные изменения, вызванные микроэлектроникой, и что мешает—в том числе и вследствие проводившейся в последние 30-40 лет стратегии развития—ей включиться в международное направление развития.

Определяющей чертой развития венгерской промышленности связи после войны является то, что национализация, проведенная в начале 50-х годов, привела к ее отрыву от прежней международной среды и нарушению этой связи и ее специализация в основном шла в направлении рынков СЭВ. Однако по разным причинам сотрудничество стран СЭВ в области техники связи уже в доэлектронный период лишь в ограниченной степени было способно интегрировать производство, развитие и рынки. Вследствие этого повышение технического уровня венгерских предприятий обеспечивалось—ввиду узости внутренних ресурсов—за счет односторонней связи с западноевропейскими рынками лишь со стороны импорта, путем ввоза современных технологий и узлов, а динамизм их роста определялся экспортными поставками на рынки СЭВ.

Вследствие изменений, которые вызвала микроэлектроника в затратах на развитие и производственных процессах, а также ввиду ухудшения внешнеэкономического равновесия венгерской экономики, продолжение такого пути роста сталкивается с трудностями. Наряду с анализом критических факторов, в статье анализируются условия и вероятность создания новой, более органично и гармонично интегрированной в международное разделение труда промышленности техники связи.

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## REVIEWS

# DEVELOPMENT TRENDS OF THE SECURITY MARKET IN HUNGARY

ZS. JÁRAI

It has been a widespread phenomenon during the last ten years that Hungarian enterprises have been able to cover their growth from after-tax profits, from budgetary grants, and from bank credits. At the same time they have been particularly short of long-term resources, and of risk funds. Beside these channels, they have had no free access to other sources of capital; a money market or a capital market have been practically missing.

The scarcity of resources was further aggravated by the sudden strong restraint following the investment peaks of the late 1970s. In the early 1980s, the necessity of financing fast economic restructuring became acute. Foreign sources could not be counted on any longer and, what is more, domestic (productive and personal) consumption had to be bridled, with a view to restoring the foreign economic balance and fulfilling debt service obligations. One single way remained open: to accelerate the reallocation of capital. This seemed to be an appropriate means for redirecting capital from other fields of the economy to enterprises capable of profitable production and dynamic growth.

It had become clear by the early 1980s that the only useful forms of capital flow were those capable of adjusting themselves to existing markets: the capital market and the money market. The reform of the financial system, i.e. the elaboration of new forms of financing, came onto the agenda. The tendencies started at that time have since continued: in addition to a reform of the banking system, non-banking financial markets have been expanding and gaining strength, and the channels of capital allocation have continued to become more diversified.

This process has contributed to a situation in which on the one hand, additional financial savings have accumulated in the economy which can be invested into development projects on the basis of the free decision of the investors. On the other hand, it has helped to promote the development of a rational capital structure for enterprises. The use of risk capital, and the accumulation of long-term sources of finance are indispensable for economic restructuring, and for the establishment of new, competitive enterprises.

Bonds and shares are to be considered as long-term instruments of the capital market. The recent history of these instruments of financing and capital flow began in the early 1980s when, after an interval of more than thirty years, bond issue began. It was first used to finance local councils' investments in 1982, and then

enterprises' investments in 1983. Parallel with this, a few experimental shares were also issued in 1982–83. In the following, the development of the security market will be analyzed from the beginnings, in 1980–82, to 1987–88.

## The emergence and growth of the market

Ever since its foundation, the *bond market* has been growing at an exponential rate, particularly in respect of sales to private individuals. In 1982, the legal rules for bonds were made with the intention of accelerating inter-enterprise capital redistribution. Therefore, the issue of bonds to private individuals was, with the initial rules, treated as being exceptional. The market started accordingly: in 1983, 86 percent of the bonds issued were sold to enterprises: however, in 1984–85 the trend turned, and bonds bought by private individuals grew in importance. (See *Table 1*).

**Table 1**

*Yearly volume of bond issues (1983–1987)*

| Year | Bonds issued to | | | | | |
|---|---|---|---|---|---|---|
| | Economic organizations | | Private persons | | Total | |
| | pc | mill.Ft | pc | mill.Ft | pc | mill.Ft |
| 1983 | 13 | 640 | 8 | 105.0 | 21 | 745.0 |
| 1984 | 9 | 358 | 23 | 824.0 | 32 | 1 182.0 |
| 1985 | 3 | 523 | 46 | 1 768.2 | 49 | 2 291.2 |
| 1986 | 11 | 1 373 | 59 | 4 198.8 | 70 | 5 570.8 |
| 1987 | 21 | 4 594 | 121 | 12 692.4 | 142 | 17 286.4 |
| Total | 57 | 7 488 | 257 | 19 587.4 | 314 | 27 075.4 |

As for its significance, the bond market seemed to have become fully ripe after 4–5 years, i.e. in 1986–87. By the end of 1987, the sum of bonds issued and sold amounted to nearly 3 percent of the GDP, 8 percent of the sum-total of deposits, and its yearly growth reached 8.5 percent of the investements into fixed assets. Furthermore, the tendencies evident in the bond market throw greater light on its significance. The growth of the bonds total siphoned off 18 percent of the growth of the stock of deposits in 1986, and practically all of its increment in 1987. This is to say that, while in 1987 the bonds total increased by more than Ft17 thousand million, the growth of the stock of deposits was less than that.

Up to the end of 1987, altogether 314 different bonds had been put on the market. 208 enterprises and cooperatives, the councils of 91 settlements, and 15

banking institutions acquired development resources on the bond market. (See *Table 2*)

**Table 2**

*Bond issues by issuers (1983–87)*

| Denomination | Amount (mill.Ft) | Number of issues |
|---|---|---|
| Banking institutions | 10482.0 | 15 |
| Local councils | 2979.0 | 91 |
| Economic organizations | 13614.4 | 208 |
| Total | 27075.4 | 314 |

The average value of a bond issue is still rather small, if international comparisons are made. The average value of an issue is Ft86 million, and there are numerous issues of between Ft10–20 million, and around 50 million. This enables many small councils and economic organizations disposing of small capital to acquire resources. As a rule, enterprises use a bond issue to finance productive investments or to increase their stocks (of materials etc.), whereas councils spend the resources obtained to build schools, kindergartens, or day-time homes.

The biggest issuers of bonds are the National Savings Bank (to accelerate residential construction and economic restructuring), the Hungarian Post Office (to develop the telephone network), and the banks (to complete their own resources). The Skála-Coop Department Store Enterprise used its three bonds to contribute to the construction of the Budapest Skála Sprint and another Skála store. The Tisza United Chemical Works added to its own sources to construct a linear polypropylene factory, and this has been working highly profitably ever since. OKGT (the National Oil and Gas Trust) raised sources to enlarge the country's gas-distribution system.

1987 brought a boom on the bond market, at least as far as the growth of the number of issues is concerned. The most important motives for this were the following:

— Because of the expectations and uncertainties concerning changes in the regulatory system to be introduced in 1988, the reform of the taxation system, and the relatively high inflation rate that had been forecast, some of the economic units brought forward the date of their investments and issued bonds to finance these.

— Because of the rush of household purchases in the second half of the year, the sum-total of the deposits at the National Savings Bank diminished during the third quarter of the year. Therefore, with a view to maintaining the balance of home-building sources, the Savings Bank issued bonds to the value of Ft3 thousand million, and this was over-subscribed, reaching thus Ft4.5 thousand million.

— The new commercial banks founded on the 1st January 1987 sold bonds amounting to more than Ft4 thousand million to enterprises and cooperatives. They did this a few months after their establishment in order to increase their long-term resources.

In itself, the fast increase of the bond market in 1987 can be regarded as neither good nor bad. As for the development of capital market, the growing bond issue seems to be advantageous, although its extremely high growth rate is also fraught with many contradictions. Supply that had grown 3.5-fold from one year to the next gave rise to tensions. The excess demand of earlier times was replaced by excess supply, especially in the second half of the year. This led—as we shall see—to some uncertainty, and thus the conditions changed.

Up to the end of 1985, the bond market was mainly organized by the State Development Bank, which also held about 90 percent of the bond subscriptions. In 1986, the National Bank of Hungary and the National Savings Bank increased their participation, and in 1987 all commercial banks started to take part actively in the organization of the market. 36.7 percent of the 1987 bond issues were organized by the National Savings Bank, 24.2 percent by the Budapest Bank Ltd., 20.3 percent by the Hungarian Credit Bank Ltd. and its affiliate Bank for Investment and Transactions, 15 percent by the Commercial and Credit Bank Ltd., and about 4 percent by other banks: Interbank, UNICBANK Ltd., the Innovation Bank for Construction Industry Ltd., the General Banking and Trust Co. Ltd., and the savings cooperatives.

The secondary trade in bonds was initiated by the State Development Bank in 1984, and this has been carried on by its legal successor, the Budapest Bank Ltd. In 1987 the latter assumed the role of residual seller and buyer, so that the liquidity of the market could be assured. Also, in 1986, and even more in 1987, other banks joined in the organization of the secondary trade, so that by the second half of the year four separate secondary markets had come into existence. Efforts were made to streamline the markets to some extent at the beginning of the year, and in December 1987 an agreement was signed between twenty-two Hungarian banking houses to organize the secondary market along uniform lines. This may be the first step towards a uniform organization of the fast expanding trade in securities. This is all the more important, as the secondary turnover of about Ft2 thousand million in 1986 had grown to almost Ft10 thousand million by 1987, and the scarcity of financial resources as well as the liquidity crisis further increased the rate of circulation.

Most probably, in 1988 and in the years to come, the bond pattern will change: government bonds will gain ground and bank issues will continue to grow, while small issuers such as small enterprises, cooperatives and small local councils operating with low capital resources will gradually withdraw from the market.

There have already been *government issues* in the 1980s. These, however, cannot be included with the securities of the bond market, even though lately they

have been integrated to some extent. The biggest government issue took place in 1984: a part of the enterprises' reserve funds accumulated during earlier years could then be spent on government bonds, totalling Ft12 thousand million. However, these government bonds, of 15 years' term and bearing 4 percent yearly interest, were not voluntarily bought and are not—or at least only with much difficulty—negotiable.

In 1988, the restrictive rule that prevented the government from issuing bonds to private individuals was lifted.

It was the bad memories of the Hungarian government bond issues during the First and Second World War years, as well as of the Peace Loans of the late 1940s and early 1950s, that moved the legislators in 1982 to totally inhibit the budget from issuing bonds to private persons. These rules, which drove the government to issue bonds to enterprises, or force them on enterprises, have now grown obsolete.

By the beginning of 1988 the bond market had reached such a state of development that even the budget could not intervene in it without having regard to its specific regularities and tendencies. This, in itself, provides adequate guarantee against any arbitrariness on the government's part. What is more, experience has shown that private individuals as well as enterprises have confidence in government issue. They consider them to be safe and therefore government bonds should continue to be—under satisfactory conditions, of course—in demand on the market. Treasury bills are to be issued to cover the short-term credit need of the budget, and government bonds to cover the long-term credit needs.

In Hungary, the bond market of the institutional investors (enterprises, cooperatives, institutions) and that of households and private persons have not developed along similar lines. Certain bonds could only be bought by institutions, and others only by private individuals. Apart from a few legal prescriptions (for example, the exclusion of the state from the private market), the sphere of customers has been determined by the issuers themselves.

In the beginning, the issues for households could only be used to finance social investments (such as schools, public services, utilities), but this restriction had practically been lifted by 1985–86. Yet the different taxation systems for institutions and for private persons have remained (household incomes were virtually tax-free before 1988, while enterprises paid on average a 40 percent profit tax). Therefore, the average rates of interest were different on the two partial markets. Enterprise bonds paid 12–13, or at most 15–16 percent, and household bonds 9.5 percent on average, or 11 percent (except for the telephone bonds). Also the protection of the investors was different on the two markets: the government provided a guarantee for all bonds purchased by households, whereas no such automatic guarantee was provided on the market of institutions.

After the strict separtion of 1983–84, the two markets began to move towards unification in 1985–86—a process noticeably influenced by demand-and-supply factors. In 1984, the household bond market started to develop in spectacular fashion:

demand usually far exceeded supply. Freshly issued bonds were sold out in a few hours or days, there was no reserve on the secondary market, and subscribers were queuing up for new bonds. In 1986, there was some change in this situation, and in 1987 there was evidence of excess supply. On the other hand, in 1983 the institutional market started with oversupply and sales difficulties. The financial managers of the institutions did not know much about bonds and were not willing to invest the enterprise's money. Oversupply caused an increase of interest rates: but even at 14–15 percent rates, bonds were difficult to sell.

Demand began to grow in 1985, when enterprises saw clearly that, owing to the liquidity of the secondary market, investing in bonds does not necessarily amount of freezing money for ten years. Yet increased demand was not followed by increased supply, since issuers preferred to go over to the household bond market because of lower interest cost there. This was enabled by the lifting of the administrative restriction.

Thus a margin of shortage developed on the institutional bond market. Finally, as a result of the two above-mentioned tendencies, quasi-harmonious conditions, with rates standing at about 11 percent, had established themselves on the two markets by early 1987. This fact, together with the changes in the rules of taxation and guarantees introduced in January 1988, enabled unification of the two markets.

In 1988, administrative separation ceased: any bond can now be bought by any investor—unless the issuers themselves delimit the sphere of customers.

Unlike the bond market, until the end of 1988 legal measures restricted the sphere of the potential buyers of *shares* in Hungary. They excluded private persons from the sphere of potential buyers. Therefore, shares could be only held by institutional investors, enterprises, cooperatives, and institutions.[1]

This restrictive measure notwithstanding, the share market has been growing considerably during recent years and several share companies have been established since the early 1980s. These new companies are in addition to the few old ones that have been formally functioning as such since before the Second World War, and were maintained after the war in order to keep the continuity of their external relations (Tungsram, IBUSZ, MAHART). 1987 brought a strong upward trend in this field, too. Of the 40 or so share companies registered in Hungary, 10–15 can be considered as genuine ones from the Hungarian viewpoint. On the other hand, the others, as has been mentioned, are either formal, or exclusive in that shares are in the hands of a few holders who do not wish to negotiate them. The latter group includes several foreign–Hungarian joint enterprises, e.g. CITIBANK, CIB, UNICBANK, etc.

[1]This situation ended by 1st January 1989 when a new Company Act was put in force which allows domestic and foreign private persons to buy shares of a Hungarian company. This will, of course, radically change the environment for the issue of and trade in shares. *Ed.note.*

One of the first genuine share companies is NOVOTRADE, which has been followed by numerous other enterprises and banks. In 1987, the new commercial banks were founded in the form of share companies. At the same time, several earlier established small banks were also transformed into share companies. Among the shareholders, there are a few hundred Hungarian enterprises and cooperatives, and their shares are, in most cases, genuinely negotiable (though sale is often difficult, because of the prior claim of shareholders).

The total invested capital of the genuine share companies exceeds Ft40 thousand million (most of the banks having been founded on rather large capital), of which negotiable shares total more than Ft20 thousand million, after deducting bank shares held by the government.

Most of the shares were subscribed to, or bought, by the investors in 1986 and 1987. Already the transformation of the banks into share companies, followed by the raising of the invested capital in 1987, brought shares to the nominal value of Ft16 thousand million into the possession of Hungarian enterprises. The greatest part of this amount—about 80 percent—has already been paid up and the remaining 20 percent is going to be paid in 1988 and, albeit a very small part, in 1989. At a time when scarcity of the resources is the most often heard complaint in the economy, it is surprising to find such share-buying propensity on the part of enterprises. In a few cases, especially in the selling of bank shares, there has certainly been some informal pressure exerted. However, the primary reason for the mass purchases has been the prospect and promise of profitable investment. In general, 10–12 percent dividends were offered on the shares sold. This corresponds to a 25–30 percent pre-tax profit rate (the dividends paid out on shares can be put into the after-tax fund).

The *secondary turnover of shares* is still occasional at the time of writing the present article. Only a few pieces change hands each year. The circulation is hindered by administrative measures, e.g. the right of preemption. What is more, price formation and a system for the provision of information on share companies are also in their initial stages. So far there has been no real need for these, since most shares are new and the holders have not yet wished to sell them.

## Yield, safety, liquidity

A qualitative comparison of the securities circulated (shares, bonds) should be based on the simultaneous analyses of the three above factors.

In Hungary, since bonds are usually issued and then purchased on the primary market at nominal value (issues below or above par have rarely occurred), the yield practically equals the nominal interest return. The average yearly interest rates of the bonds circulated are shown in *Table 3*.

**Table 3**

*Average interest rate of the bonds issued*

| Year | Interest rate on the enterprise market | Interest rate on the household market | Interest rate % |
|---|---|---|---|
| 1983 | 11.12 (between 7–13%) | 8.60 (between 7.6–10%) | 10.76 |
| 1984 | 13.20 (between 11–15%) | 9.85 (between 7–11%) | 10.82 |
| 1985 | 12.04 (between 11–12.5%) | 10.90 (between 9–11%) | 11.60 |
| 1986 | 11.20 (between 11–12%) | 9.53 (between 7–11%) | 10.12 |
| 1987 | 11.50 (between 11–12.5%) | 11.42 (between 7–13%) | 11.44 |

After the uncertainties and fluctuations which occurred at the beginning (when bonds carrying as much as a 16 percent interest rate were circulated), the interest rates of enterprise bonds stabilized at about 11–13 percent in 1985–86, and in 1987 they began to show a slight rise again.

The interest rates of the household bonds have also fluctuated. The interest rates of the experimental issues of 1982 moved between 6–8 percent. These were followed by bonds with 7–10 percent rates in 1983, and a rate of 11 percent emerged in 1984—this figure prevailed for some time. A further rise began in 1987, when there was an oversupply of bonds, so that by the end of the year the nominal interest rate of the new issues had reached 12.5–13 percent.

With regard to the nominal interest rates the market has grown practically uniform. The conversion of nominal rates into real rates is very difficult, since not only the price rises of the last years, but probable inflation must also be taken into account. Therefore, paying attention to the average 5–10 years' expiration of the bonds, investors take into consideration the real interest to be expected during the complete term; yet this is extremely complicated to estimate at present, considering the economic uncertainties.

With a view to mitigating the fluctuations of the yearly real interest rates, the so-called compound interest bonds—in the international usage: bonds with zero coupon—have recently grown quite popular. While with normal bonds the usual procedure is yearly payment of interest, with the latter kind there is practically no payment of interest. Instead, bonds are repurchased at expiration at a price agreed

beforehand. The difference between the issue price and the repurchase price is in fact the sum of the compound interest. Of course, the nominal rate has moved between 11–13 percent with these bonds, too.

The 11 percent rate of interest was relatively high at the start in 1984, considering other forms of savings. For example, the interest rates on deposits placed with the National Savings Bank were lower, and it should also be remembered that there was an annual inflation rate of 6–8 percent. In the meantime, however, the rate of price increases has grown, and so have the rates on deposits—therefore, the earlier gap has finally closed. This was one of the reasons for raising the interest rate of the new issues, but the most important reason may have been the anticipated uncertainties. Because of the changes effectuated in the system of taxation[2] an inflation rate of 15 percent was forecast for 1988, and it was felt that this might lead to an even higher increase of interest rates, if investors did not expect an abatement of inflation later on. Thus it is now estimated that the real interest of a bond purchased in 1987 will be negative in 1988, although this is expected to be compensated by the positive real interest of later years.

In judging the bonds circulated on the secondary market, *current* quotations have to be taken into consideration along with nominal rates of interest. In Hungary, current prices are mostly formed on the secondary markets of the various banks; the banks' offers, the purchase and sales prices are printed in the press, usually changing weekly. As a rule, banks assume the obligation to buy and sell permanently at the given quotations. Only the Budapest Bank quotes for all bonds, whereas other banks deal with a partial market, e.g. with the secondary circulation of the bonds originally sold by them. Therefore, as different banks' quotations sometimes deviate, well-informed customers may engage in arbitrage operations.

It is fair to say that in general, net prices of fonds (time-proportional interests deducted) fluctuated between 98 and 105 percent in the years 1984–87. This actually depended on the momentary position of demand and supply. The only exceptions were the bonds with interest rates lower than 11 percent. For example, the current price of the so-called 'telephone bond' of the Hungarian Post Office—promising 7 percent yearly nominal rate and the installation of a telephone—has settled at between 70–80 percent of the nominal value once the telephone has been acquired. Yields—nominal interest together with the profit or loss resulting from the difference in prices—have been around 10–11 percent.

In 1987, however, earlier price trends changed. Early in the year there was still excess demand, and prices rose above the nominal value by an average of 2–4 percent. By the mid-year a balanced situation had developed with prices at about the nominal value, and later in the year an oversupply resulting from mass issue depressed prices on the secondary market. At the same time, the interest rates of the new bonds were also rising. This led to a further fall of the current prices,

[2] the introduction of VAT—*Ed.note.*

since the yield differences between the primary and secondary markets could only be compensated by profits gained from differences in prices.

Falling prices caused uneasiness on the market, and this led to hastened sales, which then further contributed to the fall. There was only one way out of the negative spiral that developed in September–October, when net prices fell on average to 92–95 percent of the nominal value; in order to stabilize the market, some of the issuers offered a special interest premium on earlier bonds, and the Budapest Bank introduced business at guaranteed prices. As a result, the quotations of bonds began to rise slowly. This restored confidence in the bond market and, consequently, investments began anew. In late November and December, because of the expectations attached to the rising prices and the changes introduced in January 1988, there was an unprecedented rush to purchase bonds. This pushed prices further up, and yields somewhat further down, as a matter of course. After the October trough, average prices had risen to 98.2 percent by the end of December, and in January 1988 they stabilized at 97–98 percent. Thus the yield that can be reached on the secondary market is by and large in conformance with the nominal interest return of the new issues: it is between 11.8–12.7 percent.

Beside the usual demand-supply conditions, the reputation or popularity of the issuing enterprise may also have an influence on the current price of a bond. The hit of 1984–85 was, for example, the "Skála" bond, the net price of which reached 107–108 percent, though terms were exactly the same as those of other bonds which were changing hands at about their nominal value. A conspicuously high rise in price was reached, for example, by the first bond of compound interest issued in 1986 by the Kecskemét Municipal Council: its price rose by 8 percent in the month following its issue. It then stabilized on that high level, and fell to a reasonable level only during 1987, as the number of bonds with compound interest gradually increased. The highest rise in price occurred with the bond issued by the Tisza United Chemical Works (TVK by Hungarian abbreviation). In November 1987 a 4 percent interest premium was announced for 1988 for the bond of 11 percent interest, and the price rose by 6 percent in two weeks. The highest fluctuations have occurred with the above-mentioned telephone bonds of the Hungarian Post Office. In the case of these bonds the especially low price and the low nominal interest return, provide perhaps the highest yield. However, the supply of these bonds on the secondary market rises suddenly after the installation of a new telephone exchange when the telephone extensions have actually been linked up. This leads to a fall in price, and then a rise of 4–5 percent follows again till the next wave.

An analysis of the most significant price and yield tendencies of the secondary bond market over the past three-and-a-half years leads one to the following conclusions:

— In general, the market reacts to changes in current prices (quotations) in a lively manner, but somewhat contrary to the earlier forecasts of specialists. When current prices rise by a few percentage points, purchases are not pulled down. On

the contrary, they are pushed upwards. Namely, investors hope that a relatively fast growth of profit can be achieved and thus it is worth buying bonds. On the other hand, sinking prices do not lead to increased purchases of bonds, on the contrary, a fall of only a few percentage points has already led to a rather strong wave of selling.

Some of the investors tried to get rid of their securities because they thought that, having lost a few percentages already, they might lose even more in the future. (It is true that the international stock exchange crisis coincided with the fall in prices in Hungary, and this may have had a part in increased sales.)

— It is undoubtedly true that a rather low percentage of the total amount of bonds circulating have been placed on the secondary market; the great majority of the approximately 200,000 Hungarian holders of bonds patiently wait until bonds expire and are repaid. Yet current prices (quotations), and with them the general feeling about bonds, are determined by that low percentage.

— Some investors make use of the deviating quotations of the different banks to make arbitrage operations. This is quite natural, since the latter serve as information for the banks. Nevertheless, in future greater emphasis must be laid on the integration of the secondary market, and on at least the mutual observation of other bond prices on that market.

The bond market and the securities market, the search for, and comparison of, the different types of investments, as well as market fluctuations—all these are almost totally unknown concepts for the typical investor in Hungary today. They are only just beginning to be learned. The exaggerated reactions to even small fluctuations point to the great need of stability and safety in this field. This *safety* had been provided up to 1987—at least on the household bond market—by the *government guarantee* for the repayment of bonds, and for the payment of interest. Of course, this meant that the licensing of issues had to be somewhat bureaucratic, and the full assumption of risks burdened the budget rather heavily. Furthermore, the equal measures of safety provided made it impossible for issuers to acquire resources at costs according to creditworthiness. In any case, however, the government guarantee was necessary as well as useful. In the beginning, this was the only way to protect investors against taking too great a risk.

In 1988, the enterprise and the household bond markets will finally be integrated, and government guarantee will cease to be automatically provided for the newly issued bonds. (Of course, such guarantee remains in force for earlier issued bonds up to the time of their expiration). This change, involving the reduced safety of investors, may render the market more flexible and sensitive. Demand for securities guaranteed by the government (e.g. treasury bills, government or council bonds) will probably grow, so that they can be sold at lower interest rates and yields than the average.

The repayment of bonds issued by banks, enterprises, and cooperatives will be guaranteed by the issuers, the banking institutes entrusted, or other enterprises.

Ever since its emergence, the Hungarian bond market has been extremely *liquid*. First it was the National Development Bank and, after 1987, the Budapest Bank Ltd. that undertook to maintain the market, (i.e. to repurchase any bond, at any moment, at its own current prices). It is also the practice that, if sufficient reserves are available, the bank sells bonds. With a relatively low secondary turnover, a stable market, and stable prices, this function is not particularly difficult to fulfil: up to the middle of 1987, the total value of the bonds at the bank's disposal had usually been below Ft50–100 million. However, the fast increase in the number of bonds, excess supply, and market fluctuating had led in late 1987, to a strong wave of selling. Therefore, on certain days the value of the bonds at the Budapest Bank Co. Ltd.'s disposal reached as much as Ft2 thousand million. However, with a view to maintaining the liquidity, and thereby the stability, of the market, the bank held it to be fundamentally important to keep its role as a residual buyer. In the last months of the year the amount of bonds began to fall, and the fall was still evident in early 1988.

With a large amount of bonds in circulation one bank alone cannot undertake to steadily maintain the liquidity of the market. It would be too heavy a burden on the bank, besides, substantial resources would be needed to bridge over fluctuations. Given that the guaranteeing of liquidity is a fundamental consideration, banking institutes engaged in the circulation of bonds ought to join forces. The issue of government bonds adds to the importance of liquidity, since government bonds will also have to be repurchased at any moment, or they will have to be circulated. Therefore, the bank of issue as well as the budget should take part in providing resources. The bank of issue may substantially contribute to maintaining liquidity and stability by means of open market operations—these are frequently referred to, but so far they have not been used.

Thereby the amount of money in circulation can also be regulated; it is not accidental that the purchase and sales of securities represent an important element of the instruments of the central bank.

As for the yields, safety and liquidity on the *share market*, little can be said at present, for this market is still in a rather rudimentary state. Yet, it seems certain that the yield of earlier issued shares is extremely high: some yield, for example, a yearly average after-tax dividend of 14 percent. Of course, the sale price or current price of these shares also tends to rise on the secondary market. For example, NOVOTRADE's shares, which yield an annual dividend of 14 percent, usually change hands at a rate which is 140–150 percent of the issue price. Also the 10–12 percent dividend promised by the new banks is high. Therefore, the current price of the bank shares, so far sold only in a few exceptional cases, is also around 120 percent.

High dividends paid on shares are advantageous to shareholders, but they may lead to a depletion of the share company. If, namely, a share company can achieve a yearly 40–50 percent profit, out of which a 10–15 percent dividend may be paid, it

is not worth taking out the dividend from that company—it is better to reinvest it and thus further raise the company's income-producing ability. However, in order to understand this fact properly and act upon it, a genuine secondary market is needed. On this market the reinvestment of the dividends can actually be realized as a consequence of the rises in current prices (quotations).

Shares have, of course, a much lower degree of safety than bonds. The shareholder is in fact a part-owner, who can get dividends or the countervalue of his share only if the company works profitably, or if the share is salable. Ever since share companies started to be established in Hungary in 1982, there has been no bankruptcy or any sudden fall of current prices on the market—therefore, this field offers another, relatively safe prospect for investment. Due to the rudimentary state of the secondary market, there is only a low degree of liquidity: shares are relatively difficult to sell. Banks also organize this market but, as a rule, they sell shares only on commission. In order to increase the safety, and thereby also the liquidity of the share market, it is even more important (than it is in the case of the bond market) to develop a system of information, i.e. to have regular data and analyses of the balance-sheets, business decisions, and past and future progress of the share companies involved. The usually uninformed investors have only the official analysts to turn to for data upon which to base their investments. In the organization of the market and of the system of information, the cooperation of the banks is needed even more than before.

The experiences of the past five years have shown that the share market, which was at first just tolerated and handled as something out of the ordinary, has grown to be an organic part of the economy. Its necessity and usefulness are now generally recognized. Nowadays, this market, that originally grew out of the initiative of a few banks, clearly enjoys the support of the financial authorities and it is taken into account in planning the future. To prove this statement, it is enough to refer to the prospects concerning the issue and circulation of government securities, treasury bills, and state-loan bonds, or to the concepts regarding the reorganization of state-owned enterprises into genuine share companies. Not all these projects have been initiated "from above": it is often the enterprises themselves that suggest transformation into a share company, since the share company framework promises more efficient forms of management and incentive. It also holds out the prospect of getting additional capital. Capital market may contribute to economic development by indicating directions for the capital redistribution needed for market-oriented restructuring, by encouraging savings needed to relieve the shortage of development resources, and by directing these savings towards such fields and sectors as are in fact profitable and dynamically growing.

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# BOOK REVIEWS

VOSZKA, É.: *Reform és átszervezés a nyolcvanas években* (Reform and reorganization in the eighties). Közgazdasági és Jogi Könyvkiadó, Budapest 1988. 382 p.

Just as in her first book[1], Éva *Voszka* leads us into the centres of economic management. In her new book she presents and analyzes with great accuracy the history of the new reorganization of the state-owned enterprises. She also looks at the circumstances in which official decisions were made and how they prompted or, in actual fact, hindered the dissolution of the large enterprises.

Voszka is well-versed in this domain. Even in her earlier works it was apparent that she is a master of methods involving the professional treatment of written documents found in the depths of archives or in the desk drawers of state officials. She has again proved that she is a very capable interviewer and also reads all the domestic publications linked to her subject. Her earlier methods, however, had been extended by the addition of a new one. In other words, her experiences in the secretariat of a committee which has been responsible for issues related to enterprise organization, have enabled her to see events in parallel from inside and outside.

Voszka's opinion is that in 1978–79, when the most important personnel changes of the 1970s came to pass in the centres of power, with respect to the economic reform no essential turn took place. The (partly) new management brought about some changes in its economic policy, but tried to create internal and external equilibrium and to restrict growth in a dirigiste way, almost like a type of "manual control". The reform—in Kornai's wording—pushed administrative coordination into the background and gave prominence to market coordination. The reform had been accepted by some leaders, as part of the programme necessary for overcoming the crisis, *only after several years* of learning about its processes and mainly after the full force of the economic crisis could be felt.

However, they were not willing to postpone the transformation of enterprise organizations. A resolution on this transformation was passed as early as July 1979, and this was at a high political level. However, the important characteristics of this were that it had "not unequivocally marked out the directions of enterprise reorganizations", and that it was not a declared policy, but merely an initiative.

The author points out that the decision on reorganizations had been made precisely when the chances for the success of the reform were worsening. This incongruity of the timing of decisions is evident throughout the whole story. The dissolution of enterprises tended to show an upswing when the reform process slowed down. An acceleration of dissolutions and the introduction of new enterprise management forms tended to occur just when the reorganization process began to lose wind.

Seeing these separate movements, Voszka was able to formulate the main thesis of her book—namely, that breaking the enterprises down into smaller parts can serve both the reform, and the removal of the hindrances standing in the way of efficient enterprise management: "I am convinced that decentralized organization is an indispensable condition for moving towards a market economy. However, in itself it is insufficient for achieving the goal. It should also be taken into account that the separations may also serve ideas which are contrary to the positive ones."

Such "ambiguity" is a real possibility, especially when reorganizations are driven not by a mass movement urging a radical reform—if

[1] Voszka, É.: *Érdek és kölcsönös függőség. Átszervezési tapasztalatok* (Interest and interdependence. Experiences of reorganizations.) Közgazdasági és Jogi Könyvkiadó, Budapest 1984. 274 p. See a book review by Mihály *Laki* on the book in *Acta Oeconomica*, Vol. 35, Nos. 3–4 (1985) pp. 395–397.

such a thing can exist at all—but by one or more interim committees organized for this special purpose, and consisting of members delegated by the bodies of bureaucratic management. Voszka demonstrates in detail that the members of these committees are not particularly interested in decentralization; in fact, some of them have not the slightest interest in decentralization; their awareness of the subject is, owing to their position, rather poor and, in addition, they are not decision-makers but merely makers of propositions.

The legal status of the committees has been uncertain, and they have had little power to bargain. Even the objectives set for them have been ambiguous. Those interested in unchanged enterprise organization and, what is more, those interested in new fusions have had great influence and wide maneuvreing opportunities. They were able to interpret the recommendations and draw up the lists of the enterprises concerned. They could postpone or, in contrast, urge the implementation of decisions according to their interests. The history of reorganizations in the eighties shows that the hope of the supporters of the reform that a significant number of requests for separations would come "from beneath"—from the factory units of big enterprises—has proved to be presumptuous. This has not only been because the managers of the factory units, being anxious about their livelihood, have been careful, but also because the large enterprises, operating from the "common purse" of state-provided money, offered several advantages which might have been lost, due to the reorganization.

Therefore the efforts at, and the extent of, the reorganizations decided upon in the early eighties have remained limited, and the intentions to reorganize have lost their force. In contrast to the wave of fusions in the early sixties, in the case of decentralization no campaign could be detected. In Voszka's opinion, it might even be the case that the question of decentralization has been taken off the agenda for time being.

The author expounds and proves her standpoint in a convincing manner. Thus the reviewer can only supplement it by putting some emphasis on various points.

There seems to be little doubt that the period of "manual control"—although it set new objectives in 1978—has not disappeared but continues today. This means the regular employment of masses of bureaucratic methods which put a brake on the expansion of the market forces. These factors amount to tendencies which are contrary to the basic principles of the reform. Having recognized this, we should not forget that in 1978–79 those events which had hindered the development of market processes came to a halt, and that since then administrative coordination has, willingly or reluctantly, lost some ground. Certain central development programmes, which earlier affected the big enterprises, are now exhausted, and thus it has again become possible to talk about reform. Several people in prominent positions, who were keeping back the reform, have been replaced by people holding pragmatic views, and by leaderes who—at least int their rhetoric—have committed themselves to carrying on the reform. Voszka is also not indifferent to the fact that the wave of forced fusions in industry, which took place in the seventies, came to an end just at the time of this new wave of reform. The same can be said about the cessation of the covert nationalization of cooperatives and the molesting of their leaders.

This wave of fusions in the seventies—mentioned by the book only in passing—coincided with the period after 1972 when there was a strengthening of the management system of instructions. However, in the mid-sixties and up to 1971–72, fusions were not frequent. Disappointed with the dirigiste methods, the leaders of the country at that time outwardly supported the reform. However, even the new period, i.e. the period of the early 1980s in which ineffectiveness of administrative coordination was again recognized, brought about no changes in this respect. Maybe, I have reached this conclusion because my attitude towards the reform is rather pessimistic—indeed, more pessimistic than that of the author.

Voszka's book also reveals that great forces permanently act against the spreading of market coordination. In some periods these forces act openly and with great power; in other

periods they lose their force and this causes the pessimism: at such times they do not help the reform, but create some kind of "nostalgia for the reform". In such periods, especially if the nostalgia is strong, not only the intellectuals, but also representatives of power also speak about the reform. It is even possible, that in such instances they not only tolerate the fact that the market is gaining ground in the economy, but also make efforts to further this trend. All these things touch our subject to the extent that when, around about 1978, the forces acting against the reform came to be exhausted and massive fusions of the enterprises and cooperatives ended, although "manual control" continued to hold sway, some signs of the reform nostalgia could be discovered. Now, it is the first time since 1971 that we can and do speak about decentralization. Reorganization committees are set up and, what is more, several enterprises have already been decentralized. We may even say that Voszka's book, which is of a particularly high standard, deals with a typical symptom of the reform nostalgia. It demonstrates well the limited power of those supporting the reform, the ambivalence of the centres of power, and the weakness of their institutions. Voszka's thesis of detached movements of changing organizations and of changing institutions may be true in the periods of the reform nostalgia. In the periods, however, when administrative coordination was prevalent, great numbers of enterprises were united or fused and, parallel to this, there was also a spreading of dirigiste economic management.

One of the greatest virtues of the study is that it presents the everyday work of a committee with unparalleled accuracy and in great detail. A committee is an outstanding institution of large organizations. Not only is it an indispensable requisite for coordination, but it is simultaneously the area and tool for developing the gravity centres of power. This applies especially to dictatorships, which are characterized by the predominance of state ownership.

Voszka does not see much chance of success for a reform which is planned and whose implementation is attempted by committees which are isolated from professional and public opinion. However, she does think that certain forms of committees are more efficient in their approach to reform and decentralization. Greater spheres of authority for decision-making, relative independence of members, and the personal commitment of members to the issue, increase the chances of success for the planned action. The committees dealt with in the book are, however, not typical of this kind.

A reform, i.e. changes carried out from the top, can hardly be imagined without committees. However, committees whose members accept the rules of secrecy and exclude the public are not the most useful. Efficiency can perhaps be increased under such conditions, but a real breakthrough can be achieved by such committees which, disregarding the regulations of office, will work in accordance with the principles of democracy. However, pondering over the chances of forming such committeees is not the task of the specialized sciences and especially not that of the reviewer.

M. LAKI

ANGYAL, Á.: *A szabályozók másik oldalán* (Standing on the other side of the regulators). Közgazdasági és Jogi Könyvkiadó, Budapest 1987. 259 p.

Ádám *Angyal*, the young and dynamic captain of the Hungarian shipbuilding industry maintains, of course, that *navigare necesse est.* Taking the Latin proverb literally as well as figuratively: it is necessary to produce ships on a large scale; it is necessary to export them, and to enable the industry to grow dynamically. These developments are, according to Angyal, absolutely necessary. It is not the value and income relations that must be given prime consideration, but real processes. In other words, regulation and organization merely constitute a framework, a reflection, or an outward form, however, what really matters is production itself. "To me, supply, quality and performance represent more important, and especially more timely, concepts

and requirements than profit, balance and surplus", the author says (p. 208). The basis of this statement: "Enterprises must satisfy social needs through products and services." His conclusion is:"...industry has to be judged first of all on the basis of its social function, and only afterwards on its economic fuction." (pp. 199 and 19). If the metaphor of navigation is interpreted in this way, one must accept the book's fundamental idea: that here and now, navigation is hampered by a thick fog which is produced by central regulation. Looking deeper into the matter, it seems that progress is retarded by the entire socio-economic mechanism. (In the study, issues of power, ownership, representation of interests, and economic democracy are repeatedly raised).

Relying on the experience of several decades, the author gives a clever and ironical analysis of the environment of the leader of a rather typical Hungarian large enterprise in the mid–1980s. He illustrates his case with numerous examples, and also raises considerations which concern economic theory. In the academic sense of the word, this book is not a scientific work, but rather an essay, inspired *also* by a few strong emotions. Ádám Angyal declares his commitment to industry—that is, to large industry and to large enterprises. His bias is perplexing in a few cases—i.e. he makes serious statements which are contrary to accepted opinion but occasionally these lack evidence. At the same time, however, the neglect of "scientific instruments" is one of the virtues of the book. This is an enjoyable work, written in a sweeping style. It will be of value to all those who, in their capacity as enterprise specialists, or officials formulating the regulators, or analysis of present-day Hungary are interested in the anomalies of regulation, the hidden manoeuvres of those involved in enterprises, and in the sincere presentation of the interest of a large enterprise's managing director. Such themes are quite unusual in the professional literature.

What is Ádám Angyal fighting against? He is fighting against the bureaucratic overregulation which fetters enterprises. He is also against taxation constructions contrived by bureaucrats which—even though some of these may represent rather clever technical solutions—are contradictory, elicit undesired effects, cross economic actors' interests and in the final analysis impede even the fulfilment of central intentions. Let us take a few instances from the rich contents of the book.

The forint currency is not "convertible" even within the country, as is well known. There are orders and instructions concerning the different possible ways of money utilization. The chapter entitled "The hundred aspects of the forint", lists one hundred different forms of the forint, each having different purchasing powers. These range from the forints spent on wages, to the forints of wage taxes not covered by profit. We can believe the author when he says that the list is far from being complete.

The many different funds and quotas encourage and even force those affected to play "hide-and-seek" with accounts. If the diesel oil quota (introduced with a view to energy-saving) expires, the enterprise's lorries are stopped. In addition, in order to avoid paying extra charges and fines from after-tax profits, job transportation is ordered; this is more expensive, but it can be covered from the budget. With a view to sparing the "hard forints" of wages, lump-sum allowances and grants are paid, secondary jobs are created, and economic work-teams are organized. Investments, on which different kinds of tax are imposed, can be replaced by machinery lease. The author draws the conclusion: "The instances of waging and investment clearly illustrate that what regulation fights against is not... that the outflow of purchasing power, or investments should shrink. It cannot be this, since another system has been built up alongside both systems... Therefore, regulation allows enterprises to pay less tax because of higher costs, yet it does not attach any interest relations to saving costs which have increased due to rising inputs..." (p. 99).

Several examples of the poor operation of the regulation are provided. For instance, the effect of the prevailing construction of the subsidization of socialist exports is that it diminishes exports against dollars, and contributes to

the manipulation of overhead costs; thereby it leads to the cutting out of the "dual profit" from the budget and to the enlargement of inventories instead of the enlargement of fixed assets (which are then also sanctioned by some other methods). The subtle ways and paralyzing impact of taxing-away are discussed using various approaches. "That the debtor must pay is an old rule in economics. However, the circumstance that those who have never been debtors must also pay, and that they have to pay from what they have earned, as well as from what they have not earned, accounts for the disinterest of enterprises, and for the low morale in enterprises in general." (p. 194).

The picture, which is composed of real-life mosaics, is an authentic one. It supplies convincing proof that the failure to achieve the results that were expected *cannot* be blamed *exclusively* on the enterprises; economic management and control are incapable of attaining the objectives set for themselves and for the whole economy, while the enterprises—even the large ones which are regarded as being in favoured positions—are dissatisfied with their conditions. Restrictive measures, and "looser" ones as well, cause disorder in the economy; they fail to obtain even the agreement and cooperation of the addresses of the latter. The book holds a faithful mirror to this crisis, and many should look into this mirror.

Therefore, I do not question the author's criticism of the economic management and control, and of the mechanism of the economy. However, I do question the completeness of his criticism. Namely, I am of the opinion, that the Ganz Danubius Shipyard and Crane Factory, and the large enterprise structure of which it forms a part, are not just the sufferers from, but at least as much the creators of, the development and operation of the existing system and the emergence of a crisis situation. In other words, they are *active contributors* to these entities in the same way as the control and management organs. Another book, written with as much sincerity and passion as this one, by a representative of the "regulations-makers" might demonstrate just as tangibly, how the economic leaders are forced, by the direct and indirect pressure of the economic units (i.e. by the countermoves taken by the latter), repeatedly back to the same vicious circle—even though they see quite clearly the limited rationality and evasive nature of their actions (how good it would be if someone wrote such a book!). I think, therefore, that the existence of two opposing parties is illusory; in fact, they are the two elements of a homogenous system—being mutually constraining yet at the same time interdependent necessarily. In this sense, the managing director of the large enterprise of today does *not* stand *on the opposite* side of the regulation; not only that, he does not want to go over to the opposite side, either.

Namely, where does Ádám Angyal seek the way out of this "jungle of the laws?" The reader becomes somewhat confused if he tries to sum up the book's guidelines and purposes.

It is clear what the managing director of the large enterprise wants to change: "If you expect the boxer to win, you must give him meat before the fight, as Hemingway says, and I add that you must not tie his hands during the fight." (p. 245) As the author explains repeatedly, freedom of movement implies the elimination of the defencelessness and subjection of the economic units, the diminution of the importance of bargaining which anyway is often humiliating and of an uncertain outcome, and the establishment of relations with the economic management and control. The latter relations should be based on equality of rights, democratic principles, and an efficient representation of the enterprise managers' interests. With regard to the economic mechanism, this implies getting rid of the existing form of indirect control; it also means the exclusion of those apparently viable trends from the up-dated version of the command economy i.e. the hand-steering manner of control which involves the hierarchical subordination of enterprises.

However, these objectives do not clearly indicate the exact method to be adopted, not even in principle. Of the conceivable possibilities, two emerge in the book—these alternate and, at the same time, are in parallel with each other.

On the one hand, the author shows himself to be an adherent of the market mechanism. He advocates equality of the various forms of ownership, neutrality of taxation, regulation of activities instead of regulation of organizations, and the importance of competition and enterprise. He also states explicitly: "... The only way to break from the bonds of indirect control is to create the conditions of regulation based on market and interest relations." (p. 208) These remarks also fit into the array of ideas which are directed against the patriarchal-paternalistic relations prevailing between economic control organs and enterprises, and against the predominance of a market administered from the centre.

The latter remarks, however, do not unambiguously point towards the market. At several points in the book there are formulations which suggest that the market ought to be delimited. Ádám Angyal expresses such suggestions in different ways: "... I do not think our relationship with the control organs can be genuinely loosened... Regulation must arrive at a point where enterprises which find themselves in an impossible position because of the regulatory system are granted some possibility arriving at an individual solution... I am for regulation which is made to measure..." (pp. 150, 147, 145). He also specifies his proposal in the following way: "If, within industry, the largest one hundred enterprises were individually regulated, and a uniform system of regulation was applied to the approximately two thousand smaller units, it would represent a more precise, and more efficient regulatory system than the existing one." (p. 145). In other words, let there be a market—but not for the large enterprises. For the latter, an adequate solution involves increasing their influence on the control organs, institutionalizing the bargaining processes, and establishing a system based on agreement. This would provide an organic development of the indirect mechanism (i.e. the maintenance of the fundamental principles) while simultaneously changing the power positions and specific rules of the game. It is an open issue whether—if in this now huge key sector of the national economy the fundamental mechanism is a non-market one—a veritable and lasting market outside this sector can function at all without distortion.

A real market mechanism or an institutionalized mechanism based on agreement—these are the genuine alternatives open to us today. I think that Ádám Angyal votes for the latter, along with many of his colleagues. In his ironical manner, the author would probably remark that the reviewer understands the book in accordance with her own tastes. I do not mind admitting my bias since I have been commenting here on a biassed book and it is exactly for that reason that it is so interesting.

É. VOSZKA

CHAVANCE, B. (ed.): *Régulation, cycles et crises dans les économies socialistes.* Édition de l'EHESS, Paris 1987. 294 p.

The individual phases of the history of the socialist countries, short but full of tensions, are often marked by calendar decades—even though in reality the various phases merely accidentally coincide with those decades. Nevertheless, the late 1970s and early 1980s do mark a turn: as a consequence of the sharpening of old tensions and the emergence of new ones, these countries entered a period in which one could witness the evolvement of real processes which are different from those found in earlier periods, and pointed to the proliferation of crisis phenomena.

In that same period, the results of several major research projects—carried out first of all in Hungary—became known and internationally recognized. They approached the fluctuations in the development of the socialist countries in an entirely new way, from the aspect of institutions.

The need for a theoretical assessment of the new situation increased scholarly interest in the question and resulted in timely scholarly debates. One such debate was arranged in Paris in 1986, under the title "Regulation, cy-

cles and crises". It was attended by numerous eminent specialists in the relevant subjects. On account of what has been said above, it is a happy fact that after the debate the papers of ten scholars (seven French, three Hungarian, one Polish and one Italian) were published in a volume in 1987.

The papers—based on different experiences, fields of knowledge, and methodologies—have been arranged in four main subject areas. Under the title "Cycles and crises", there are studies which deal with the different structural explanations for the emergence of facts which contradict the theses concerning harmonious and proportional socialist growth and development formulated on an ideological basis; at the same time, these explanations are given a critical elaboration. The second part, which is a continuation of the first, starts with the issue: "from the cycles to the crises" and discusses the way in which the investment cycles function. Under the title "Explanation of economic fluctuations", various analyses are found: some analyze economic cycles which also involve investment cycles, while some even doubt the cyclical nature of investments. The last part's title is: "Comparative analyses". In the light of the specific subjects of the previous chapters this may seem a somewhat unhappy choice at first sight, yet it is justified, among other things, by the circumstance that this part is concerned with more than just the best-known European CMEA countries.

The first study in the volume, that of Bruno *Dallago*, starts with a comprehensive critical review and a theoretical-historical treatment of the explanations of the fluctuations and cycles found in Soviet-type economies. Relying on the "final causes", it specifies five main trends and takes into consideration time and spatial dimensions; it is evident that in different periods different trends have predominated. It is also apparent that certain schools of thought were more closely related with the researchers of a particular country or a particular group of countries. The existence of the fluctuations having been recognized, in the East European countries it was first assumed that the causes lay in the discontinuity of the reproduction process based on the Marxian scheme. Working partly with a similar logic, Yugoslav economists attributed a decisive role to the fluctuations of technical progress. The stressing of the subjective or political bases of the fluctuations spread particularly fast among the Western researchers. This was manifest in the way in which they demonstrated cycles of political motives, while others denied the regularly recurrent nature, i.e. cyclicity, of economic fluctuations. The trend which was identified in the economic debates of Czechoslovakia in the 1960s, suggests that the economic cycles were caused by the growth maximization following decisions made in and deriving from the administrative system. This idea formed part of the basis of the institutional-structural school, which concentrated its attention on the hierarchical functioning of the Soviet-type economies. It also relied mainly on the investigations of Hungarian economists—these having been published during the last decade and representing the principal trend (even on the international level) of current research work dealing with the cycles of socialist economies.

Wladimir *Andreff*'s study also concentrates on a critical elaboration of the different explanations. The authors's attention is mainly directed towards the latest developments: the crises emerging in the European CMEA countries and in the Soviet Union in the course of the 1980s. Relying on confirmed empirical results, he warns against generalizations in judging the situation, as well as in explaining the crises. His main objections are directed towards two trends: first, he argues against those explanations of crises which rely on the prolongation of the cycles, and in doing so points out the role of cycles in economic regulation; second, he criticizes the various "catastrophe" theories concerning the crises of the centrally-planned economies. At the same time, without accepting the idea of crisis-import, he demonstrates that external shocks had contributed considerably to bringing domestic economic difficulties to the surface. These difficulties suggest that the countries under examination are going through a structural crisis which involves the impossibility of making the transition to a new type of accumulation. The ele-

ments of this situation include the crisis of regulation, the crisis of the technical and industrial adjustment of economies which are increasingly open to the external world, and the crisis concerning work processes.

Marcel *Drach*, whose views were mainly contested by Andreff in connection with the catastrophe theory, analyses the explanations of crises of different time horizons in the Soviet-type economies in his study "Short time, long time, stochastic time". He maintains that in these economies the notion of crisis can be mentioned in connection with the cyclicity of growth and investments, the slow deterioration of economic performance and, finally, political events. In addition, since in these societies it is not money but the apparatus that is at the centre of the socialization process which transforms force into a social relation and reproduces it, and because this situation is an issue of a specific type, it is political crisis that should at first be considered as system-specific. At the same time the author points out that, specifying his earlier view, beside the fundamental importance of the above-mentioned fact, the crises occurring in these countries are to be described as the superposition of crises of different time horizon and different natures.

As if in reaction to the questions raised in the former studies, Tamás *Bauer* arrives at the conclusion, following a short review of his cycle theory, that the recession of the early 1980s is in conformity with his own theory. Further, on reviewing the developments that followed in the small CMEA countries after 1979, and relying on vast empirical material, he points out that in the prolongation and depth of the cyclical recession a role was played also by foreign economic factors (increased debts in convertible currency, deteriorating terms of trade in the socialist relations). These are to be considered exogenous factors, however, only in respect of the functioning of the cycle, since essentially they are the consequence of a form of economic management which leads to wasteful growth. The new circumstances, in themselves, do not question the existence of the cycle, as a long recession period does not in itself represent a crisis. However, the troubles manifest in the functioning of the cycle as a whole do clearly point to the existence of crisis in the countries of the region.

Despite the coverage mentioned so far, several other aspects of the cycle mechnism still need to be clarified. In this spirit, analysing the twenty years preceding the 1980s in the Polish and the Hungarian economies, Maria *Lissowska* examines the system of relations prevailing in the regular fluctuations found in the production factors and productivity improvement of investments. Relying on empirical analysis, she comes to the conclusion that while the launching of investments can improve productivity only with a time-lag, the growth of the investment volume can directly improve. This is true even though this relationship does not exist in the case if cycles and productivity develop along other lines than earlier, as is shown by the Polish case.

In her study, Irena *Grosfeld* builds an econometric model of the planners' role in investment cycles relying on the Polish experience. Within the framework of this model, she seeks to find, which variables are taken into consideration by planners when they make their investment plan, and further, upon which basis planners change their decisions on investment expenditure. Relying to no small extent on Hungarian analyses, she points to the role of the variables of foreign economic balance and domestic stability (manifest in increasing real wages) in shaping the planners' attitude. She also stresses that decisions are only altered if real processes threaten to pass beyond the disequilibrium threshold, determined on the basis of current conditions.

In order to be able to judge the cyclical nature of economic fluctuations, i.e. the functioning of these in the socialist economies, Jacques *Sapir* starts from a model based on a regulation method which is determined by economic and social relations—this model being built upon the principles of the French regulation school. Building up a model of economic cycles, and of the relations between investments, employment and productivity based on the Soviet case, the author traces back the final cause of the economic cycles to the invest-

ment drive caused by behavioural factors, and horizontal and vertical conflicts.

Gérard *Duchêne* uses statistical analysis in trying to judge the economic fluctuations of the Soviet economy. After presenting the methodological difficulties, he investigates economic activities between 1965 and 1984 by means of series of data compiled according to the logic of national (economic) accounts in the Western countries. He compares the various items of sources and uses, and draws the conclusion that the fluctuations occurring in the Soviet economy are basically explained by the fluctuations in agricultural production. At the same time, through changes in stocks and through imports, planners have so far succeeded in preventing them from spilling over into the consumption sphere. The fluctuations of the investment costs adjusted to production are probably neutralized by the stock of investments already in process.

Starting from a substantial data basis and essential methodological considerations, Péter *Mihályi* centres his attention on the question: are the investment fluctuations found in the Eastern European countries to be considered regular, i.e. cyclical? He bases his objections to cycles on the uncertainties connected with the trend; these make it impossible to demonstrate regularities in the deviations from it. After that, relying mainly on the changes of the gross investment expenditure of 1950–1987 (computed at comparative prices), he arrives at the conclusion that the fluctuations are the outcome of random endogenous and exogenous factors. Finally, as regards coordination of the fluctuations, he points out that—against common belief that this may be attributed to foreign trade relations—the changes in investment ratios coincide for historical and political reasons.

Among the comparative analyses, Károly Attila *Soós*'s study discusses questions of a general nature: the mechanism of slackening and, within this, the role of money and financial institutions in the downward phase of the cycle. He seeks the answers with special reference to two countries: Hungary and Yugoslavia—both countries in which the market is allowed a relatively large scope. In presenting the important yet naturally insufficient role of the administrative measures and campaigns in the slackening, the author makes it clear that the function of financial organs is instrumental in the downward phase, even in planned economies. The critical analysis of the two cases under examination leads him to the conclusion that in Hungary and Yugoslavia the role of money is no longer passive. However, because of the administrative nature of the financial regulation, the curbing of cycles bears the essential marks of bureaucratic management.

The economic history of socialist Cuba has shown cyclical fluctuations, claims Charles *Bettelheim*. In the fluctuations of economic growth between 1959 and 1985 he believes it is possible to discern seven cycles. Phases of growth were followed by periods of curbing; exorbitant investments, which jeopardized the foreign economic balance as well as domestic stability, led to interventions on the part of the political leadership. Two important traits of the Cuban cycles must be pointed out. First, the cycles of economic growth have been closely connected to the fluctuations in sugar production, i.e. in the world market price of sugar. This phenomena can be clearly shown in the case of the first three cycles. Second, the downgoing phases of the cycles are generally followed by significant economic and social changes. By the early 1980s this situation had led to the emergence of a serious social and political crisis.

The closing study of the volume, written by Bernard *Chavance*, discusses the fluctuations and cycles found in the Chinese economy. In order to demonstrate his thesis he relies on his own analysis of the production, investment, and productivity data of the past 35 years (which have only recently been published). He then goes on to review the most important explanations of the Chinese cycles, i.e. of their particular nature. Finally, with a view to comparison, he deals with two spheres of problems. First, although the Chinese economy displays several important features which distinguish it from the Eastern European countries, a number of its development characteris-

tics are shaped through a socio-economic institutional system which has been created by practically the same logic. Second, the outstanding role of politics notwithstanding, no cycles related to purely political motives can be mentioned in the Chinese case, either.

As for cycles, the volume of writings proves convincingly what Bruno Dallago states in his theoretical-historical review: most of their fundamental components have been sufficiently revealed by scientific research. Therefore, reliable theoretical grounds are available for further research (p. 38). However, this is not to say that there are no controversial issues, or that unanimity has been reached on the subject of cycles; Bernard Chavance points this out—in a positive sense—in his foreword. (p. 12) In consideration of the foregoing, all the reader can regret is that while the main points of the discussion are made clear to him in the volume, there are no references made to the crucial points of the live debate of the conference. This holds not only for the cycles, but also for the fluctuations taking place in socialist countries. This comment applies to every author, and further, to the interpretations of the existence of crises, which none of the studies questions. The idea that such crises exist has not been challenged since the conference—not even on the political level in some of the countries under examination. As for some of their essential aspects, these crises make it doubtful whether certain results produced by earlier research can directly (mechanically) contribute to the evaluation of the present situation. At the same time, it is exactly upon the basis of this situation that the message of the book obtains its particular timeliness. This is, to no little extent, due to the fact that the research works dealing with fluctuations have revealed some deeply rooted characteristics of the gen eral functioning of planned economies. Without a critical reconsideration of these, no positive answer can be given to the questions raised by the social need to get out of such crises. Also, the reform—so often proclaimed nowadays—will be no more than a slogan even if its other requirements are now left unmentioned.

I. SALGÓ

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*We acknowledge the receipt of the enlisted books. No obligation to review them is involved.

# AUTHORS

dr. R. István GÁBOR, b. 1948. Cand. of econ. sci. Assistant professor at the Karl Marx University of Economics, Budapest. Formerly visiting assistant professor at the State University of New Jersey, Camden (1983–84) and research assistant at the Groupe de Sociologie du Travail, Université Paris VII (Sept.–Dec. 1987). Author of "Second economy in state socialism: Past experience and future prospects (The case of Hungary)" European Economic Review, under publication; "Main issues and major trends of government employment and wage policies" in G. Rodgers— T. D. Horváth—Gy. Sziráczki (eds): Flexibility and rigidity in the Hungarian labour market. ILO, Geneve under publication, and several studies both in English and Hungarian on secondary economy, small-scale industry, labour shortage in socialism, wage-reform and economic way out.

dr. György KŐVÁRI, b. 1946. Cand. of econ. sci. Head of department at the Karl Marx Uni- versity of Economics, Budapest. Author of "Form of wage-payment and on-the-job stimulation" (Institute of Social Sciences, Vienna Centre 1986) and co-author of "Old and new forms of wage bargaining on the shop floor" (with Gy. Sziráczki) in P. Galasi—Gy. Sziráczki (eds): Labour market and second economy in Hungary (Campus, Frankfurt 1985) and several other studies both in English and Hungarian on labour allocation, job security, labour market.

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Gyula PÁRTOS, b. 1950. Head of main department at the Ministry of Transportation, Telecommunication and Construction. Formerly scientific research worker at the Institute for World Economics, Hung. Acad. Sci. Author of several studies both in English and Hungarian on infrastructure, housing in Hungary.

Teréz LAKY, b. 1926. Sociologist. Scientific consultant of the Research Institute for Labour and assistant professor at the Department of Sociology of the Karl Marx University of Economics, Budapest. Author of several studies published in Acta Oeconomica on enterprises in bargaining position, recentralization, small enterprises in Hungary, enterprise business work partnership and enterprise interest etc.

dr. Zsigmond JÁRAI, b. 1951. Economist. Deputy Minister of Finance. Formerly Deputy General Manager of the Budapest Bank Ltd.

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